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AN UPDATE ON STATE BUDGET CUTS

At Least 39 States Have Imposed Cuts That Hurt Vulnerable Residents; Federal Economic Recovery Funds and State Tax Increases Are Reducing the Harm

By Nicholas Johnson, Phil Oliff, and Jeremy Koulish[1]

With tax revenue declining as a result of the recession and budget reserves largely drained, more than three-fourths of states are making spending cuts that hurt families and reduce necessary services. These cuts, in turn, will make the recession worse because families and businesses have less to spend in their local economies. Federal recovery act dollars and funds raised from tax increases are greatly reducing the extent, severity, and economic impact of these cuts, but only to a point.

Many cuts — including those hurting vulnerable families — will take effect July 1, 2009, the first day of the new fiscal year in most states, or soon after. For example, dental and vision services for many Medicaid recipients in California and Michigan will be eliminated. Hundreds of thousands of people with disabilities in those states and in New Mexico will experience cuts in aid. Reimbursement rates for some health care providers and human services agencies will decline July 1 in Minnesota, Utah, Washington, and Wyoming. In coming months, public university tuition will rise at double-digit percentage rates in Florida, Washington, and elsewhere — and school districts will absorb cuts in state aid.

The cuts enacted in at least 39 states are occurring in all major areas of state services, including health care (21 states), services to the elderly and disabled (22 states), K-12 education (24 states), higher education (32 states), and other areas. States are making these cuts because the recession has caused declining revenues from income taxes, sales taxes, and other revenue sources used to pay for these services. At the same time, the need for these services has not declined and has, in fact, risen as the number of families facing economic difficulties increases.

And these figures do not include the proposed cuts that many states still are discussing. As of June 25, some 18 states had not enacted budgets for the upcoming fiscal year. Many of those states, including Arizona, Illinois, Massachusetts, New Jersey, and North Carolina, are almost certain to enact further cuts.

[1] Elizabeth C. McNichol, January Angeles, and Sarah Lueck contributed to this report.

Cuts to state services not only harm vulnerable residents but also worsen the recession by reducing overall economic activity. When states cut spending, they lay off employees, cancel contracts with vendors, reduce payments to businesses and nonprofits that provide services, and cut benefit payments to individuals. *All* of these steps remove demand from the economy. For instance, at least 41 states have reduced overall wages paid to state workers, by laying off workers, requiring them to take unpaid leave (furloughs), freezing new hires, or similar actions. Such measures not only can reduce the level or quality of service available to state residents, but also reduce the purchasing power of workers' families, which in turn affects local businesses.

States are taking actions to mitigate the extent of these cuts. Most states are enacting or considering tax increases. At least 24 states in 2009 are addressing their budget shortfalls in part by increasing taxes. Like budget cuts, tax increases remove demand from the economy, by reducing the amount of money people have to spend. But tax increases can be less detrimental to state economies than budget cuts because some of the tax increases affect upper-income households so are likely to result in reduced saving rather than reduced consumption. Many more states will need to consider tax increases or other revenue measures, as well as such steps as tapping state rainy day funds, as a way to minimize harmful budget cuts.

The cuts in state-funded services — and resulting harm to families' well-being and to state economies — would be much greater had not the federal government enacted the American Recovery and Reinvestment Act in February. The measure is providing roughly $140 billion over two-and-a-half years to help states pay for education, health care, public safety, and other key services. In some cases, it is possible to identify specific services that were slated for cuts but have been protected by the federal funds; these include child care in Alabama and Arizona, public safety funding in Virginia and Washington, prescription drugs for seniors and tuition assistance in New York, and education funding in a number of states. In other cases, the specific "what-if" cannot be identified. But it is indisputable that families and communities would be facing much more serious consequences from state cuts without the recovery act funds.

The Deep Recession Is Creating Widespread Deficits

The national recession is producing both declines in state and local revenues and increased need for public programs as residents lose jobs, income, and health insurance. The imbalance between available revenues and what is needed for services led most states to face budget gaps in the now ending 2009 fiscal year. The vast majority of states also faced (or are facing) additional shortfalls projected for the 2010 fiscal year, which in most states begins July 1, 2009. Even more budget gaps are projected for fiscal year 2011. Total shortfalls through 2011 have been estimated at roughly $350 billion to $370 billion, and could be even higher if job losses fail to stop soon.[2]

Virtually all states are required to balance their operating budgets each year or each biennium. Unlike the federal government, states cannot maintain services during an economic downturn by running a deficit. States had record reserves heading into this recession, but those have mostly been drawn down. Since federal economic recovery funds are closing, on average, about 40 percent of

[2] See Elizabeth McNichol and Iris J. Lav, "State Budget Troubles Worsen," Center on Budget and Policy Priorities, revised June 29, 2009, http://www.cbpp.org/files/9-8-08sfp.pdf.

budget gaps, states must address remaining shortfalls with a combination of spending cuts and/or tax increases.

State Budget Cuts

States began cutting their budgets last spring, as the recession brought sharply weakened revenues. The cuts have intensified as the economy has worsened. At least 39 states to date have reduced services since the recession began. Service cuts with particular ramifications for vulnerable populations have occurred in the following areas:

- **Public health programs:** At least 21 states have implemented cuts that will restrict low-income children's or families' eligibility for health insurance or reduce their access to health care services. For example, **Rhode Island** eliminated health coverage for 1,000 low-income parents; **Minnesota** is cancelling a health insurance program for 29,500 low-income adults; and **California** and **Utah** are reducing services covered by their Medicaid programs.

- **Programs for the elderly and disabled:** At least 22 states plus the District of Columbia are cutting medical, rehabilitative, home care, or other services needed by low-income people who are elderly or have disabilities, or significantly increasing the cost of these services. For example, **Florida** has frozen reimbursements to nursing homes and relaxed staffing standards, **Nevada** is making it harder for beneficiaries to qualify for nursing home care, and **Rhode Island** is requiring low-income elderly people to pay more for adult daycare. **Arizona** eliminated temporary health insurance for people with serious medical problems.

- **K-12 education:** At least 24 states are cutting aid to K-12 schools and early education programs. **Arizona, Florida,** and **South Carolina** have each cut school aid by an estimated $95 or more per pupil. **Rhode Island** is eliminating early education funding for 550 children, and **Massachusetts** is reducing funding for a number of early care programs.

- **Higher education:** At least 32 states have cut assistance to public colleges and universities, resulting in reduction in faculty and staff in addition to tuition increases. Tuition at all 11 public universities in **Florida** is increasing by 15 percent this coming year. Students in Washington and other states face significant tuition increases as well, costing families hundreds or sometimes thousands of dollars per year.

- **State workforces:** At least 40 states and the District of Columbia have made cuts affecting state government employees. At least 26 states and the District of Columbia have instituted hiring freezes, 11 have announced lay-offs, 17 have reduced state worker wages, and several have delayed scheduled pay increases (including cost of living adjustments).

These measures are described in more detail in the Appendix.

The Role of Revenue Increases and Federal Dollars

Several states facing large budget shortfalls have averted deep cuts in vital services by enacting temporary or permanent revenue increases.

- In late 2007 and 2008, some 10 states enacted tax increases, closed loopholes, restricted tax credits, or implemented other revenue-raising measures. Major packages were enacted in **Maryland, Michigan,** and **New York**.

- So far in 2009, at least 24 states have raised taxes, sometimes quite significantly, and another 13 states are considering tax increases. Increases have been enacted or are under consideration in personal income, business, sales, and excise taxes.

States also are using funds made available in the federal economic recovery law passed in February to avert spending cuts. The law gave states roughly $140 billion over a two-and-a-half year period to help fund ongoing programs, including K-12 education, higher education, and health care. The money is addressing approximately 40 percent of the budget shortfalls states faced. In state after state, it is abundantly clear that spending and service cuts in health care, education, human services, public safety, and other areas would have been much deeper had the federal funds not been available.

The 2009 tax measures and states' use of federal recovery funds are detailed in separate Center on Budget and Policy Priorities analyses.[3]

[3] "Tax Measures Help Balance State Budgets," and "Federal Fiscal Relief Is Working As Intended," both revised June 29, 2009.

AT LEAST 39 STATES HAVE CUT SERVICES					
	Public Health (21)	Elderly/ Disabled (23)	K-12 Education (24)	Higher Education (32)	State Workforce (41)
Alabama		X	X	X	X
Alaska					X
Arizona	X	X	X	X	X
Arkansas					
California	X	X	X	X	X
Colorado				X	X
Connecticut			X	X	X
Delaware			X		X
Dist. of Columbia		X			X
Florida	X	X	X	X	X
Georgia	X	X	X	X	X
Hawaii			X	X	X
Idaho	X		X	X	X
Illinois	X				X
Indiana					
Iowa			X	X	X
Kansas		X	X	X	X
Kentucky			X	X	X
Louisiana	X	X		X	X
Maine	X	X	X	X	X
Maryland	X	X	X	X	X
Massachusetts		X	X	X	X
Michigan	X	X			X
Minnesota	X	X		X	X
Mississippi			X	X	X
Missouri					
Montana					
Nebraska					
Nevada	X		X	X	X
New Hampshire	X				X
New Jersey	X			X	X
New Mexico		X		X	X
New York	X			X	X
North Carolina				X	X
North Dakota					
Ohio		X	X		X
Oklahoma				X	
Oregon			X		
Pennsylvania		X		X	X
Rhode Island	X	X	X	X	X
South Carolina	X	X	X	X	X
South Dakota					X
Tennessee	X	X		X	X
Texas					
Utah	X	X	X	X	X
Vermont		X		X	X
Virginia		X	X	X	X
Washington	X	X	X	X	X
West Virginia					
Wisconsin					X
Wyoming	X				X

Appendix: Budget Cuts by Area

At least 39 states plus the District of Columbia have enacted budget cuts that will affect services for children, the elderly, the disabled, and families, as well as the quality of education and access to higher education.[4] Those cuts are detailed below.

Public Health Programs

At least 21 states have implemented cuts that will restrict eligibility for health insurance programs and/or access to health care services.

- **Arizona** is reducing its Medicaid rolls by requiring some adult beneficiaries to reapply for benefits more frequently. (Research has shown such added paperwork requirements cause many eligible people to lose coverage.) The state also cut funding for community health centers and vaccines and suspended funding for the children's rehabilitative services program, affecting 4,700 children with chronic or disabling conditions.

- **California** has increased co-payments and reduced dental benefits, among other changes, in its children's health program. The state also has cut payments to regional service providers in its Medicaid program (known as Medi-Cal) by 7 percent and suspended a scheduled cost-of-living increase for other Medi-Cal providers.

- **Minnesota** has eliminated funding for its General Assistance Medical Care program, which provides health care to 29,500 low-income persons between the ages of 21 and 64 who have no dependent children and do not qualify for federal health care programs.

- **Rhode Island** has reduced the maximum income level at which parents can receive public health insurance to 175 percent of the federal poverty line from 185 percent, eliminating coverage for approximately 1,000 parents. More than 7,800 other low-income families are paying higher monthly premiums for public health insurance.

- In **Tennessee**, an estimated 30,000 to 40,000 seriously ill people are expected to lose hospitalization and other needed medical services provided through TennCare, the state's Medicaid program.

- **Utah** cut Medicaid funding for physical therapy, occupational therapy, and speech and hearing therapy services for adults – as well as Medicaid provider rates for hospitals, skilled nursing, and dentists.

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[4] The 39 states that have already enacted cuts are Alabama, Arizona, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Virginia, Washington, and Wyoming. The District of Columbia is also making such cuts.

- **Washington** is increasing premiums by an average of 70 percent for a health plan serving low-income residents. Premiums for the poorest plan members — those earning up to 125 percent of the poverty line — will double. The premium increase is expected to cause between 7,000 and 17,000 enrollees to leave the program.

- Several states, including **California**, **Michigan**, **Nevada,** and **Utah,** have dropped coverage of dental and/or vision services for adult Medicaid beneficiaries.

- Other states that have enacted cuts in Medicaid or CHIP include **Florida, Georgia, Idaho, Illinois, Louisiana, Maine, Maryland, Michigan, New Hampshire, New Jersey, New York, South Carolina,** and **Wyoming.** Cuts include reduced or frozen reimbursements to health care providers.

Programs for the Elderly and Disabled

At least 22 states and the District of Columbia have cut medical, rehabilitative, home care, or other services needed by low-income people who are elderly or have disabilities or significantly increased the amounts that such people must pay for services.

- **Alabama** has ended homemaker services for approximately 1,100 older adults. These services often allow people to stay in their own homes and avoid nursing home care.

- **Arizona** has eliminated temporary health insurance for people with disabilities who are coping with serious medical problems. The state also eliminated general assistance, a program designed to provide time-limited cash assistance to adults with physical or mental disabilities. In addition, in February 2009 the state eliminated independent living supports for 450 elderly residents and respite-care funding for 130 caregivers. It also established a waiting list for vocational rehabilitation services, affecting 2,100 disabled individuals. Furthermore, the state has eliminated early intervention services that support young children with special needs for 850 infants and toddlers at risk of developmental delay.

- In **Florida,** nursing homes and other providers will not receive scheduled cost-of-living adjustments in their reimbursements and staffing standards will be relaxed for one year, in the expectation that the freeze will result in staffing cuts. The state also has cut Medicaid reimbursements to hospitals and community-based services for the elderly, such as meals and homemaker services.

