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February 3, 2004

DECLINE IN FEDERAL GRANTS WILL PUT ADDITIONAL SQUEEZE ON STATE AND LOCAL BUDGETS

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President Bush has touted his budget as one that holds down spending. One way he is appearing to cut spending is by passing down costs to other levels of government, leaving states and localities the option of either curtailing services or paying for those services with increasingly scarce state or local funds.

- Under the President's budget, grants to state and local governments for all programs other than Medicaid would *decline* by 2.6 percent, after adjusting for inflation. (Medicaid is excluded because changes in Medicaid grants largely reflect inflation in health-care costs in the public and private sectors alike. Considering grants other than Medicaid gives a more accurate picture of the relative level of federal funding for state and local services.)

- Adjusting for population growth as well as inflation yields another — and somewhat better — measure of whether the grants would be adequate to maintain the current level of state and local services they support. This measure is better because the cost of providing state and local programs and services generally increases when the price of providing those services (in terms of wages, contracts, supplies) goes up and the size of the population in need of the program or service increases. Adjusting for inflation and population changes, the value of grants for all programs other than Medicaid would decline by $6 billion, or 3.5 percent.

- The $6 billion shortfall would add to the fiscal stress that states and localities continue to face. States face budget deficits of approximately $40 billion for state fiscal year 2005, following budget deficits of nearly $200 billion over the previous three years. Cuts in federal grants will enlarge the deficit gaps that have to be closed at a time when states and localities are struggling to maintain needed programs and services, and will force states and localities to institute additional budget cuts and tax increases.

Discretionary and Mandatory Grants

The President's 2005 budget proposes cuts in both discretionary grants that are appropriated annually and in entitlement programs. The budget does not propose large cuts in specific major programs, but rather a myriad of small- and moderate-sized cuts in a large number of programs.

Table 1
Grants-In-Aid to State and Local Governments in the FY 2004 Budget, *excluding Medicaid*
Budget Authority (funding) in billions of dollars

	FY 2003	FY 2004	FY 2005
Discretionary Funding	$131.2	$128.8	$126.8
Mandatory Funding	95.0	99.6	97.8
Total Funding	226.2	228.4	224.6
Total Funding adjusted for technical anomalies*	227.6	228.3	224.6
In 2005 dollars (i.e., adjusted for inflation)	232.7	230.7	224.6
In 2005 dollars per capita (i.e., adjusted for both inflation and population growth)**	$825	$810	$782
Percent change after adjusting for inflation		**-1.8%**	**-2.6%**
Percent change, real per-capita grants (i.e., after adjusting for both inflation and population growth)		**-2.6%**	**-3.5%**

* Adjustments were made to exclude disaster relief funding in all years and fiscal relief in 2003 and 2004, to reflect funding for highways and mass transit as the level of obligations for those programs rather than the level of "contract authority," to remove distortions that can occur when the level of "advance" appropriations changes from year to year.

** The dollar figures in these lines are the actual dollar figures, not figures in billions of dollars.

- Funding for grants to state and local governments through discretionary programs would *decline* by 1.1 percent between 2004 and 2005 under the President's budget.

- After adjusting for inflation, discretionary grants to state and local governments would decline by 2.2 percent. After adjusting for population as well, the decline would be 3.0 percent.

- On the entitlement or "mandatory" side of the budget, grants to state and local governments other than for Medicaid would decline by 3.9 percent from 2004 to 2005, after adjustment for inflation (and by 4.8 percent after adjustment for both inflation and population growth).

- Total discretionary and mandatory grants combined, other than Medicaid, would decline by 2.6 percent after adjusting for inflation, and by 3.5 percent after adjusting for population growth as well.

Future Years

Much deeper losses of federal grants would be in the offing in years after 2005 under proposals included in the President's budget. This would occur because the budget proposes a cap on discretionary spending. A single cap would cover most discretionary spending, including defense, international, and most domestic discretionary spending. This would put domestic and defense spending in competition for funding.

If the levels proposed in the budget for defense, homeland security, and international affairs are fully funded — and some experts believe the budget understates the Administration's future funding plans in those areas — domestic discretionary spending would be heavily squeezed. By 2009, discretionary spending outside of these three areas would be substantially below the baseline level, which means it would be substantially below the level necessary to maintain current levels of programs and services.

Within domestic discretionary spending, grants to states and localities account for nearly one-third of the total. Grants to states and localities would be likely to sustain at least a proportionate cut in funding if the proposed cap were to become law, and might be cut disproportionately if spending in other areas were protected.

Other Impacts of Budget on States

In addition to the loss of federal grants for programs, states face the loss of significant amounts of revenue as a result of the federal tax changes proposed in the Bush budget. Federal tax changes often affect state revenues, because most states use federal definitions of income, federal depreciation allowances, and other features of the federal tax code as the basis for their own taxation. The 2005 budget includes a number of tax initiatives that could result in the loss of approximately $5 billion in state revenues over the next five years. (A forthcoming analysis will discuss these revenue issues in more detail.)