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MANY STATES CUT BUDGETS AS FISCAL SQUEEZE CONTINUES

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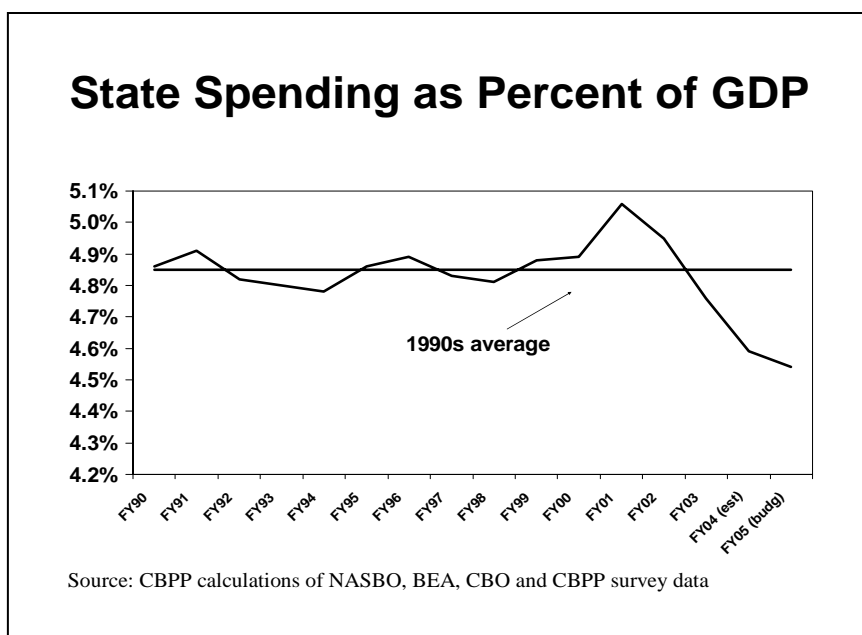
State government continues to shrink as states struggle to deal with the lingering state fiscal crisis. States cut expenditures over the last three years as they filled budget gaps that totaled about \$250 billion. Despite the turnaround in the national economy, many states continue to face gaps in their fiscal year 2005 budgets. States remain reluctant to raise taxes and are running out of short-term fixes; they are once again turning to spending cuts to close those gaps.

Figure 1 shows total state spending as a percent of Gross Domestic Product — a widely used measure of the size of the country's economy.

(See Appendix for information on the methodology used and data sources.) State spending as a share of the economy remained fairly steady between 1990 and 2000, averaging 4.85 percent of GDP. In fiscal year 2001, state spending as a share of the economy grew as the softening of the economy had a delayed impact on state revenues and budgets. Since then, state spending has declined significantly. This year — fiscal year 2004 — spending totals 4.60 percent of GDP — well

below the level of FY1990 and below the level to which spending dropped in the depths of the recession the early 1990s. Current indications are that this decline will continue in fiscal year 2005.

Figure 1



State Budget Cuts

The decline in expenditures continues to put important government services at risk in many states. Many states are considering or have adopted budget cuts for fiscal year 2005. These cuts would come on top of the widespread budget cuts adopted over the last few years. (See box on page 3.)

- Publicly funded health insurance for low-income families and children continues to face cutbacks in a number of states this year. Georgia, Florida, California, Missouri and New York are among the states that have adopted or are considering limiting eligibility for health insurance programs for low-income families in their fiscal year 2005 budgets. For example, the Georgia state legislature has just approved a budget that reduces Medicaid eligibility levels for almost 20,000 pregnant women and infants. The Missouri legislature is considering a budget that would sharply trim Medicaid — ending coverage for about 65,000 low-income people, including 41,000 low-income parents and 21,000 children.
- Another area that has been particularly hard hit over the past few years is child care subsidies for low-income working families. States subsidize child care for low-income families through subsidies to providers or assistance to families with child care costs. Some states are proposing new cuts in child care programs in their FY 2005 budgets. For example, funding for child care subsidies is cut in proposed budgets in Florida and Massachusetts. Moreover, there is little evidence that cuts made in other states over the past several years are being reversed to any large degree as the economy recovers.
- While states usually show great reluctance to cut K-12 education, the amount of state education spending included in proposed fiscal year 2005 budgets in a number of states — including California, Georgia, Maryland, Massachusetts, Michigan, Mississippi, New York, Oklahoma, and Oregon — falls short of the amount needed to maintain current-law funding levels or restore cuts made over the last few years.
- States throughout the country are cutting higher education, leading to double digit increases in public college and university tuition and significantly reduced course offerings, creating barriers to a higher education for low- and moderate-income families. For fiscal year 2005, state funds for public universities or colleges will be reduced or held to a level that will require tuition increases or service reductions in California, Maine, Maryland, Massachusetts, and Texas.
- Proposed budgets in California, Connecticut, Maryland, Massachusetts, Michigan, and New York contain reductions in aid to local governments. Reductions in aid to localities usually lead to cuts in services and programs such as social services or public safety that local governments provide. Alternatively, such cuts may lead to local property tax increases.

