CENTER ON BUDGET AND POLICY PRIORITIES

NEWS RELEASE

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Biggest Tax-Cutting States In 1990s Did Worst In Downturn
Findings Suggest Need for Caution as Economy Recovers

The large tax cuts some states enacted during the economic boom of the 1990s appear to have led to unusually deep budget and economic distress in the subsequent recession, according to a new report from the Center on Budget and Policy Priorities. These findings indicate that states should be wary of new tax cuts or other revenue restrictions as they emerge from the fiscal crisis.

Compared to states that enacted smaller tax cuts (or none at all) during the 1990s, the big tax-cutting states faced larger budget shortfalls during the state fiscal crisis that began in 2001 and were forced to take more drastic steps to balance their budgets. The economies of the big tax-cutting states also performed worse than those of the states that had been more cautious about tax cuts.

"Supporters of large tax cuts said they were affordable and would boost economic growth, but the data we've gathered about how states did during the downturn doesn't support either of those arguments," said Robert Zahradnik, senior policy analyst at the Center and author of the report, *Tax Cuts and Consequences.* The deeper economic distress the big tax-cutting states experienced during the downturn (in terms of lower employment and income growth) wiped out much of the gains these states made during the boom years.

As the economy recovers, states should be wary of new rounds of tax cuts that would repeat this cycle, he added.

Larger Budget Shortfalls, Weaker Economic Performance

Most states cut taxes in the mid- to late 1990s, but some states cut them especially deeply: 16 states reduced revenues by more than 7 percent. The biggest tax-cutting states were Colorado, Connecticut, Delaware, Massachusetts, New Jersey, and New York, each of which reduced revenues by 10-25 percent.

The Center compared the 16 states that had reduced revenues by more than 7 percent with the 34 states that had been more cautious about cutting taxes and found that the states with the biggest tax cuts:

- had larger budget shortfalls (more than 1 ½ times as big as the other states);
- were forced to impose larger spending cuts and tax increases to close those shortfalls; and
- were more likely to have their credit rating downgraded.

In terms of states' economic performance during the downturn, the states that cut taxes most during the 1990s:

- lost more jobs (in percentage terms, they lost three times as many jobs on average as the other states); and
- had slower income growth.

Lessons for State Policymakers

As state revenues begin rebounding from several years of declines, some states are considering a new round of tax cuts, partly in hopes of spurring economic growth.

The findings of the Center's report indicate that states should not expect tax cuts to lead automatically to a stronger economy. They also suggest that before states enact tax cuts or other revenue restrictions, they should determine whether these measures are affordable over the long term.

The Center's finding that the biggest tax-cutting states had weaker economic performance during the downturn suggests that tax cuts do not necessarily promote economic growth. Several studies have made this same point: a 2002 study by economist Robert G. Lynch found that when businesses decide where to locate, they pay more attention to factors such as access to qualified workers, proximity to customers, and quality public services than to tax rates. Nevertheless, one of the most common arguments for tax cuts has been that they will help economic growth, and the Center's report shows that this did not happen in any sustained way.

In addition, the Center's finding that the biggest tax-cutting states of the 1990s had the biggest budget problems during the downturn demonstrates that many of those tax cuts were not affordable.

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