- **Georgia** has reduced such programs for the elderly as Alzheimer services, elder service centers, prescription drug assistance, and elder support.

- **Louisiana** will impose a limit on the number of Medicaid prescriptions it will pay for. This may affect access to prescription drugs for mentally ill or disabled individuals who rely on several medications to manage their conditions.

- In **Massachusetts,** the governor has ordered cuts in programs for elders, including home care, geriatric mental health services, and prescription drug assistance.

- **Minnesota** has capped enrollment at current levels for a program that provides expanded health services and care coordination for people with disabilities.

- **New Mexico** will cut cash assistance payments for low-income disabled residents by a third beginning in July. The state provides these payments to an average of 2,100 disabled individuals each month who cannot work and are not eligible for Temporary Assistance to Needy Families.

- **Ohio** plans to close two mental health facilities.

- In **Rhode Island**, low-income elderly people must pay higher rates for subsidized adult day care. This is estimated to affect more than 1,200 people with incomes below $20,000.

- **Tennessee** has reduced community-based services for people with intellectual disabilities and cut nursing services for some adults with serious disabilities.

- **Vermont** has reduced some home-based services, such as housekeeping and shopping, for people who are elderly or disabled. Such services help people stay in their own homes and possibly delay or avoid more expensive nursing home care.

- **Virginia** has decreased reimbursements for special hospitals serving people with needs relating to mental health, mental retardation, or substance abuse. The state also reduced pass-through grants for various aging programs and funding for local mental health providers.

- Other states that have capped or reduced funding for programs that serve people who have disabilities or are elderly include **California**, the **District of Columbia, Kansas, Maine, Maryland, Michigan, Pennsylvania, South Carolina, Utah,** and **Washington.**

K-12 Education and Other Childhood Education Programs

At least 24 states have implemented cuts to K-12 education.

- **Arizona** enacted mid-year cuts of $96 per pupil in core K-12 funding.

- **Florida** cut aid to local school districts by at least $140 per pupil.

- **South Carolina** cut per-pupil funding by $95 this past year.

- **California** is reducing basic K-12 education aid to local school districts. It also is cutting a variety of other programs, such as adult literacy instruction, and is reducing funding for some grants and programs aimed at helping high-needs students.

- **Georgia** made a $112 million cut to the equalization component of the state's education aid formula established to help close the gap in funding between wealthier and poorer school districts.

- **Maryland** cut funding for a school breakfast pilot program, professional development for principals and educators, health clinics, gifted and talented summer centers, and math and science initiatives.

- **Massachusetts** enacted cuts to Head Start, universal pre-kindergarten programs, and early intervention services to help special-needs children develop appropriately and be ready for school. The state also cut K-12 funding, including spending for mentoring, teacher training, reimbursements for special education residential schools, services for disabled students, and programs for gifted and talented students.

- In **Nevada**, the governor has ordered various cuts to K-12 education, including delaying an all-day kindergarten expansion, cutting per pupil expenditures by $400 in a pilot program, eliminating funds for gifted and talented programs and a magnet program for students who are deaf or hard of hearing, and making across-the-board cuts. Additionally, young children with developmental delays will lose more than 15,000 hours of needed services.

- **Rhode Island** has frozen state aid for K-12 education at last year's levels in nominal terms and reduced the number of children who can be served by Head Start and similar services by more than 550.

- State education grants to school districts have also been cut in **Alabama, Connecticut, Delaware, Hawaii, Idaho, Iowa, Kansas, Kentucky, Maine, Mississippi, Ohio, Oregon, Utah, Washington,** and **Virginia.**

Colleges and Universities

At least 32 states have implemented cuts to public colleges and universities and/or made large increases in college tuition to make up for insufficient state funding.

- **Arizona** State University has addressed its loss of state funds by eliminating over 550 staff positions and 200 faculty associate positions, imposing employee furloughs ranging from 10 to 15 days, consolidating several schools and almost two dozen academic departments, and limiting enrollment in its nursing school. Tuition in Arizona this year rose 9.5 percent in response to funding cuts.

- As a direct result of state budget cuts, the **California** State University system is cutting enrollment by 10,000 students. The University of California system is reducing California resident freshman enrollment by 2,300 students for next year.

- **Florida** has cut university budgets and community college funding. The University of Florida has announced it will eliminate 150 positions for the coming year, resulting in 49 staff and nine faculty layoffs. Florida State University plans to lay off up to 200 faculty and staff members. Tuition at all 11 Florida public universities will rise by 15 percent next year.

- At the State University of **New York,** resident undergraduate tuition increased by 14 percent (over $600 per year) between the fall and spring semester of this past academic year.

- When **Rhode Island** cut higher education funding, the University of Rhode Island, Rhode Island College, and the Community College of Rhode Island all increased tuition for this past academic year. Each of these institutions went one step further by increasing tuition further mid-year, by 6.7 percent, 8.2 percent, and 4.3 percent respectively.

- Budget cuts reduced state funding for the University of **Washington** by 26 percent for the coming biennium. The budget authorizes the university to increase tuition up to 14 percent to compensate for this funding loss.

- Other states cutting higher education operating funding include **Alabama, California, Colorado, Connecticut, Georgia, Hawaii, Idaho, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Mississippi, New Jersey, Nevada, New Mexico, North Carolina, Oklahoma, Pennsylvania, South Carolina, Tennessee, Utah, Vermont,** and **Virginia.**

Cuts in Other Services

States also are making cuts in a variety of other programs, including those for very poor families and other vulnerable populations.

- **Arizona** is reducing TANF cash assistance grants for 38,500 low-income families, eliminating substance abuse services for 1,400 parents and guardians, and decreasing homeless shelter capacity by 1,100 individuals.

- **California** is suspending cost-of-living adjustments to cash assistance programs for low-income families and cutting child care subsidies.

- In **Connecticut**, the governor has ordered budget cuts to programs that help prevent child abuse and provide legal services for foster children.

- The **District of Columbia** has reduced its cash assistance payments to needy families. It also cut funding for services that help low-income residents stay in their own homes and communities.

- **Illinois** has reduced funding for child welfare, mental health, youth services, and other programs.

- In **Maine,** the governor has cut funding for homeless shelters.

- **Maryland** has cut reimbursement rates for institutions that provide services to abused and neglected children.

- **Minnesota**'s governor has announced he will cut the state's renter's credit by 27 percent, an average of $129. The credit provides a tax refund to over 270,000 low- and moderate-income Minnesota renters.

- The **Nevada** welfare agency will make it harder for low-income families to receive cash assistance and health insurance, with the expected result that fewer families will receive those benefits. For instance, the state will require some families that have lost benefits to wait longer before reapplying.

- **Rhode Island** has cut funds for affordable housing, eliminated health insurance for home-based child care providers, restricted TANF cash assistance for children, reduced health insurance for retired state workers, and cut support to localities by $10 million.

- The **South Carolina** Department of Juvenile Justice has lost almost one-fourth of its state funding since July, resulting in over 260 layoffs and the closing of five group homes, two dormitories, and 25 after-school programs.

- To operate within a reduced budget, the Chief Justice in **Vermont** ordered the court system to close for half a day each week.

Some states, such as **Delaware, Maryland, Michigan, Minnesota, New Jersey, New York, Rhode Island**, and **Virginia**, have implemented cuts to localities, leading to local concerns about reductions in funding for policing, meals for the elderly, hospice care, services for veterans and seniors, and other services.

Cuts in State Government Workforces

At least 40 states plus the District of Columbia are eliminating or not filling various state jobs, imposing mandatory furloughs (time off without pay), or making other cuts affecting their state workforce. Such steps can make it more difficult for residents to obtain state services. Cutting staff — whether on a permanent or temporary basis — also may contribute to increased unemployment.

- A number of states are imposing furloughs and/or pay cuts for some state employees. These include **Arizona, California, Georgia, Hawaii, Idaho, Iowa, Kentucky, Maryland, Massachusetts, Michigan, New Jersey, New Mexico, Nevada, Ohio, North Carolina, South Carolina,** and **Utah.**

- To deal with budget cuts in **Kentucky**, the Department of Public Advocacy (which defends clients in the criminal justice system) instituted a strict hiring freeze, gave early retirement to 25 employees, and furloughed remaining employees.

- **New Jersey** has eliminated 2,000 state positions by encouraging early retirement, leaving vacancies unfilled, and laying off staff.

- The **Ohio** governor has announced plans to eliminate as many as 2,700 positions, about 4.5 percent of the state workforce, through a combination of early retirements, layoffs, and leaving vacancies unfilled. In the Department of Jobs and Family Services — which oversees disability services, child care, child support, health care, child welfare, and other services — fully 14 percent of positions will be eliminated or left unfilled. Overall, the Ohio state workforce declined by 3,000 between March 2007 and December 2008.

- **Rhode Island** plans to reduce the state workforce by 2,000 or more. The state is encouraging early retirement but has announced that it will lay off workers if needed.

- The **Tennessee** governor has announced elimination of over 2,000 state positions, about 5 percent of the state workforce. Some 1,500 employees accepted buy-outs for early retirement.

- In **Washington,** a hiring freeze imposed by the governor in August caused the state's workforce to decline by more than 1,400. In early January the state replaced the freeze with a cap on the number of budgeted positions at each state agency; the state's workforce is expected to fall by another 2,600 under the cap.

- **Virginia's** governor has eliminated 800 currently unfilled positions, laid off 567 state workers, and delayed a 2 percent salary increase scheduled for November 2008.

- Hiring freezes have also been ordered in **Alabama, Arizona, California, Colorado, Connecticut, Delaware**, the **District of Columbia, Florida, Georgia, Hawaii, Iowa, Kansas, Louisiana, Maine, Michigan, Minnesota, Mississippi, New Hampshire, New Mexico, New York, North Carolina, Pennsylvania, South Dakota, Vermont, Wisconsin,** and **Wyoming.**

- Additional states — such as **Arizona, Florida, Illinois, Maine, Massachusetts, Michigan,** and **South Carolina,** plus the **District of Columbia** — have laid off or announced plans to lay off state employees.

- As noted above, a number of state colleges and universities in states such as **Alabama, Arizona, Florida, Kentucky,** and **New Jersey** are responding to budget cuts by cutting faculty and staff positions.

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STATE BUDGET TROUBLES WORSEN

By Elizabeth McNichol and Iris J. Lav

The ongoing decline in tax receipts has worsened state budget problems. At least 48 states addressed or are facing shortfalls in their budgets for the upcoming year totaling $166 billion or 24 percent of state budgets. New data show a majority of states expect shortfalls in 2011 as well. Aggregate gaps through 2011 likely will exceed $350 billion.

Most states start their fiscal year July 1 and have either adopted budgets for fiscal year 2010 or will do so shortly. In doing so, they have used federal stimulus dollars, cut spending, raised revenues, and drawn down reserves.

Indications are that the budgets taking effect July 1 will not long be in balance because of continually eroding revenues. As of the last week in June, two-thirds of the states have adopted budgets for 2010 and already 12 of these states face new shortfalls totaling $23 billion before the fiscal year has even officially begun. Combining those new shortfalls with the fiscal year 2010 gaps already addressed, and those faced by states that have not yet completed their budgets, the total amount for fiscal year 2010 is at least $166 billion.

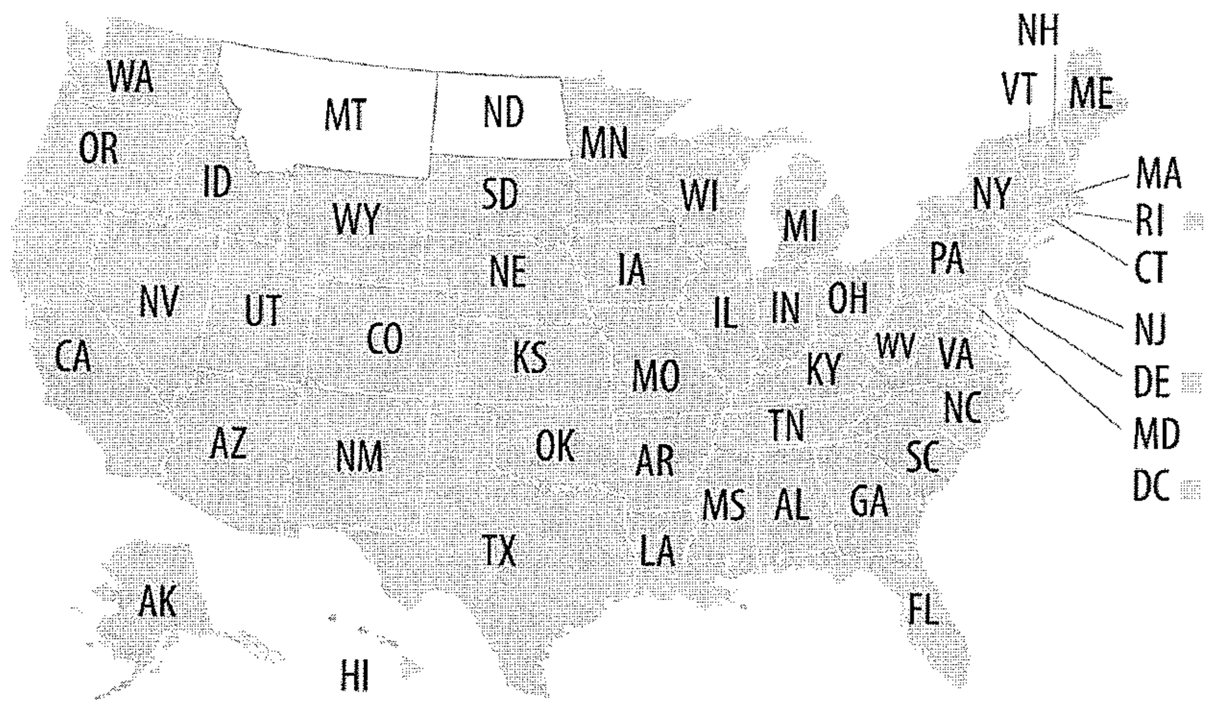
STATE FISCAL STRESS DEEPENS

- At least 48 states addressed or still face shortfalls in their budgets for the upcoming year.
- Even before the new fiscal year starts July 1, new shortfalls of $23 billion have opened up in the adopted 2010 budgets of at least 12 states and the District of Columbia. Shortfalls for fiscal year 2010 – those already addressed and those still open – total $166 billion.
- At least 29 states have prepared estimates for the 2011 fiscal year. Initial estimates of these shortfalls total almost $38 billion. As the full extent of 2011 deficits become known, shortfalls are likely to equal $160 to $180 billion.
- Combined budget gaps for the remainder of this fiscal year and state fiscal years 2010 and 2011 are estimated to total over $350 billion.

