CENTER ON BUDGET AND POLICY PRIORITIES

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IS THE STATE FISCAL CRISIS REAL?

By Nicholas Johnson

In a pair of January 15, 2003 stories in *USA Today*, reporter Dennis Cauchon expresses doubt about the severity of the fiscal crisis in the states by asserting that state and local governments are expanding, not contracting. He seeks to disprove predictions that states must cut spending or raise taxes in order to balance their budgets, even though those predictions have been issued by numerous elected officials of both parties in nearly every state as well as by a wide range of independent, nonpartisan analysts and experts.

These stories include a number of errors in reporting and analysis. It is these inaccuracies that allow the newspaper to reach conclusions so at odds with the assessment of nearly everyone else who has studied the issue. For example:

- Cauchon says state and local governments are spending more money than last year. *In fact, real spending by state governments has already declined in this fiscal crisis, and is likely to decline further.* Data from the National Association of State Budget Officers shows that state general fund spending — the category of spending that typically is subject to year-to-year appropriations — declined from fiscal year 2001 to 2002, in inflation-adjusted terms, by 0.4 percent, and is projected to decline again from 2002 to 2003 by 0.9 percent based on budgets enacted last spring.

  Some 38 states — three out of four states — either cut spending in 2002, are projected to cut spending in 2003, or both. The *USA Today* story uses the NASBO data (unadjusted for inflation) in a table accompanying the story, but does not acknowledge these figures in the story itself.

- Governors have already begun implementing additional reductions in their fiscal year 2003 budgets that will push spending below last spring's levels of appropriations. Thus it is likely that the decline in real general-fund spending will be greater when the books are closed on 2003, and greater still in fiscal year 2004.

- In California, where Cauchon asserts that deficit projections do not reflect a genuine decline in spending, the widely respected, nonpartisan Legislative Analyst's Office (the state equivalent of the Congressional Budget Office) says the governor's budget proposal for the upcoming fiscal year would *reduce* state general fund spending, even in nominal terms, by some $13 billion. According to the LAO:

"The budget proposes total state spending in 2003-04 of $89.2 billion (excluding expenditures of federal funds and bond funds). This represents a decrease of 5.7 percent [from the current year]. General Fund spending is projected to fall from $75.5 billion in the current year to $62.8 billion in the budget year."[1]

Cauchon similarly writes that, even with budget cuts, spending in Minnesota will rise. Again, this is untrue. Spending in the current two-year budget period in Minnesota totals $27.1 billion; funds available to spend in the upcoming budget period that begins July 1 total $26.9 billion — a more than $200 million decline.[2]

- More fundamentally, the articles fail to recognize the likelihood that many states will be forced to reduce the level of public services provided to families even if they can maintain spending. Cauchon focuses narrowly on the number of dollars in state budgets in nominal terms (i.e., without adjusting for inflation) and asserts that "most of the budget cuts under consideration are reductions in planned spending increases, not actual declines in spending from last year." This is not only factually inaccurate in many cases (see above) but also fails to recognize that for state governments, as for private businesses and households, costs rise over time, due to such factors as general inflation and rising health care costs.

  To avoid cutting services, states must have enough revenue to cover inflation in the cost of providing services as well as population growth. For instance, in the area of health care, state governments — like private firms — face constantly rising costs due to higher drug prices and other factors. In fact, Medicaid cost growth at present is relatively modest compared to the cost of health insurance in the private sector; per capita premiums for employer-based health care in 2002 rose 12.7 percent, compared with 7 percent growth in the cost of Medicaid for the comparable population of non-elderly adults and children.[3] Moreover, the number of children and senior citizens that qualify for state-subsidized care is rising. Similarly, enrollment in elementary and secondary schools is rising at a rate of roughly 300,000 children per year, meaning that schools must hire more teachers to keep student-teacher ratios stable.