Proposed Fiscal Year 2005 Budget Cuts Would Be In Addition to Widespread Cuts of Recent Years

Some 34 states have adopted cuts that are causing 1.2 to 1.6 million low-income people to lose health insurance. Most of the cuts have affected children and parents in families in which the parents work at low-wage jobs. For example, Texas will end coverage under the Children's Health Insurance Program for nearly 160,000 children in working families, and Connecticut reduced Medicaid eligibility for parents with incomes from 100 to 150 percent of poverty, with about 20,500 parents affected. Six states — Alabama, Colorado, Florida, Maryland, Montana and Utah — have stopped enrolling eligible children in their State Children's Health Insurance Program (SCHIP.) New or higher copayments for public health insurance services were imposed by 21 states for fiscal year 2004; the previous year 17 states added or increased copayments. Research has shown that copayments are a significant deterrent to the use of essential medical care and prescription drugs among low-income populations, and that there are adverse health consequences when such treatment is foregone or delayed.

Since January 2001, some 23 states have made policy changes that reduce the availability of child care subsidies for low-income working families. In about half the states, low-income families who are eligible for and need child care assistance are either not allowed to apply or are placed on a waiting list. As of December 2003, there were some 47,000 children on the child care waiting list in Florida. Tennessee no longer even accepts child care applications from families that do not receive TANF cash assistance. In many cases, a child care subsidy is necessary to make it possible for a parent to work.

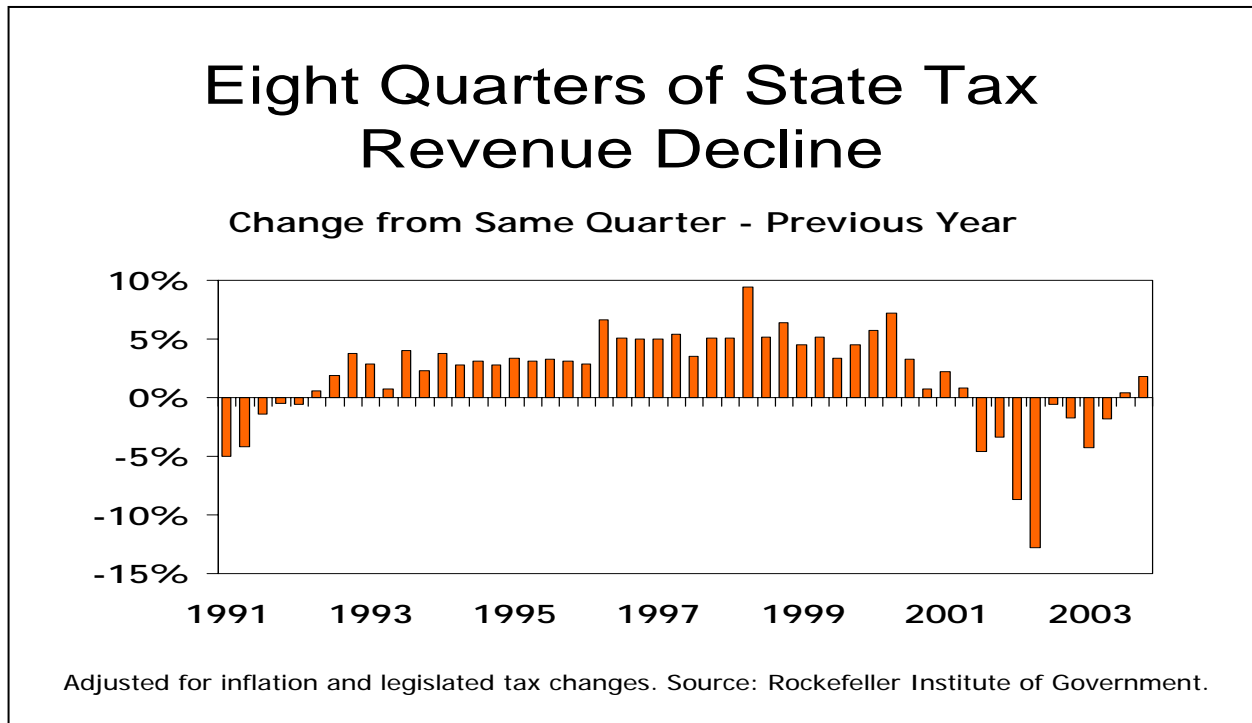
While states usually show great reluctance to cut K-12 education, 11 states made cuts for fiscal year 2004, following 9 that did so the previous year. In 34 states, real per-pupil aid to school districts has declined since 2002; in 19 states the decline exceeds 5 percent. This has resulted in imposition of new or higher fees for textbooks and courses, shorter school days, reduced personnel, reduced transportation, and a variety of other types of cutbacks. And states throughout the country are cutting higher education, leading to double digit increases in public college and university tuition and significantly reduced course offerings, creating barriers to a higher education for low- and moderate-income families.