The states' fiscal problems are continuing into the next year and likely beyond. At least 29 states have looked ahead and anticipate deficits for fiscal year 2011. These shortfalls total $38 billion — 8 percent of budgets — for the 21 states that have estimated the size of these gaps by comparing expected spending with estimated revenues, and are likely to grow as more states prepare projections and revenues continue to deteriorate.

FIGURE 1:

48 States Face Budget Shortfalls



Note: Includes states with shortfalls in fiscal 2010.

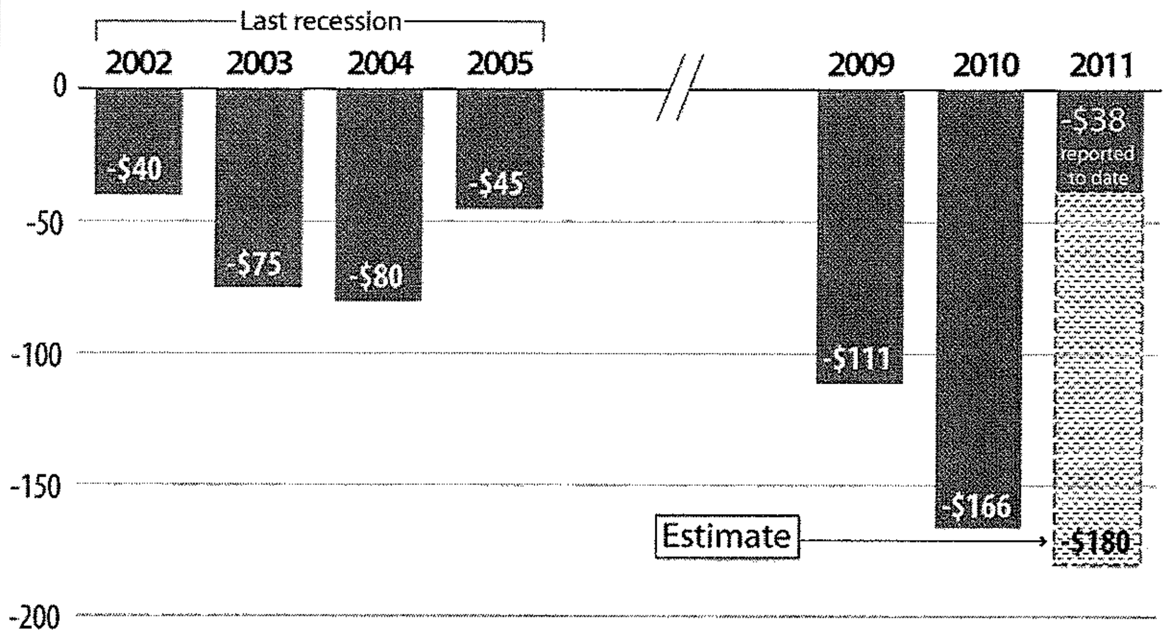
The budget shortfall figures for fiscal years 2010 and 2009 show the national recession's impact on state budgets. These figures are the total size of the shortfall identified by each state listed. In many cases all or part of this shortfall has already been closed through a combination of spending cuts, withdrawals from reserves, revenue increases and use of federal stimulus dollars.

Figure 2 compares the size and duration of the shortfalls that occurred in the recession of the first part of this decade to shortfalls this time. The current recession is more severe — deeper and longer — than the last one, and state fiscal problems have proven to be worse and are likely to remain so. Unemployment, which peaked after the last recession at 6.3 percent, has already hit 9.4 percent, and many economists expect it to rise higher. This would further reduce state income tax receipts and increase demand for Medicaid and other essential services that states provide. With consumers' reduced access to home equity loans and other sources of credit, sales tax receipts have fallen more steeply than in the last recession. These factors suggest that state budget gaps will continue to be significantly larger than in the last recession. All but a handful of states have had to face or are still dealing with shortfalls in fiscal year 2010 that total some $166 billion. If, as is widely expected, the economy does not begin to significantly recover until the end of calendar year 2009 or later, state shortfalls are likely to be even larger in fiscal year 2011 (which begins in July 2010 in most

FIGURE 2:

How Bad Will It Get?

Total state budget shortfall in each fiscal year, in billions



states).[1] The deficits over the next two-and-a half years are likely to be in the $350 billion to $370 billion range.

Several factors could make it particularly difficult for states to recover from the current fiscal situation. Housing markets might be slow to fully recover; their decline already has depressed consumption and sales tax revenue as people refrain from buying furniture, appliances, construction materials, and the like. This also would depress property tax revenues, increasing the likelihood that local governments will look to states to help address the squeeze on local and education budgets. And as the employment situation continues to deteriorate, income tax revenues will weaken further and there will be further downward pressure on sales tax revenues as consumers are reluctant or unable to spend.

Unlike the federal government, the vast majority of states are governed under rules that prohibit them from running a deficit or borrowing to cover their operating expenses. As a result, states have three primary actions they can take during a fiscal crisis: draw down available reserves, cut spending, and raise taxes. States already have begun drawing down reserves; the remaining reserves are not

[1] The projected budget shortfalls do not account for the effects of major economic recovery legislation. The fiscal aid states receive will reduce these shortfalls. In addition, if economic growth is significantly better than projected next year as a result of stimulus efforts, state revenue collections would likely be higher than projected — although it is difficult to know when that effect would first be felt.

sufficient to allow states to weather the remainder of the recession. The other alternatives — spending cuts and tax increases — can further slow a state's economy during a downturn which produces a cumulative negative impact on national recovery as well.

Some states have not been affected by the economic downturn, but the number is dwindling. Mineral-rich states — such as New Mexico, Alaska, and Montana — saw revenue growth as a result of high oil prices. However, the recent decline in oil prices has begun to affect revenues in some of these states. The economies of a handful of other states have so far been less affected by the national economic problems.

In states facing budget gaps, the consequences are severe in many cases — for residents as well as the economy. As the 2009 fiscal year ends and states plan for next year, budget difficulties have led some 39 states to reduce services to their residents, including some of their most vulnerable families and individuals.[2]

For example, at least 21 states have implemented cuts that will restrict low-income children's or families' eligibility for health insurance or reduce their access to health care services. Programs for the elderly and disabled are also being cut. At least 22 states and the District of Columbia are cutting medical, rehabilitative, home care, or other services needed by low-income people who are elderly or have disabilities, or significantly increasing the cost of these services.

At least 24 states are cutting or proposing to cut K-12 and early education; several of them are also reducing access to child care and early education, and at least 32 states have implemented cuts to public colleges and universities.

In addition, at least 41 states and the District of Columbia have made cuts reducing the size or work time of state government employees. Such cuts not only often result in reduced access to services residents need, but also add to states' woes because of the impact on the economy from less consumer activity.

If revenue declines persist as expected in many states, additional spending and service cuts are likely. Budget cuts often are more severe in the second year of a state fiscal crisis, after largely depleted reserves are no longer an option for closing deficits. The experience of the last recession is instructive as to what kinds of actions states may take. Between 2002 and 2004 states reduced services significantly. For example, in the last recession, some 34 states cut eligibility for public health programs, causing well over 1 million people to lose health coverage, and at least 23 states cut eligibility for child care subsidies or otherwise limited access to child care. In addition, 34 states cut real per-pupil aid to school districts for K-12 education between 2002 and 2004, resulting in higher fees for textbooks and courses, shorter school days, fewer personnel, and reduced transportation.

Expenditure cuts and tax increases are problematic policies during an economic downturn because they reduce overall demand and can make the downturn deeper. When states cut spending, they lay off employees, cancel contracts with vendors, eliminate or lower payments to businesses and nonprofit organizations that provide direct services, and cut benefit payments to individuals. In

[2] For more detailed information see Facing Deficits, Many States are Imposing Cuts that Hurt Vulnerable Residents http://www.cbpp.org/3-13-08sfp.htm.

TABLE 1: STATES WITH PROJECTED FY2010 BUDGET GAPS				
	FY2010 pre-budget	**FY2010 mid year gap**	**FY2010 Total**	**FY2010 Total – % of Budget**
Alabama	$1.2 billion	0	$1.2 billion	16.7%
Alaska	$1.3 billion	0	$1.3 billion	30.0%
Arizona	$4.0 billion	0	$4.0 billion	41.1%
Arkansas	$146 million	0	$146 million	3.2%
California*	$34.2 billion	$19.5 billion	$53.7 billion	58.2%
Colorado	$1.0 billion	$384 million	$1.4 billion	18.6%
Connecticut	$4.1 billion	0	$4.1 billion	23.2%
Delaware	$557 million	0	$557 million	17.6%
District of Columbia	$650 million	$150 million	$800 million	12.7%
Florida	$5.9 billion	0	$5.9 billion	22.8%
Georgia	$3.1 billion	$750 million	$3.9 billion	22.3%
Hawaii	$682 million	$297 million	$978 million	19.1%
Idaho	$411 million	0	$411 million	16.4%
Illinois	$9.2 billion	0	$9.2 billion	33.0%
Indiana	$1.1 billion	0	$1.1 billion	7.5%
Iowa	$779 million	0	$779 million	13.2%
Kansas	$1.4 billion	Yes, DK size	$1.4 billion	22.6%
Kentucky	0	$1.1 billion	$1.1 billion	11.3%
Louisiana	$1.8 billion	0	$1.8 billion	21.6%
Maine	$640 million	0	$640 million	21.4%
Maryland	$1.9 billion	Yes, DK size	$1.9 billion	13.6%
Massachusetts	$5.0 billion	0	$5.0 billion	17.9%
Michigan	$2.4 billion	0	$2.4 billion	12.0%
Minnesota	$3.2 billion	0	$3.2 billion	21.0%
Mississippi	$480 million	0	$480 million	9.6%
Missouri	$923 million	0	$923 million	10.3%
Nebraska	$150 million	0	$150 million	4.3%
Nevada	$1.2 billion	0	$1.2 billion	37.8%
New Hampshire	$250 million	0	$250 million	16.2%
New Jersey	$8.8 billion	0	$8.8 billion	29.9%
New Mexico	$345 million	0	$345 million	6.3%
New York	$17.9 billion	0	$17.9 billion	32.3%
North Carolina	$4.6 billion	0	$4.6 billion	21.9%
Ohio	$3.3 billion	0	$3.3 billion	12.3%
Oklahoma	$600 million	0	$600 million	10.5%
*Oregon**	0	0	0	0.0%
Pennsylvania	$4.8 billion	0	$4.8 billion	18.0%
Rhode Island	$590 million	0	$590 million	19.2%
South Carolina	$725 million	0	$725 million	12.5%
South Dakota	$32 million	0	$32 million	2.9%
Tennessee	$1.0 billion	0	$1.0 billion	9.7%
Texas	$3.5 billion	0	$3.5 billion	9.5%
Utah	$721 million	$279 million	$1.0 billion	19.8%
Vermont	$278 million	0	$278 million	24.8%
Virginia	$1.8 billion	Yes, DK size	$1.8 billion	10.9%
Washington	$3.4 billion	$195 million	$3.6 billion	23.3%
West Virginia	$200 million	0	$200 million	5.3%
Wisconsin	$3.2 billion	0	$3.2 billion	23.2%
Wyoming	0	$32 million	$32 million	1.7%
Total	**$143.2 billion**	**$22.7 billion**	**$165.9 billion**	**24.4%**

Notes: The pre-budget shortfall shown for California has been reduced by $5.8 billion to remove double counting of potential revenues affected by the May ballot measures.

Oregon has a two-year budget. The size of the projected shortfall is shown in Table 2. States in italics had not adopted FY10 budgets as of the date of this report. Some or all of the pre-budget shortfalls have already been addressed.