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[1] The decline in general fund spending reflects, in part, a shifting of $8 billion in state responsibilities to local governments, along with $8 billion in new tax revenue to pay for them. Even if that $8 billion is counted in the general fund amount for the coming year, however, the budget still reflects a $5 billion cut. Legislative Analyst's Office, *2003-04: Overview of the Governor's Budget*, January 14, 2003.

[2] Minnesota Department of Finance, *November 2002 Economic Forecast*.

[3] Leighton Ku and Matthew Broaddus, *Why Are States' Medicaid Expenditures Rising?* January 13, 2003 (http://www.cbpp.org/1-13-03health.htm).

Thus even if a state spends the same number of dollars in one year as in the previous year, the services that it provides likely must be scaled back.

- Although Cauchon's articles do not acknowledge it, state budget crises are already having real, quantifiable impacts on public services. Some one million people have lost or would lose state-subsidized medical insurance under enacted or proposed budget cuts in 11 states.[4] Tuition at dozens of state colleges and universities is rising rapidly. Child care subsidies for working parents have been scaled back in a number of states. Many other services are being cut as well.

- Cauchon suggests that the gaps that states now project between revenues and spending for fiscal year 2004, which are estimated to total somewhere between $60 billion and $85 billion, are accounting fictions that are purely "political" in nature and will not necessarily lead to spending cuts or tax increases. Cauchon cites the dispute between the California governor and the state's LAO as to the size of the state's shortfall to suggest that the existence of the shortfall is a "political" fiction. The LAO, however, disagrees, saying that the difference is purely "definitional" and does "not have any implications for the amount of real solutions that must be achieved." Both large program reductions and large tax increases, the LAO says, will need to be considered as the legislature seeks to enact a balanced budget.

- The articles contend that state spending rose "dramatically" in the 1990s. In fact, real per-capita state spending grew at an annual rate of 2.0 percent in the 1990s, a lower growth rate than in any of the previous four decades. The growth that did occur can largely be explained by such not-so-dramatic factors as rising health care costs, rising enrollment in elementary and secondary schools, and shifts in responsibilities away from local and federal governments and toward state governments.[5]

- To the extent that policy initiatives account for increasing spending in the 1990s, it is hard to view those initiatives as excessive, for two reasons. First, many of these initiatives, such as reducing class size in K-12 schools, expanding health care coverage to more children, and imposing longer prison terms for certain crimes, responded to changes in the broader economy and in public preferences. Second, these initiatives were well within the bounds of affordability. State and local spending today is about 10.1 percent of Gross Domestic Product, essentially the same level that it was a decade ago.

[4] See Leighton Ku et al, *Proposed State Medicaid Cuts Would Jeopardize Health Insurance Coverage For One Million People,* http://www.cbpp.org/12-23-02health.htm.

[5] This point, and the one that follows, are discussed more fully in Elizabeth C. McNichol and Kevin Carey, *Did States Overspend in the 1990s?* at http://www.cbpp.org/10-15-02sfp.pdf.

- Many state programs are designed to be counter-cyclical, stepping in to provide assistance during an economic downturn to newly unemployed workers and their families as well as to those whose income has been reduced. A case can be made that state spending *should* rise during hard times, to allow it to fulfill this role.

  Although many states are laying off workers, states have not shed nearly as many jobs since the beginning of the recession as the private sector has, but that in part is because states did not add nearly as many jobs as the private sector did during the economic expansion. Over the past ten years, a period that covers both expansion and recession, state government employment has fallen from 4.1 percent of all salaried workers in the economy to 3.8 percent. Note that this stability is good for the economy, because it helps to maintain consumer spending and thus prevent private-sector employment from declining even more than it otherwise would.

The true severity of the present budget crisis may best be understood by the extent to which it is forcing elected officials with reputations for *cutting* taxes — both Republicans and Democrats — to propose tax increases. Although it is early in the budget season, 17 governors of both political parties all have called for increases in taxes in their states, indicating that such tax increases are necessary to avoid even more devastating reductions in public services. It is not credible to suggest, as *USA Today* does, that these elected officials — many of whom built their public identities in part around *lower* taxes — would propose unnecessary tax *increases*.