CENTER ON BUDGET AND POLICY PRIORITIES

820 First Street, NE, Suite 510, Washington, DC 20002
Tel: 202-408-1080 Fax: 202-408-1056 center@cbpp.org http://www.cbpp.org

December 13, 2001

WHITE HOUSE STIMULUS PROPOSAL WOULD SUBSTANTIALLY WIDEN STATE BUDGET DEFICITS

Proposal Would Require States to Make Additional Spending Cuts and Tax Increases, Worsening Recession

By Nicholas Johnson

As state governments face their worst fiscal crisis in at least two decades, the Bush Administration yesterday proposed legislation that would make the state fiscal crisis substantially worse than it already is. The Administration's "framework for fiscal recovery" includes business tax provisions that would reduce state revenue by about $5 billion per year beginning immediately. At the same time, the Administration plan fails to include any direct fiscal relief to states, thereby missing an opportunity to provide one of the most effective forms of economic stimulus.

New estimates from state budget officials show that state deficits for the current year equal or exceed $40 billion, an amount that includes at least $35 billion in revenue shortfalls and higher-than-expected spending on countercyclical programs such as Medicaid, plus an additional $5 billion in unanticipated spending on homeland security. These deficits are widespread. Because not all states yet have estimated the size of their budget deficits, and because state economies are expected to worsen as unemployment continues to rise, the National Governors Association projects that shortfalls for the current fiscal year could rise to $50 billion or nearly 10 percent of state budgets, a much larger shortfall than in even the worst year of the last recession.

The Administration proposal would increase those shortfalls. The Congressional Research Service estimates that the provision known as "bonus depreciation" or "immediate expensing," which would allow corporations to write off a portion of business equipment purchases immediately rather than spreading them over several years, would cost state governments $5.4 billion in the current fiscal year, $5.1 billion in FY 2003, and $4.2 billion in FY 2004. Some states would lose additional revenue as a result of two other corporate tax provisions in the Administration proposal: the provision for net operating loss carryback and any reductions in the corporate alternative minimum tax.

These losses would occur because some 44 states use the federal rules on expensing and depreciation in the calculation of their own state corporate and other business income taxes; these 44 states would experience significant state revenue losses if this provision becomes part of federal law. A 45th state, Michigan, would lose some individual income tax revenue if this provision is enacted. The District of Columbia and New York City, which have local income taxes, also would experience revenue losses.

State revenue estimators and budget planners concur with those estimates. For example, Oregon officials estimate that the bonus depreciation would reduce state revenue by $154 million in the current two-year budget cycle, adding to a $720 million budget shortfall. (The Oregon estimate takes into account any boost to economic activity that might occur as a result of the stimulus package.) Governors across the country and across the political spectrum, including John Engler of Michigan, Bob Taft of Ohio, Parris Glendening of Maryland and Tom Vilsack of Iowa, have expressed strong concern that the $5 billion in lost revenue will make it much harder for states to take part in the economic recovery.

Because they are required to balance their budgets, states must respond to budget shortfalls by cutting spending, raising taxes, or both. Most states have already enacted spending cuts, and several have postponed scheduled tax cuts or raised revenues; further such actions will be necessary in the absence of substantial federal assistance. As Joseph Stiglitz, the 2001 Nobel Prize winner in economics, has noted, "This not only weakens the vital public services that are provided at the state and local levels, but also deepens the economic downturn."

Stiglitz and other economists point out that easing state fiscal crises is one of the very best ways to promote economic recovery. Yet yesterday's Administration proposal fails to offset the $5 billion in lost state revenue with *any* provision for state fiscal relief. In contrast, the Senate Finance Committee stimulus package provides state fiscal relief in the form of a temporary, one-year increase in the federal matching rate for Medicaid expenditures (FMAP). Such an increase would provide some $5.1 billion in assistance to state budgets this year. The Senate package also includes a smaller bonus depreciation provision that costs states only $2 billion, so the net assistance to states would equal about $3 billion.

If a final stimulus package includes a temporary increase in the federal share of Medicaid costs that provides more revenue to states than they lose from bonus depreciation, then the accelerating decline in state fiscal conditions will be alleviated, states will enact fewer tax increases and spending cuts, and the economy will benefit. But if, as the Administration proposes, the stimulus package simply increases state budget deficits by $5 billion, the economy will suffer.

Estimated Loss of State Tax Revenues in FY 2002
Due to Depreciation Tax Provisions in Administration Proposal
Millions of Dollars

Alabama	$56	Louisiana	$57	Ohio	$200
Alaska	70	Maine	30	Oklahoma	48
Arizona	110	Maryland	120	Oregon	100
Arkansas	53	Massachusetts	270	Pennsylvania	340
California	n/a	Michigan	60	Rhode Island	19
Colorado	87	Minnesota	180	South Carolina	58
Connecticut	99	Mississippi	55	South Dakota	8
Delaware	31	Missouri	87	Tennessee	110
Florida	210	Montana	22	Texas	340
Georgia	180	Nebraska	33	Utah	43
Hawaii	21	Nevada	n/a	Vermont	11
Idaho	31	New Hampshire	42	Virginia	140
Illinois	360	New Jersey	260	Washington	n/a
Indiana	180	New Mexico	40	West Virginia	36
Iowa	60	New York	710	Wisconsin	140
Kansas	57	North Carolina	190	Wyoming	n/a
Kentucky	73	North Dakota	15	**States total**	**$5,430**
Additional impacts:					
New York City	390	District of Columbia	40	**States plus NYC & DC**	**$5,850**