TABLE 2: STATES WITH PROJECTED FY2011 BUDGET GAPS		
	Size of Gap	**Percent of FY2010 General Fund Budget**
Alabama	DK	na
Alaska	$677 million	15.3%
Arizona	$2.6 billion	26.7%
California	$15 billion	16.3%
Colorado	$873 million	11.6%
Connecticut	$978 million	5.6%
Georgia	DK	na
Hawaii	$320 million	6.2%
Indiana	$316 million	2.2%
Kansas	DK	na
Kentucky	$598 million	6.2%
Maryland	$1.2 billion	8.7%
Massachusetts	DK	na
Michigan	$2.0 billion	10.0%
Mississippi	$544 million	10.9%
Nebraska	$150 million	4.3%
New Hampshire	$250 million	16.2%
New Jersey	DK	na
New York	$2.2 billion	3.9%
North Carolina	$4.4 billion	21.0%
Ohio	$1.1 billion	4.1%
Oregon	$4.2 billion	29.0%
Rhode Island	$197 million	6.4%
Vermont	$67 million	6.0%
Virginia	DK	na
Washington	DK	na
West Virginia	$243 million	6.4%
Wisconsin	DK	na
Wyoming	$147 million	8.0%
Total	**$38.0 billion**	**8.2%**

Notes: An entry of "DK" in Size of Gap means that an estimate of the size of the projected gap in that state is not yet available

all of these circumstances, the companies and organizations that would have received government payments have less money to spend on salaries and supplies, and individuals who would have received salaries or benefits have less money for consumption. This directly removes demand from the economy. Tax increases also remove demand from the economy by reducing the amount of money people have to spend – though to the extent these increases are on upper-income residents that effect is minimized because much of the money comes from savings and so does not diminish economic activity.

The federal government — which can run deficits — can provide assistance to states and localities to avert these "pro-cyclical" actions.

States Have Restrained Spending and Accumulated Rainy Day Funds

The current situation has been made more difficult because many states never fully recovered from the fiscal crisis of the early part of the decade. This heightens the potential impact on public services of the shortfalls states now are projecting.

State spending fell sharply relative to the economy during the 2001 recession, and for all states combined it still remains below the fiscal year 2001 level. In 18 states, general fund spending for fiscal year 2008 — six years into the economic recovery — remained below pre-recession levels as a share of the gross domestic product.

In a number of states the reductions made during the downturn in education, higher education, health coverage, and child care remain in effect. These important public services were suffering even as states turned to budget cuts to close the new budget gaps. Spending as a share of the economy declined in fiscal year 2008 and is projected to decline further in 2009 and again in 2010.

One way states can avoid making deep reductions in services during a recession is to build up rainy day funds and other reserves. At the end of fiscal year 2006, state reserves — general fund balances and rainy day funds — totaled 11.5 percent of annual state spending. Reserves can be particularly important to help states adjust in the early months of a fiscal crisis, but generally are not sufficient to avert the need for substantial budget cuts or tax increases. In this recession, states have already drawn down much of their available reserves; the available reserves in states with deficits are likely to be depleted in the near future.

Federal Assistance Crucial

Federal assistance can lessen the extent to which states need to take pro-cyclical actions that can further harm the economy. The American Recovery and Reinvestment Act recognizes this fact and includes substantial assistance for states. The amount in ARRA to help states maintain current activities is about $135 billion to $140 billion — or less than half of projected state shortfalls. Most of this money is in the form of increased Medicaid funding and a "Fiscal Stabilization Fund." This money has reduced to a degree the depth of state spending cuts and moderated state tax and fee increases. There are also other streams of funding in the economic recovery act flowing through states to local governments or individuals, but this will not address state budget shortfalls.

TABLE 3: SIZE OF TOTAL FY2009 BUDGET GAPS				
	Gap before budget was adopted	Additional mid-year gap	Total	Total Gap as Percent of FY2009 General Fund
Alabama	$784 million	$1.1 billion	$1.8 billion	22.2%
Alaska		$360 million	$360 million	6.8%
Arizona[1]	$1.9 billion	$1.8 billion	$3.7 billion	36.8%
Arkansas	$107 million		$107 million	2.4%
California	$22.2 billion	$13.7 billion	$35.9 billion	35.5%
Colorado		$1.1 billion	$1.1 billion	14.2%
Connecticut	$150 million	$1.9 billion	$2.1 billion	12.2%
Delaware	$217 million	$226 million	$443 million	12.2%
District of Columbia	$96 million	$583 million	$679 million	10.8%
Florida	$3.4 billion	$2.3 billion	$5.7 billion	22.2%
Georgia[1]	$245 million	$2.2 billion	$2.4 billion	11.5%
Hawaii		$417 million	$417 million	7.3%
Idaho		$452 million	$452 million	15.3%
Illinois	$1.8 billion	$4.3 billion	$6.1 billion	21.4%
Indiana		$1.2 billion	$1.2 billion	9.1%
Iowa	$350 million	$134 million	$484 million	7.6%
Kansas		$186 million	$186 million	2.9%
Kentucky	$266 million	$456 million	$722 million	7.8%
Louisiana		$341 million	$341 million	3.7%
Maine	$124 million	$140 million	$265 million	8.6%
Maryland	$808 million	$691 million	$1.5 billion	10.0%
Massachusetts	$1.2 billion	$4.0 billion	$5.2 billion	18.5%
Michigan	$472 million	$1.5 billion	$2.0 billion	8.5%
Minnesota	$935 million	$654 million	$ 1.6 billion	9.2%
Mississippi[1]	$90 million	$363 million	$453 million	8.9%
Missouri		$542 million	$542 million	6.0%
Nevada	$898 million	$561 million	$1.6 billion	19.9%
New Hampshire	$200 million	$50 million	$250 million	8.0%
New Jersey[1]	$2.5 billion	$3.6 billion	$6.1 billion	18.8%
New Mexico		$454 million	$454 million	7.5%
New York	$4.9 billion	$2.5 billion	$7.4 billion	13.2%
North Carolina		$3.2 billion	$3.2 billion	14.9%
Ohio[1]	$733 million	$1.9 billion	$2.6 billion	9.4%
Oklahoma	$114 million		$114 million	1.7%
Oregon		$442 million	$442 million	6.6%
Pennsylvania		$3.2 billion	$3.2 billion	11.3%
Rhode Island	$430 million	$442 million	$872 million	26.6%
South Carolina	$250 million	$871 million	$1.1 billion	16.3%
South Dakota		$27 million	$27 million	2.2%
Tennessee[1]	$468 million	$1.0 billion	$1.5 billion	13.4%
Utah		$620 million	$620 million	10.4%
Vermont	$59 million	$82 million	$141 million	11.6%
Virginia	$1.2 billion	$1.1 billion	$2.3 billion	13.8%
Washington		$1.3 billion	$1.3 billion	8.5%
Wisconsin	$652 million	$1.0 billion	$1.7 billion	11.7%
Wyoming		$119 million	$119 million	6.8%
TOTAL	**$47.6 billion**	**$63.2 billion**	**$110.8 billion**	**15.3%**

[1]Only the low end of the estimated FY09 gap for these states — ones that provided a range of estimates — is shown in this table. For more detail see *29 States Faced Total Budget Shortfall of At Least $48 billion in 2009* available at http://www.cbpp.org/1-15-08sfp.htm.

Note: In some cases all or part of these shortfalls have already been addressed.

TABLE 4 – SOURCE OF GAP ESTIMATES	
State	**Source**
Alabama	Legislative Fiscal Office
Alaska	Legislative Finance Division Overview of proposed budget
Arizona	Joint Legislative Budget Committee, Financial Advisory Committee, NCSL
Arkansas	Governor's proposed budget
California	Governor's proposed budget and Legislative Analysts Office
Colorado	Colorado Fiscal Policy Institute analysis of Joint Budget Committee data
Connecticut	Connecticut Voices for Children analysis of Office of Fiscal Analysis data
Delaware	Governor's proposed budget
District of Columbia	Chief Financial Officer
Florida	Revised revenue projections
Georgia	Governor's proposed budget and Georgia State University
Hawaii	Council on Revenues forecast
Idaho	Legislative summary of adopted budget
Illinois	Governor's office
Indiana	State Budget Committee
Iowa	Fiscal Services Division
Kansas	Revenue Estimating Conference and State Budget
Kentucky	Governor's office
Louisiana	Revenue Estimating Conference /Commissioner of Administration
Maine	Office of Fiscal and Program Review – Note: In FY11 (the second year of a 2 year budget cycle) Maine closed a projected $765 million gap.
Maryland	Department of Legislative Services
Massachusetts	Governor's Office
Michigan	Consensus Revenue Forecast, Michigan League for Human Services
Minnesota	Management and Budget forecast
Missouri	Governor's proposed budget and Missouri Budget Project
Mississippi	Governor's proposed budget
Nebraska	Tax Rate Review Committee
Nevada	Board of Examiners and May Economic Forum
New Hampshire	Budget Director
New Jersey	Governor's office, New Jersey Policy Perspectives
New Mexico	New Mexico Voices for Children, Consensus Revenue Estimate
New York	Division of Budget
North Carolina	North Carolina Fiscal Research Division
Ohio	Office of Budget and Management
Oklahoma	State Tax Commission projections
Oregon	Joint Committee on Ways and Means
Pennsylvania	Legislative Caucus
Rhode Island	House Fiscal Advisory Staff
South Carolina	State Budget and Control Board and revised revenue projections
South Dakota	Governor's proposed budget
Tennessee	Press reports of State Funding Board meeting
Texas	Center on Public Policy Priorities analysis of Legislative Budget Board, Comptroller and HHS Commission data.
Utah	Governor's proposed budget, Legislative Fiscal Analyst
Vermont	State budget
Virginia	Governor's office
Washington	Washington Budget and Policy Center
West Virginia	Governor's budget
Wisconsin	Legislative Fiscal Bureau
Wyoming	Consensus Revenue Estimating Group

For source information for the original shortfall estimates, see *29 States Faced Total Budget Shortfall of At Least $48 billion in 2009* available at http://www.cbpp.org/1-15-08sfp.htm.

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Special Series: Economic Recovery Watch

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FEDERAL FISCAL RELIEF FOR STATES IS WORKING AS INTENDED

By Phil Oliff, Jon Shure, and Nicholas Johnson[1]

As dire as the states' fiscal condition is — with dramatic revenue downturns leading in some cases to unprecedented service cuts — evidence shows this bad situation would be substantially worse if not for federal recovery assistance.

The $787 billion American Recovery and Reinvestment Act package enacted in February included about $140 billion for states to use in various ways to help lessen the need for spending cuts, service reductions, and such other budget-balancing actions as tax increases. These funds were expected to provide states on average with about 40 percent of what they need to keep budgets in balance in the 2009, 2010, and 2011 fiscal years.

To date it appears that the funds are working as intended. They are enabling states to balance their budgets with fewer cuts in public services that would harm residents and further slow the economy.

Although the evidence is far from complete, the available information so far suggests that:

- **The federal aid is enough to close, on average, roughly 30-40 percent of state budget shortfalls.** The $787 billion American Recovery and Reinvestment Act (ARRA) included approximately $135 billion to $140 billion for states to maintain current programs, which are being squeezed between rising demand for services and sharply declining tax revenues. These ARRA dollars closed 31 percent of New York's budget gap and 37 percent of Virginia's. Other states, such as Georgia, Maryland, Utah, Washington, and West Virginia report similar outcomes. States are closing the remaining gaps with a mix of spending cuts, revenue increases, withdrawals from reserve funds, and other measures.

- **The federal aid is arriving at a crucial time.** States were seriously considering even more severe cuts than were enacted in such services as health care, education, and public safety prior to passage of federal stimulus legislation. Those cuts very likely would have taken place in the absence of the federal aid.

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[1] Frank Mauro of the Fiscal Policy Institute in New York and Michael Cassidy of the Commonwealth Institute in Virginia provided extensive research and analytic assistance for this report.

The examples of two states in particular are instructive. In both New York and Virginia, major cuts that had been proposed before the federal assistance was made available were never enacted. Virginia is using the fiscal assistance to keep open three facilities serving persons with mental health needs, reverse a planned cut in Medicaid payments to hospitals, lessen a reduction in aid to universities that almost certainly would have led to large tuition increases, avoid a major education budget cut, and avoid a funding cut that would have resulted in the loss of an estimated 310 deputy sheriffs' positions. The governor had proposed these cuts before the federal funds became available.

New York is using recovery-act assistance to sustain state-funded pharmaceutical coverage for seniors on fixed incomes; maintain aid to hospitals and nursing homes; avert a proposed reduction in payments to low-income residents who are elderly, blind, or have disabilities; undo a proposed $1.1 billion cut in K-12 funding; reduce a proposed funding cut for community colleges; maintain programs that provide professional development for teachers; and avoid cuts in college tuition assistance for low- and moderate-income students. The aid also allowed New York to avoid shifting special education costs to local school districts, which would have had to cut services or raise property taxes more than they already are. As in Virginia, all of these cuts had been proposed by the governor prior to ARRA.

In addition, the federal aid undoubtedly is averting other, unspecified cuts in Virginia and New York. In both states, the governor's proposed spending reductions prior to ARRA would have been insufficient to balance the budget as the revenue situation worsened.

- **The flexibility afforded by ARRA dollars is important.** ARRA's state fiscal assistance consisted primarily of $87 billion in increased Medicaid funding and a creation of the $50 billion State Fiscal Stabilization Fund administered by the federal Department of Education. (See the text box on page 3.) As ARRA requires, states are using most of these dollars for health care and education. However, the availability of the federal funds also allows states to use available state money to protect other important programs *not* specifically supported through ARRA.

  Again, New York and Virginia are instructive. New York used some of its savings resulting from the additional federal Medicaid funding to restore aid for New York City, while Virginia used ARRA Medicaid savings to help address an $820 million revenue shortfall that otherwise would have resulted in deeper cuts in a range of areas. States also are receiving money for criminal justice, human services, family assistance, child care, and other areas that they can, under some circumstances, use to pay for programs that otherwise would have been cut.

- **Federal aid will continue to play an important role as states — and the national economy — recover.** Most expect budget problems to continue at least through 2011, and many states are planning to time the use of federal dollars so that some of the funds will be available for that year (which the federal law allows). This gradual expenditure also will allow the states to adapt to unforeseen circumstances over the next year.

State Fiscal Assistance Intended to Support Public Services and State Economies

Congress included state fiscal assistance in ARRA for two reasons. One was that extensive evidence provided by economists and others made the case that helping states close their budget shortfalls was one of the best ways the federal government could strengthen the national economy. Each dollar of federal aid to states, according to Moody's Economy.com, produces $1.36 in increased economic output — a far bigger "bang-for-the-buck" than most other forms of economic stimulus under consideration, including tax cuts.

The reasoning is straightforward. When states reduce spending, they lay off employees, cancel contracts with vendors, lower payments to businesses and nonprofits that provide services, and cut benefit payments to individuals. *All* of these steps lower aggregate demand in the economy, which worsens a downturn.

The second reason for state fiscal assistance in ARRA was the extent to which cuts in important services would harm residents and communities. Massive state budget shortfalls — almost certainly the largest since the Great Depression — already have led roughly three-fourths of the states to cut back on health care, assistance for seniors and people with disabilities, K-12 and higher education, and other services. With the economy worsening, revenues continuing to fall, and more Americans turning to local and state agencies for help, these shortfalls clearly were having dramatic human impacts.

ARRA's two main streams of operating funds to states are:

- *An estimated $87 billion in federal Medicaid funding.* Under the recovery act, the federal government is paying a larger-than-normal share of the Medicaid expenses that states incur from the fourth quarter of 2008 through the end of 2010. The primary purpose of these funds is to address the rising Medicaid costs that come as more people lose employer-provided coverage and qualify for Medicaid.

- *A new $48 billion State Fiscal Stabilization Fund* administered by the federal Department of Education. Of this amount, $39.5 billion is to be used for ongoing operating support to public schools, colleges, and universities, mostly replacing state aid that otherwise would likely be cut due to insufficient revenues. The remaining $8.8 billion is in a flexible block grant that states can use to support general government services.

The recovery act also contains smaller funding sources for states — some of which can help solve their budget problems. Examples include Byrne Grant law enforcement block grants, child care block grants, and grants through the Temporary Assistance to Needy Families program. Under some circumstances, states may use these funds to pay for services they otherwise would have cut, helping addressing their budget shortfalls.

Other major streams of funding in the recovery act that flow through state governments *cannot* be used to address state operating budget shortfalls. Some are specifically targeted for programs that generally lie outside of the operating budget, such as transportation and unemployment insurance. Others are designed to be passed on to local governments.

States' Use of ARRA Funds to Balance Their Budgets

As states resolve lingering budget problems from the current fiscal year (2009) and enact new budgets for fiscal year 2010 — which in most states begins July 1 — most are using a combination of federal relief, cuts in spending, revenue increases, and such other measures as drawing down reserve funds to balance their budgets.

Although it is still too early to have a complete picture of how the funds are affecting every state's budget, all evidence to date suggests that the money is making a substantial difference. Without the funds, the extent of budget cuts undoubtedly would be greater. A handful of concrete examples:

- The **Alabama** Department of Human Resources avoided cutting 3,000 subsidized child care slots; the state also saved an estimated 3,800 education jobs and kept most agencies at or near level funding in Fiscal Year 2010 instead of facing cuts.

- **Arizona** used $20 million to reverse cuts to child care subsidies for low-income families. The cuts were scheduled to take effect this spring and ultimately would have affected 20,000 children.

- **California** reversed a requirement that Medi-Cal (Medicaid) beneficiaries renew their eligibility more frequently, which was expected to cause large numbers of children to lose coverage.

- **Georgia** amended its budget for Fiscal Year 2009 to use $145 million in federal funds to replace funding that school districts were scheduled to lose. Overall, in its 2009 and 2010 budgets, Georgia is using federal funds to close 36 percent[2] of its projected budget gap; the rest is being closed with spending cuts, a cigarette tax increase and other budget measures.

- **Maryland** used $2.5 billion to help balance the state's budget in fiscal years 2009 and 2010. The money helped reverse a number of cuts the governor had proposed to K-12 public schools and community colleges, avoid 700 proposed layoffs, and fund anticipated cost growth in the state's Medicaid and energy assistance programs, among other measures. Overall, the federal funds are offsetting 38 percent of the state's projected 2009 and 2010 budget gaps.[3]

- **New York** passed a fiscal year 2010 budget that uses $4.9 billion to help close the state's budget shortfall and mitigate Governor Paterson's proposed cuts to K-12 and higher education, health and human services funding, and state municipal aid; the impact in New York is described further below.

- In **Oklahoma** federal aid filled in for an unexpected decline in revenues. Among other impacts, the aid allowed universities to avoid raising tuition for next year.

[2] Center on Budget and Policy Priorities calculation using Georgia Budget and Policy Institute data.

[3] Maryland Budget and Tax Policy Institute.

- In order to qualify for the enhanced level of federal Medicaid assistance under the new federal law, **South Carolina** reversed previously made cuts that had restricted eligibility and access to Medicaid services. Most notably, the state will not impose tighter income requirements that would have resulted in loss of coverage for an estimated 3,700 elderly and disabled persons.

- **Utah** used federal assistance to mitigate cuts to K-12 and higher education, among other areas.

- **Virginia** enacted a revised two-year (2009 and 2010) budget that uses federal stimulus aid to mitigate previously proposed cuts to health care, K-12 and higher education, and the state government workforce. Virginia impacts are described further below.

- In **Washington,** federal aid is being used to avert or mitigate cuts to funding for property-poor school districts, cuts to funding for educational quality improvements such as class size reduction, early learning and professional development, and cuts to higher education funding. It is also being used to lessen cuts to public safety and rehabilitation programs. The Senate Ways and Means Committee reports that federal funds reduced the size of the state's budget gap by one-third.

A Closer Look at New York and Virginia

New York and Virginia provide useful case studies of the recovery act's impact on state budgets, for several reasons. Their projected budget shortfalls in the latter part of 2008 and early 2009 were very large relative to the size of their budgets. (New York's was one of the nation's largest.) Their governors' proposed budgets, issued *before* Congress enacted ARRA, provide a useful snapshot of what the states might have done in the absence of the recovery act dollars. And, because they were among the first states to enact new budgets in the spring of 2009, detailed information is available showing how ARRA funds affected the budget process. In both Virginia and New York, recovery act funding is important to closing budget gaps, but it is only part of the solution.

Virginia: Recovery Funds Closing 37 Percent of Budget Shortfall

The recession opened a wide hole in Virginia's budget by shrinking state revenues. When enacted in June 2008, the budget for the 2009-10 biennium (i.e., the two-year period ending June 30, 2010) was in balance. But subsequent estimates showed that the state was unlikely to collect enough revenue to cover budgeted spending. By February 2009, the gap between projected revenues and expenditures had risen to $4 billion. At roughly 13 percent of the budget, the shortfall was somewhat below the national average but still sizable and difficult to close.

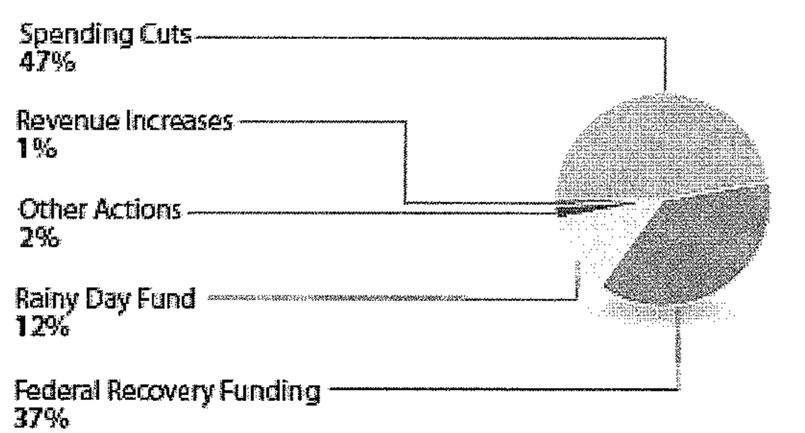
Virginia enacted a revised budget for 2009-10 just a few weeks after passage of the federal recovery act. The updated plan reflects the state's decision to use $962 million in new federal Medicaid funding, $491 million from the education portion of the State Fiscal Stabilization Fund, and $24 million in Byrne Grant funds for law enforcement.

Virginia is closing the remainder of its budget gap with a combination of spending reductions, small revenue increases, and drawing down the state's reserve fund (see Figure 1). Even with the recovery act funding, the state has cut spending substantially: the revised budget is 8 percent below the original budget for 2009-2010 and approximately 7.6 percent below the budget for 2007-2008, despite rising costs and caseloads.

Virginia plans to use approximately 71 percent of the federal Medicaid funding it expects to receive over the lifetime of the recovery act, as well as 50 percent of the education stabilization funding and about 60 percent of its Byrne Grant funding, during the 2009-2010 biennium. Most likely it will use the remainder of the recovery act funds in the next budget period (which begins July 1, 2010), although the state could use some of these funds sooner if budget conditions deteriorate further.

FIGURE 1

Federal Recovery Funding Is Closing Almost 40 Percent of Virginia's FY2010 Budget Gap



New York: Recovery Funds Closing 31 Percent of Budget Shortfall

Prior to ARRA's enactment, New York faced an even more precarious fiscal situation than Virginia. The crisis in the nation's financial services industry — highly important to the state's revenue base — and the broader economic downturn led revenues to decline sharply. New York predicted that without changes to its revenue structure or spending programs, available funds in fiscal year 2010 (the 12-month period beginning April 1, 2009) would fall about $17.9 billion or 26 percent short of what was needed to balance the budget. In addition, New York's FY2009 budget was projected to be short $2.2 billion due to declining revenues and rising costs.[4]

[4] The state budget is defined here as the state's general fund plus funding for the health care reform act, which is a separate component of the state's budget. These figures exclude federal aid.

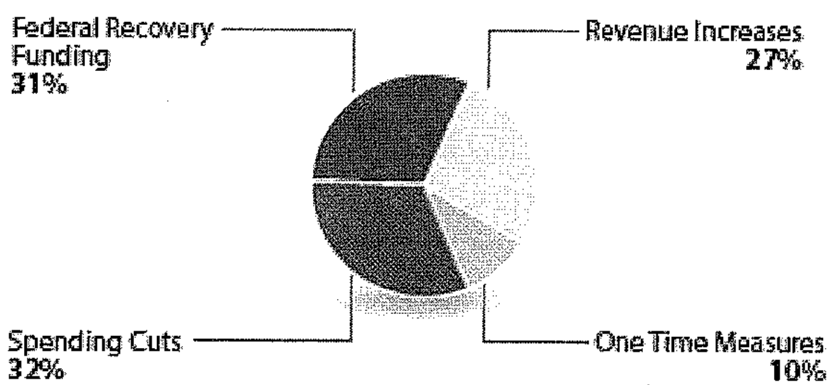
The federal recovery law is providing New York $6.2 billion in federal funding that it is using to help close its budget gap. This includes $5 billion in additional federal Medicaid funding, $876 million in education-related State Fiscal Stabilization Fund money, and $274 million from the "government services" component of the State Fiscal Stabilization Fund.

To put these numbers in perspective, across two fiscal years (2009 and 2010) federal recovery assistance is closing roughly 31 percent of New York's budget hole. A major tax increase will cover about 27 percent of the shortfall, spending reductions another 32 percent, and such one-time budget maneuvers as fund transfers the remaining 10 percent (see Figure 2).[5]

As in Virginia, New York is not planning to use all of its available recovery act funding by the end of fiscal year 2010, instead reserving some for 2011 as the law allows. The state plans to use approximately 60 percent of its increased Medicaid funding, 36 percent of education stabilization funding, and 50 percent of government services stabilization funding in fiscal years 2009 and 2010.

FIGURE 2

Federal Recovery Funding Is Closing Almost One-Third of New York's Budget Gap for Fiscal Years 2009 and 2010



Recovery Act Averting Cuts in Important Services

Virginia: Reversing Proposed Cuts in Health, Education and Public Safety

When Governor Kaine proposed a revised budget for 2009 and 2010, he did not take federal recovery act funding into account because the legislation was far from certain. Instead, he proposed deep spending cuts. A comparison of the governor's proposal with the budget he eventually signed in March 2009 — which *did* reflect the recovery act — suggests the kinds of cuts the legislation allowed the state to avoid. The federal funds:

[5] CBPP analysis of New York State Division of Budget data. The budget gap that existed prior to the federal recovery legislation and prior to enactment of the budget bill reflects the gap between projected revenues and the cost of providing current-law services. The cost of services thus reflects such items as rising need for state-financed health care programs and other rising cost factors.

- *Enabled the state to retain its funding for some 13,000 non-teaching school personnel — such as janitors, psychologists, and administrative assistants — that the governor had proposed eliminating.* The proposed $341 million cut for local school districts (relative to previously budgeted levels) would have placed additional stress on already strained school district budgets.[6]

- *Allowed the state to reduce its planned cut to state colleges and universities from $296 million to approximately $169 million (not taking into account other smaller changes enacted by the legislature), lessening the need for tuition increases.* For example, following release of the governor's budget proposal, the president of Virginia Tech said the university would need to raise tuition by 9 percent, on top of an 11 percent increase implemented in the fall of 2008.[7] Ultimately, with the help of federal stimulus aid, Virginia Tech held its tuition increase for the coming academic year to 5 percent.[8]

- *Prevented closure of three hospitals and treatment centers serving persons with mental health needs.* Closing these facilities would have entirely eliminated Virginia's public inpatient psychiatric services for children. This raised concerns that the 844 children and adolescents served there might have trouble finding alternative sources of treatment. Opponents of the closures feared that private hospitals might be unable or unwilling to care for the patients with the most severe disabilities. They also raised concerns that some of these patients might end up in juvenile detention facilities for lack of available alternatives.

- *Enabled the state to provide 200 mentally disabled individuals with care outside of an institutional setting.* This funding, which was eliminated in the governor's proposed budget revisions, means that recipients can reside outside of a mental health institution while receiving intensive treatment (such as skilled nursing services) that they would not otherwise be able to afford. More than 4,200 people are on a waiting list for this funding, according to the Department of Mental Health.

- *Prevented a 3 percent cut in inpatient hospital reimbursement rates relative to previously budgeted levels.* The proposed cut would have reduced revenue to the state's nonprofit hospitals at a time when many are likely to face budget problems of their own — potentially leading to staff layoffs or cutbacks in patient care.

- *Averted a proposed cut in aid to local sheriffs' departments.* The Virginia Sheriffs' Association had warned that the cut would have forced the elimination of 310 deputy sheriffs' positions.

The legislature likely would have approved the governor's proposed cuts had recovery act funding not been available. In fact, there is good reason to think it would have gone even further. Between December 2008 (when the governor outlined his proposals) and March 2009, the Virginia revenue forecast was revised downward even further by over $800 million. The legislature also rejected the governor's proposal to raise the cigarette tax. Thus, the federal recovery funding helped to avert not

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6 Specifically, the governor proposed cutting a state program that reimburses school districts for a substantial share of the cost of employing key non-teaching personnel. Given Virginia school districts' own budget problems, it is likely that all or most of those positions would be eliminated without the state funds.

7 Warren Fiske, "College Presidents: Tuition Will Increase With State Cuts," *The Virginian-Pilot,* January 22, 2009

8 Larry Hincker, "Board of Visitors Sets Tuition and Fees for 2009-10," *Virginia Tech News,* April 23, 2009.

only the governor's proposed cuts, but also the additional cuts that would have resulted from the further decline in the revenue forecast and the legislature's decision not to raise the cigarette tax.

New York: Reversing Proposed Cuts to Education, Other Core Services

Governor Paterson, like his counterpart in Virginia, issued his budget proposal in December 2008, before the recovery act was enacted, so it did not reflect the additional federal dollars. As in Virginia, a comparison of the proposed December budget with the final budget signed in March suggests the impact of the recovery act funds. The funds:

- *Contributed $750 million to pay for anticipated increases in Medicaid costs in fiscal years 2009 and 2010.* The state's Medicaid enrollment is projected to grow by 3.7 percent between fiscal years 2008 and 2009 and 7.9 percent between 2009 and 2010. (Medicaid is a countercyclical program, designed so rolls can increase during economic downturns when people lose jobs, health insurance, and income.) The state had not anticipated such levels of increase at the time the governor submitted his original budget.

- *Averted $1 billion in planned health care cuts.* The governor had proposed deep cuts to state reimbursements for hospitals and nursing homes that serve Medicaid patients. He also had proposed eliminating state funding to help seniors with limited incomes to purchase drugs that Medicare Part D does not cover.

- *Allowed the state to reduce its share of spending on health care relative to the federal share and use the resulting savings to fill holes in other areas of the budget.* By this means, New York reduced by $1.3 billion the revenue increases the governor had advocated for fiscal year 2010. These included proposed taxes on non-diet soft drinks and digital downloads, as well as the imposition of sales taxes on an array of items.

- *Prevented several proposed cuts to human services, mental health, and other programs.* Using $164 million of the added federal Medicaid funds, New York is cancelling several proposed reductions in human services and related areas. These included planned cuts of between $16 and $28 in monthly Supplementary Security Income (SSI) payments to low-income residents who are elderly, blind, or have disabilities.

- *Averted the proposed elimination of $328 million in aid for New York City.* New York City is facing its own considerable fiscal challenges, and Mayor Bloomberg recently released an austere budget proposal that includes more than 3,700 layoffs.[9] The elimination of state municipal aid would likely have resulted in further layoffs and program cuts.

- *Reversed a sweeping cut to K-12 education aid for the 2009-2010 school year.* Governor Paterson had called for a $1.1 billion reduction in state K-12 education aid. Faced with declining state revenues and growing expenses, school districts would have had little choice but to cut

[9] New York City Office of Management and Budget.

positions, salaries, and programs or raise property taxes more than they already are. The federal recovery funds allowed New York to undo the proposed cut.[10]

- *Averted proposed cuts to community college funding.* New York used $39 million in education stabilization aid to avoid the cuts, reducing the need for tuition increases and program and staff cuts.

- *Helped the state avoid a number of the governor's other proposed cuts, primarily in K-12 and higher education.* The "government services" stabilization funding in the recovery act enabled the state to avoid proposals to shift some pre-school special education costs to local school districts and to cut professional development resources for teachers.

- *Averted proposed eligibility restrictions for a college tuition assistance program for low- and moderate-income New York residents.* The program helps these students afford in-state colleges or universities.

As in Virginia, most or all of the governor's proposed cuts would likely have become law had it not been for the federal funding. Like Virginia, New York received new revenue estimates in early 2009 indicating the 2009 and 2010 budget gaps were even worse than the governor's budget had assumed, meaning that his proposals — severe as they were — would have been insufficient to balance the budget. As it happened, the federal recovery funds helped to avert not only many of the governor's proposed cuts, but also likely additional cuts.

Conclusion

As the first state fiscal year to be seriously affected by the current devastating national recession ends and a new one — with even greater challenges anticipated — begins, federal fiscal assistance for state governments clearly is having the intended impact. Though deep cuts in vital services and programs cannot be avoided entirely, ARRA assistance has enabled states to close their large budget shortfalls with smaller cuts in education, health care, and other important services than would have occurred otherwise. This has lessened both the hardship faced by the most vulnerable residents and the damage to state economies that comes when states sharply reduce spending in a recession. Federal assistance has helped change the state budget equation for the better.

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[10] The federal aid was insufficient, however, for the state to fully fund its foundation education formula, which had been enacted in 2007 to address a court decision that the state had failed to meet its legal obligation to ensure adequate education funding for all children.

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Special Series | Dealing with Deficits: How States Can Respond

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TAX MEASURES HELP BALANCE STATE BUDGETS

A Common and Reasonable Response to Shortfalls

By Nicholas Johnson, Andrew C. Nicholas, and Steven Pennington

With the recession continuing to widen the gap between shrinking revenues and residents' increasing need for services, a growing number of states are adopting a balanced approach to their budgets that includes revenue increases as well as spending cuts. Since January 1, fully half of all states have raised taxes and another 12 states are considering doing so.

These steps are in addition to revenue actions taken by 10 states in late 2007 and 2008 as the recession's effects began to be felt. Although some of these measures are relatively small in terms of the amount of revenue raised, others — such as packages enacted in California and New York and under consideration in Oregon — are very significant.

The great majority of states have cut services to families and individuals, including services that benefit vulnerable families. But these cuts have not been sufficient to solve state budget shortfalls; their size is too great for a cuts-only strategy. Were states to rely on spending cuts alone to close their gaps, it would require unprecedented reductions in such essential public services as health care, education, and assistance for the elderly and disabled.

KEY FINDINGS

- In response to the current recession, 25 states this year have enacted tax increases. Another 12 states are considering similar measures.
- This response is consistent with past practices. States often reduce taxes during economic expansions and increase them during downturns. In the recession of the early 1990s, some 44 states raised taxes; in the early 2000s, some 30 states did so.
- Raising taxes can reflect sound policy judgment. Tax increases can be less harmful to families and less damaging to state economies than the likely alternative: deep cuts in services.
- Federal economic recovery funds are reducing the size and extent of state tax increases. But those funds are insufficient to avert the need for tax increases.

By July 1, the start of the fiscal year in all but four states, most states will have employed a combination of budget solutions that also involves drawing down reserve funds, maximizing the use of federal dollars, and raising taxes. A number of prominent economists have pointed out that budget cuts are more harmful to state economies during a recession than properly structured tax increases, so it is good policy to use tax increases to fill a substantial portion of deficits that exceed the amount that can be closed with reserves or federal funds.

Historically, raising taxes in a recession is a common response by states. During the recession of the early 1990s, 44 states raised taxes by a significant margin (at least 1 percent). In the recession of 2001, 30 states did so. These actions increased annual revenue collections by tens of billions of dollars. (States often go in the opposite direction during periods of strong economic growth: 36 states cut taxes from 1994 to 2001.)

Contrary to what some consider common wisdom, a tax increase can be good policy during a recession. Tax increases are a better option than deep spending cuts — better both for families already suffering due to the recession and for state economies. Tax increases can be designed in such a way that they impose relatively little or no costs on the most vulnerable families; this can be done, for example, by targeting the increase on households with the highest incomes or on profitable corporations. Moreover, as the economists Joseph Stiglitz and Peter Orszag (among others) have noted, tax increases take less money out of the economy than spending cuts, for reasons described more fully below.

One major factor that is reducing, though not eliminating, the need for tax increases in this recession is the American Recovery and Reinvestment Act (ARRA). Enacted in February 2009, it provides substantial money for state governments that includes roughly $140 billion to help alleviate budget shortfalls through funding for education, health care, and other government services. New York, for instance, scaled back the size of a proposed tax increase package by about $1.3 billion after the ARRA funding was announced.

Tax Increases in the Current Recession

So far this year, at least 25 states have enacted tax increases, and (as of June 26) another 12 are considering such measures.[1] (See Figure 1.)

State tax increases began with the recession's onset in late 2007, in order to preserve education, health care, and other services in the face of flattening or declining revenues. At least 10 states enacted tax and revenue measures in late 2007 or 2008. These included major revenue packages in Maryland, Michigan, and New York, and somewhat narrower measures in Alabama, California, Delaware, Massachusetts, New Hampshire, New Jersey, and Rhode Island. Many of those states have enacted or are considering further measures in 2009, reflecting the worsening of the recession.

Enacted Tax Increases In 2009

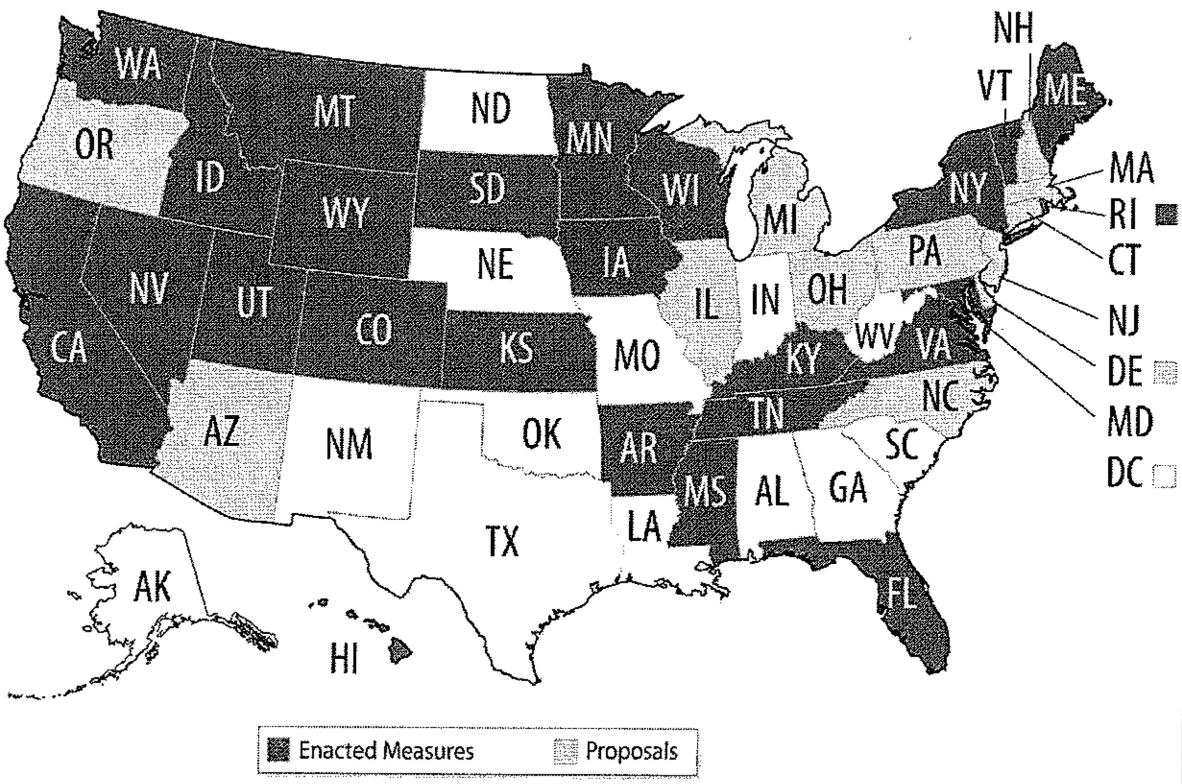
Tax increases enacted so far in 2009 include increases in personal income taxes (at least six states), sales taxes (11 states), business taxes (eight states), tobacco and alcohol taxes (10 states), motor

[1] This analysis attempts to capture states that have enacted or are considering measures that will increase net tax revenues relative to current law. Because some states have yet to adopt their budget for fiscal year 2010, these results are subject to change. A previous version of this analysis included Georgia as having enacted tax increases. Since then, Georgia enacted a number of tax cuts, resulting in a net decrease in total tax revenues, and was removed from the current analysis.

FIGURE 1

2009 State Tax Increases.

Lawmakers in 37 states have enacted or are considering proposals to increase taxes and fees.



Note: Status as of June 26, 2009.

vehicle taxes and fees (nine states), and others (11 states). Many states are raising more than one tax in order to diversify the new revenue sources and distribute the additional revenue collections more broadly.

Personal Income Taxes

Six states have enacted measures that will increase revenues from the personal income tax in fiscal year 2010. These changes include rate increases, the addition of new upper-income tax brackets, and reductions in various credits, exemptions, and deductions. Major income tax increases enacted in 2009 include:

- Along with cutting services by $14.9 billion, California enacted a 0.25 percentage point increase in each of the state's income tax brackets. A tax credit for dependents was also reduced.

Income tax measures are expected to increase tax revenues by more than $5 billion in the coming fiscal year.[2]

- Colorado ended taxpayers' ability to deduct capital gains income derived from assets or businesses located within the state. This change will generate about $15.8 million per year in new income tax revenues.

- Faced with a $682 million shortfall in the coming fiscal year, Hawaii adopted a measure temporarily creating three new state income tax brackets. Beginning in tax year 2009, for married couples the rates will be 9 percent on income between $300,000 and $350,000; 10 percent between $350,000 and $400,000; and 11 percent rate for income above $400,000. Additionally, the state's standard deduction and the personal exemption were each raised by 10 percent, which will lower tax bills for low- and moderate-income families. All of these changes are set to expire after tax year 2015. Hawaii's previous top tax rate was 8.25 percent on all income over $96,000. All of these provisions are expected to increase tax revenues by nearly $100 million during the fiscal year 2009-2011 biennium.

- New York State also faced a sizable gap — 29 percent — in the state's fiscal 2010 budget. As part of a budget-balancing package that included both cuts in services and tax increases, in April New York enacted two new temporary income tax rates levied on the highest-income filers. For households with taxable income above $500,000, regardless of filing status, the tax rate rises to 8.97 percent from 6.85 percent; for those with taxable income below $500,000 but above $200,000 for single individuals, $250,000 for heads of households, and $300,000 for married couples filing joint returns, the rate increases to 7.85 percent from 6.85 percent.

  In addition, New York placed limits on itemized state income tax deductions for taxpayers making over $1 million and reduced a state-funded credit on New York City's personal income tax. The changes are projected to raise more than $5 billion a year.

- Vermont enacted a budget that includes several major changes to the state's income tax structure. Although all income tax rates were lowered, net revenue will increase. This is for two reasons. One, the package eliminated a 40 percent exemption on capital gains income, replacing it with a flat exemption of $2,500. This new exemption will rise to $5,000 beginning in tax year 2011. And, two, lawmakers capped the amount of state and local income taxes that can be deducted from federal adjusted gross income at $5,000. On net, income tax provisions in Vermont will raise $9 million in new revenue in fiscal year 2010.

- By restructuring a credit for land preservation, Virginia raised income tax revenues by $75 million per year.

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[2] These measures were enacted in February with the goal of balancing the state's FY 2010 budget. The deepening recession, however, has thrown the budget out of balance again, necessitating additional spending cuts and/or revenue increases (probably both).

Sales Taxes

In 2009, 11 states have increased sales tax revenues by such means as raising rates, expanding the tax base to cover previously untaxed goods and services, and administrative changes. The following sales tax increases occurred:

- California enacted a temporary 1 percentage point increase in the sales tax rate, which is expected to generate about $4.5 billion in fiscal 2010.

- The sales tax was extended to the sale of tobacco products in Colorado. The state also enacted legislation temporarily reducing the rate at which it reimburses retailers for collecting sales taxes. These measures will generate nearly $70 million in the coming fiscal year.

- Hawaii entered into the multi-state Streamlined Sales and Use Tax Agreement (SSUTA) — a compact that simplifies sales tax collections for participating businesses. This change is expected to generate about $10 million in the fiscal 2010-2011 biennium.

- Kentucky extended the state's sales tax to include alcoholic beverages. The change will generate about $52 million each year.

- As part of a large package of tax changes, Maine expanded the sales tax to include amusement parks and sporting events and a range of maintenance and service transactions including auto repair and dry cleaning. (The package also replaced the state's graduated income tax structure with a flat 6.5 percent rate plus a 0.35 percentage point surcharge on income over $250,000.) In total, compared to current law, tax revenues will be modestly higher in fiscal 2010 as a result of these changes.

- In Nevada, the sales tax rate was temporarily increased to 6.85 percent from 6.5 percent. This change will raise revenues by $280 million over the next two years.

- New York raised sales tax revenues by about $35 million by taxing a broader range of companies previously selling tax-free over the Internet, and certain types of transportation services like limousine and car hires.

- Tennessee extended the sales tax to include software maintenance contracts and limited an exemption on computer software. These changes will generate about $10.5 million per year in new revenues.

- Vermont expanded the sales tax to include liquor and digital downloads, raising over $3 million in new revenues in fiscal 2010.

- Washington State eliminated a sales tax exemption on hybrid vehicles and enacted legislation designed to curtail abuse of certificates that allow businesses that buy products for resale to avoid paying the retail sales tax. These measures will increase sales tax revenues by about $70 million.

- Wisconsin enacted legislation to enter into the SSUTA. The state also altered its method for taxing prewritten computer software and expanded the sales tax to include digital products, such as music and video downloads and subscriptions to online periodicals. Sales tax revenues will rise by more than $30 million as a result of these actions.

Business Taxes

At least eight states have enacted business tax increases:

- Iowa placed limits on the size of five costly business tax credits, saving the state about $18 million in fiscal year 2010.

- Kansas suspended its film production credit for two years. For dozens of other credits, the state temporarily reduced the amount firms can claim by 10 percent. In the next fiscal year, these changes will increase revenues by over $10 million.

- Maryland tightened the cap on corporate income tax credits for mined coal, which will increase business tax revenues by $9 million in fiscal 2010.

- Nevada altered its business payroll tax, generating $346 million in new revenue in the fiscal 2010-2011 biennium. For non-financial businesses, the tax rate on the first $250,000 in payroll is lowered to 0.5 percent from the flat rate of 0.63 percent. The tax rate on payroll over $250,000 rises to 1.17 percent.

- New York imposed a new fee on certain business partnerships and restructured the business tax benefits administered through the "Empire Zone" program.

- Tennessee increased franchise and excise tax revenues by eliminating an exemption on rental income earned by certain non-corporate businesses. This change increased revenues by more than $25 million per year.

- The corporate income tax in Virginia was expanded to include investment income from Real Estate Investment Trusts (REITs). About $75 million in new revenues will be generated as a result of this change.

- Wisconsin instituted "combined reporting," which increases revenue by requiring companies with subsidiaries to calculate their profits as one sum instead of allowing various entities to report separately and claim numerous deductions. One result is that in-state and multi-state corporations will be taxed more equivalently. Under combined reporting, corporate income tax revenues will increase by over $75 million in fiscal 2010.

Tobacco and Alcohol Excise Taxes

At least 10 states have increased excise taxes on tobacco and alcoholic beverages.

- Arkansas raised the cigarette tax by 56 cents, to $1.15 per pack. The tax on other tobacco products was increased to 68 percent from 32 percent of the wholesale price. These changes are expected to generate over $85 million per year in new tax revenue.

- Florida enacted legislation adding a $1 surcharge to the tax on each pack of cigarettes. A surcharge equal to 60 percent of the wholesale price also was imposed on other tobacco products. These surcharges will increase tax revenues by nearly $1 billion in the coming fiscal year.

- Hawaii increased the cigarette tax by 2 cents per pack. The state also increased taxes on other tobacco products by various levels. Depending on the product, taxes on tobacco other than cigarettes will range up to 70 percent of wholesale price; the previous rate was 40 percent of the wholesale price. These changes will increase tax revenues by nearly $50 million in the upcoming fiscal 2010-2011 biennium.

- Kentucky doubled its cigarette tax to 60 cents per pack from 30, which will raise more than $106 million a year.

- Maine changed how it taxes smokeless tobacco products. Previously, the state taxed them at 78 percent of the wholesale price. Beginning in fiscal 2010, taxes on smokeless tobacco will be based on weight, at a rate of $2.02 per ounce. Tobacco tax revenues will increase by about $2 million in the upcoming fiscal year.

- Mississippi increased the cigarette tax to 68 cents per pack from 18 cents, which is expected to raise more than $100 million in fiscal 2010.

- New York raised $14 million in new revenue by increasing the state excise tax on beer and wine to 30 cents per gallon from 18.9. The method for taxing cigars was changed to generate about $10 million in fiscal 2010.

- Rhode Island increased its cigarette tax by $1 to $3.46 per pack.

- The cigarette tax in Vermont was increased by 25 cents, to $2.24 per pack from $1.99. The tax on other tobacco products rises to 92 percent from 41 percent of the wholesale price. These changes will increase tax revenues by about $6 million in fiscal 2010.

- Wyoming changed its method for taxing moist snuff tobacco, basing it on net weight. This is expected to generate about $820,000 in new tax revenues each year.

Motor Vehicle License Fees & Gasoline Taxes

Nine states have increased various fees and taxes related to motor vehicles and fuels:

- California temporarily increased vehicle license fees to 1.15 percent of value from 0.65 percent, raising about $1.7 billion in new revenues each year in fiscal years 2010 and 2011.

- Colorado raised several fees, fines, and surcharges to support transportation improvements and instituted a $2 per day rental car fee. These changes will generate about $250 million in new tax revenues in fiscal 2010. Additionally, a motor vehicle fee to support local emergency services was increased to $2 from $1.

- Florida increased a variety of vehicle registration and license fees, raising over $1 billion in new revenues each year.

- Idaho added fees for driver's licenses, vehicle title transfers, copying records, and replacing registration stickers. Additionally, a 2.5 cent per gallon tax exemption for biodiesel and gasohol was removed. These changes will generate about $30 million in new revenues beginning in fiscal 2010.

- Montana removed an exemption valued at 0.0401 cents per gallon on motor fuels blended with ethanol. The measure will raise about $6.4 million in new revenues each year.

- Nevada altered the rate at which vehicles depreciate in value for purposes of the registration tax. The minimum vehicle registration tax was increased to $16 from $6. These changes will increase revenues by about $94 million in fiscal 2010.

- New York added an auto rental excise tax which will generate up to $8 million in fiscal 2010.

- In South Dakota, about $4.2 million in new annual revenues was generated through a $1 increase in commercial and noncommercial vehicle license fees.

- Utah increased some motor vehicle fees by $20, which will generate about $53 million per year.

Other Taxes and Fees

- Colorado increased hospital provider fees, generating about $390 million each year to expand medical assistance programs.

- Florida increased fees on slot machine licenses, park admission, and off-shore fishing licenses, among other transactions and activities.

- Hawaii increased the motel room tax by one percentage point to 9.25 percent. The state also increased conveyance tax rates on property transfers worth more than $1 million.

- Iowa increased a number of court fees, including those for divorce filings and real estate title transfers. This is expected to generate about $17 million in fiscal year 2010.

- Maine increased license fees for hunting, fishing, and archery. Several residential and business property tax credits were reduced.

- Minnesota reduced a property tax refund for low-and-moderate-income renters, saving the state

$51 million in the upcoming fiscal biennium.[3]

- Montana changed laws requiring tax information agents to report certain real estate transactions, which will generate about $900,000 in fiscal 2011.

- New York eliminated a property tax rebate for homeowners with incomes below $250,000. This will save the state about $1.4 billion per year.

- In Tennessee, the gross receipts tax on health maintenance organizations (HMOs) was increased to 5.5 percent from 2 percent, a change that will increase revenues by more than $136 million each year.

- South Dakota increased its gross receipts tax on gaming proceeds to 9 percent from 8 percent. Additionally, several excise taxes on activities related to tourism — motel stays, event tickets, and campsite fees — were temporarily increased. These increases will generate about $4 million in new revenues each year in fiscal 2010 and 2011.

- Wisconsin is imposing hospital assessment taxes based on gross patient revenues. Annually, this will increase revenues by over $300 million.

Tax Increases under Consideration

In addition to the 25 states that have already enacted tax increases, policymakers in another 12 states had before them proposals to do so as of late June. As budget deliberations continued, these states had on the table tax increases that were either included in executive budget proposals or supported by legislative leaders: Arizona, Connecticut, Delaware, Illinois, Massachusetts, Michigan, New Hampshire, New Jersey, North Carolina, Ohio, Oregon, and Pennsylvania.

These include a proposal by Delaware's governor to increase the top income tax rate, a measure passed by the Massachusetts legislature to increase the sales tax rate and extend it to alcoholic beverages, active proposals to increase the income tax rates on high-income taxpayers in New Jersey, a recent proposal from the governor of Pennsylvania to increase the state's flat income tax rate to 3.57 percent from 3.07, and a measure passed by the Oregon legislature creating two new brackets for upper-income taxpayers.

Tax Increases in Past Recessions

For states to raise taxes in this recession is consistent with the experience of the past two recessions.

- In response to the recession of 1990-91, 44 states increased taxes significantly.[4] From 1990 to

[3] The reduction in the property tax refund was not passed by the Minnesota legislature, but is scheduled to take effect in FY2010 through a process known as "unallotment," a constitutional provision allowing Minnesota's governor to make unilateral cuts when the state faces a budget deficit.

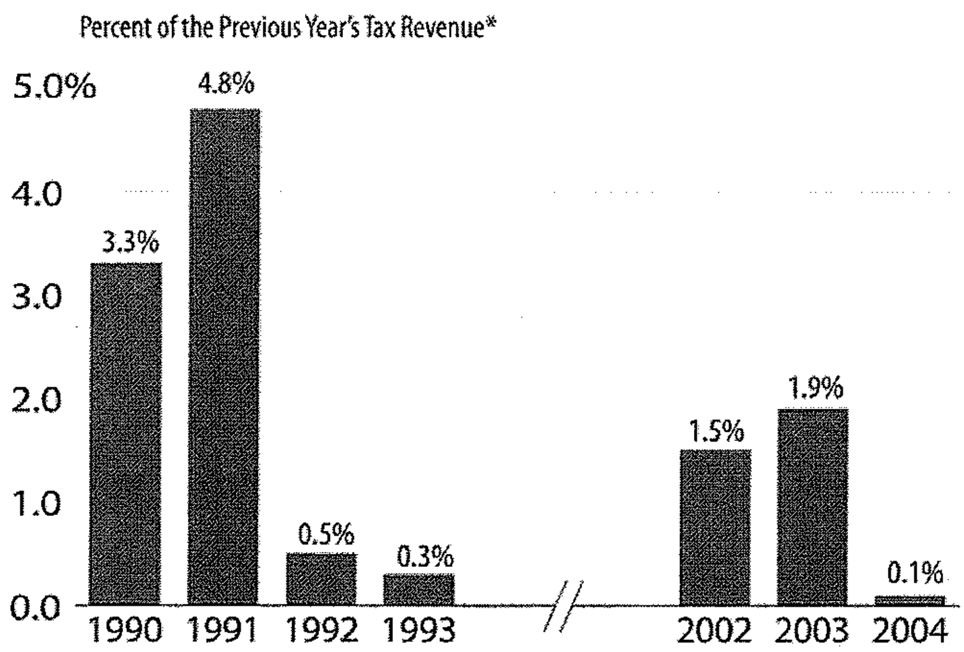
1993, 26 states increased personal income taxes or corporate income taxes and 37 increased sales or excise taxes. In aggregate, states enacted more than $25 billion in net tax increases. The new taxes raised total state tax revenues by about 8.9 percent during the period. (See Figure 2.)

- In the wake of the recession of 2001, 30 states raised taxes. In 15 of them, tax increases were very significant, with revenue increases of more than 5 percent. Another 15 states enacted tax increases of between 1 percent and 5 percent of total state revenues. In total, states increased net revenues by about 3.5 percent, or about $18.6 billion, from late 2001 to 2004. Of the 30 states with significant tax increases during this period, 10 raised personal income taxes, 16 raised taxes on businesses and corporations, 16 increased sales tax rates or broadened the base to include more goods and services, and 29 raised excise taxes on tobacco products or alcohol.

The tax increases occurred in a diverse group of states. States raising taxes during each of those periods included those with Democratic governors or legislatures and those led by Republicans. States in all regions of the country raised taxes. By most standards, the recessions of 1990-91 and 2001 were relatively mild. Had the recessions been more severe, the tax increases likely would have been greater.

FIGURE 2

Tax Increases During the Last Two Recessions: 1990-1993, 2002-2004.



* Net tax changes. Data for 2002 include tax increases enacted in late 2001.

[4] Nicholas Johnson and Daniel Tenny, "The Rising Regressivity of State Taxes," Center on Budget and Policy Priorities, January 15, 2002, www.cbpp.org/archiveSite/1-15-02sfp.pdf. A "significant" tax increase is one that exceeds 1 percent of a state's tax revenue.

Is It Good Policy for States to Raise Taxes in a Recession?

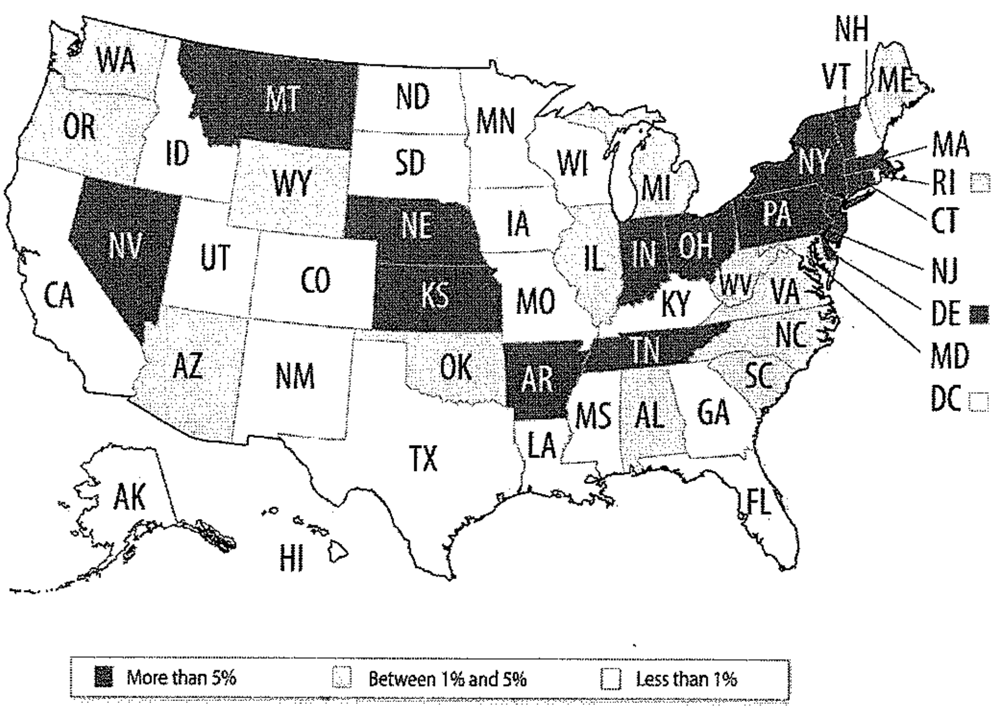
During a recession, unemployment rises, families have a harder time paying for necessities, and many either lose or can no longer afford health coverage. By raising taxes, states can help ensure that those families and individuals hurt most by the recession do not face even more difficulties because of cuts in government programs and services they need, including those involving assistance with housing and health care, or access to higher education. Unfortunately, many of the spending cuts that states have enacted or are considering would have the most harmful impact on low- and moderate-income families and others hit hard by the recession. Tax increases can avert such cuts.

Tax increases have another advantage over spending cuts: they are often better for a state's economy. During recent deliberations in New York over how to close a growing budget gap, Governor Paterson and the legislature received a letter from 120 economists in the state. Citing "economic theory and historical experience," the letter observed that "raising taxes during a downturn — particularly taxes that affect only higher-income families — is generally better for a state's economy, and better for its citizens, than sharp budget cuts."

FIGURE 3

Most States Raised Taxes Significantly during the Last Recession.

Net Tax Increases as a Percent of the Previous Year's Tax Revenue, late 2001-2004.



Source: CBPP calculations of data from the Census Bureau, the National Conference of State Legislatures, and state fiscal offices.

The letter went on:

"The reasons are simple. Almost every dollar that states and localities spend on aid for the needy, salaries of public employees, and other vital services enters the local economy immediately. So if states cut their spending in these areas, overall demand suffers at a time when demand is already too low and support services are most needed.

"The alternative — raising taxes — also reduces spending, but by less than budget cuts of comparable size. And by targeting these taxes appropriately, their negative effects can be minimized. For example, high-income households typically spend only a fraction of their income and save the rest. As a result, each $1 increase on taxes on high-income households will reduce their spending by much less than $1."[5]

The letter echoed the conclusions of a paper written during the last recession by Columbia University professor and Nobel Prize winner Joseph Stiglitz and Peter Orszag, now director of the U.S. Office of Management and Budget, asserting that spending cuts can be more harmful for a state's economy in a recession than tax increases.[6]

The Recent Economic Experience of States That Raised Taxes in Recession

The recession of 2001 hit some states harder than others. As a result, some states raised taxes while others did not. But there is no evidence that tax-raising states were any faster or slower to recover from the recession than those that did not raise taxes. States that raised taxes were just as fast to rebound from the recession as states that did not, even though they were typically climbing out of a deeper hole.

As Table 1 shows, states that had enacted significant tax increases (more than 1 percent of revenues) in the 2002-04 period saw growth rates in personal income, employment, and the median wage from 2004 to 2007 that closely matched national averages. Furthermore, a number of states that enacted significant tax increases during the early 2000s subsequently experienced above-average growth in these key economic indicators.

TABLE 1: ANNUAL ECONOMIC GROWTH BY VARIOUS INDICATORS, 2004-2007

	Average Annual Growth Rates	
Indicator	States that Increased Taxes Significantly	National Average
Total Personal Income	6.1%	6.2%
Employment	1.6%	1.7%
Median Wage	3.1%	3.1%

Source: Bureau of Labor Statistics, Bureau of Economic Analysis, and CBPP calculations of data from the NCSL and state revenue departments.

Note: States were grouped according the amount of gross tax increases between late 2001 and 2004. States that increased taxes significantly are those that enacted cumulative increases of at least 1 percent of the previous year's tax revenues.

- North Carolina, for example, raised taxes by about 3.5 percent of revenues during the last downturn. From 2004 to 2007, total personal income in the state grew by about 6.7 percent

[5] See letter dated December 13, 2008, available on the Fiscal Policy Institute website, www.fiscalpolicy.org.

[6] Peter Orszag and Joseph Stiglitz, "Budget Cuts vs. Tax Increases at the State Level: Is One More Counter-Productive than the Other during a Recession?" Center on Budget and Policy Priorities, revised November 6, 2008, http://www.cbpp.org/archiveSite/10-30-01sfp.pdf. Of course, it would be preferable if states had to *neither* make large spending cuts *nor* raise taxes, but that is not an option for most states.

each year compared to the nationwide rate of 6.2 percent during this period. North Carolina experienced faster-than-average growth in employment following the last recession, growing about 2.5 percent each year from 2004 to 2007. Nationwide, employment grew at an annual rate of 1.7 percent during this period.

- Similarly, growth in total personal income and employment from 2004 to 2007 exceeded national averages in South Carolina, Virginia, and Washington — all of which enacted significant tax increases during the recession of the early 2000s.

On the other hand, a number of states that did not raise taxes, or cut them, during the last recession subsequently saw slower-than-average economic growth. Among them are Iowa, Kentucky, Minnesota, Missouri, New Hampshire, and Wisconsin. Those states' decision to avoid tax increases (and, in some cases, to enact large cuts in services) failed to protect them from below-average growth in both personal income and employment during the subsequent period.

In short, neither economic theory nor experience supports the idea that states should shy away from raising taxes in a recession for fear of harming their economic performance.

Federal Economic Recovery Act Funding Is Reducing But Not Eliminating the Need for Tax Increases

In the current recession, state budget shortfalls are projected to exceed $350 billion over the next two-and-a-half years. Even with assistance from the federal stimulus legislation (the American Recovery and Reinvestment Act), states will continue to face large budget gaps. The $135 billion to $140 billion that ARRA provides states to help balance budgets is expected to cover only about 40 percent of aggregate shortfalls.[7] The remaining shortfalls are still too large to close with budget cuts alone; tax increases should remain on the table in most states. Indeed, most of the tax increases described earlier in this paper were proposed and/or enacted after passage of ARRA.

There is another reason that states may wish to consider raising revenues in tandem with using ARRA funds. Tax increases can be structured to be a recurring revenue source. By contrast, the ARRA funds that states can use to balance their budgets generally are available only until state fiscal year 2011, so federal aid to states likely will return to pre-ARRA levels starting in 2012. States that increase taxes to close a portion of their 2010 and 2011 gaps will find it easier to adjust to the loss of federal revenues in 2012 because they will have the recurring tax revenues to fall back on.

[7] Nicholas Johnson, Iris J. Lav, and Elizabeth McNichol, "Funding For States in Economic Recovery Package Will Close Less Than Half of State Deficits," Center on Budget and Policy Priorities, February 20, 2009, www.cbpp.org/2-20-09sfp.htm.