More detail on fiscal year 2005 cuts in these and other areas is provided later in this paper.

State Taxes are Declining

State budgets are shrinking because state tax collections were hard hit by the economic downturn. State tax revenues declined relative to the same quarter of the prior year for eight straight quarters — two complete fiscal years — according to data collected from state revenue departments by the Nelson A. Rockefeller Institute of Government which is adjusted for inflation and tax law changes. (See Figure 2.) Real per capita state tax revenue remains far below the levels of 2001.

Figure 2



State tax revenue did begin to grow at the end of 2003. According to the most recent data collected by the Rockefeller Institute, state tax revenue grew by 1.8 percent in the October to December 2003 quarter compared to a year ago, after adjusting for inflation and tax law changes. While this return to growth in real underlying state tax revenues is welcome, it would be premature to declare the end of the state fiscal crunch.

- Not all states are experiencing revenue growth. Revenues declined over this period in 14 states and grew by less than one percent in seven others.
- Tax revenue growth of 1.8 percent is still well below normal — about half the level of the mid 1990s. Many quarters of growth at higher levels than we have yet seen will be required to restore revenues to pre-recession levels.
- In addition, all states used some one-time measures to balance their budgets over the last few years; a number of states relied very heavily on these types of measures. As a result, states will need higher than average revenue growth in order to sustain average expenditure growth. These one-time revenues will have to be replaced with ongoing revenue in future budgets.

Why Are State Taxes Declining?

One reason for the revenue decline is the economic downturn. The sales tax and the income tax are the main sources of state tax revenue. The job losses of the recession and continued weak economy resulted in reduced incomes for families and reduced spending which, in turn, depressed sales tax collections. The decline in incomes had a direct effect on state income tax collections. In addition, most states tax the realization of capital gains and the decline in income tax revenues was particularly pronounced because of the dramatic stock market decline that accompanied the recession.

Another reason for the revenue decline is the ongoing erosion of state tax bases. Sales tax collections make up about one-third of state tax revenues. Most states mainly tax the consumption of goods, not services. Sales tax collections have lagged economic growth as untaxed services have become an increasing portion of overall economic activity.

The tax cuts of the 1990s also played a role in reducing state revenues. Despite the fact that the surge in revenues in the 1990s was temporary, many states enacted permanent tax cuts with the resulting surpluses. As a result, state revenues have not been sufficient to sustain services now that the economy has slowed. Since 2001, some 29 states have responded by raising taxes, but these tax increases have not been large enough to offset the earlier cuts.

- Considering state and local tax revenues together as a share of Gross Domestic Product, revenues remain at their lowest levels since the late 1980s. In 2002 and 2003, state and local taxes were about 8.8 percent of GDP — or roughly three-tenths of a percentage point lower than the level to which taxes fell in the economic downturn of the early 1990s. (Three-tenths of one percent of GDP equals about \$32 billion.)

State Budget Cuts for Fiscal Year 2005

The sections below summarize some of the budget cuts adopted or being considered by the states as they adopt fiscal year 2005 budgets. These examples are drawn from a number of sources including press accounts and budget summaries published by state-based non-profit policy organizations. To the extent possible the cuts listed were checked with additional sources. Because many state legislatures are still in the process of budget deliberations, the specific proposals cited below are subject to change. This list is not meant to be comprehensive but rather gives examples of the kinds of spending cuts that states are considering.

Health Care

A large number of people are becoming uninsured as a result of the fiscal crisis. Budget cuts enacted since the fiscal crisis began have eliminated Medicaid or State Children's Health Insurance Program (SCHIP) coverage for more than one million people nationwide. Health care services for low-income families continue to face cutbacks this year.

- **Georgia** – The state legislature has just approved a budget that reduces Medicaid eligibility levels for almost 20,000 pregnant women and infants with incomes between 200 percent and 235 percent of the poverty line (between \$31,000 and \$37,000 for a family of three). The infants could be covered in the State Children’s Health Insurance Program (SCHIP), but would have fewer benefits and higher cost-sharing. In addition, the state approved plans to increase cost-sharing for some SCHIP children, which will lead a large number of these children to drop off coverage.
- **Florida** – The state recently enacted legislation to restrict eligibility for low-income children in its SCHIP program, KidCare. The state stopped enrolling new applicants last year and built up a waiting list of more than 100,000 kids. State officials bowed to popular pressure to cover most of the children on the waiting list (about 70,000), but took other actions to restrict future eligibility. To make it hard to keep track of future actions, the state will no longer maintain a waiting list.
- **California** - Governor Schwarzenegger has proposed a number of deep cuts in health programs. These include: freezing enrollment in SCHIP (Healthy Families) so that about 114,000 children would not get coverage and reducing payment rates to health care providers by 10%. Two subcommittees in the legislature have rejected the SCHIP enrollment freeze, but the overall outcome (as well as the overall state budget) remains up in the air.
- **Missouri** - The legislature is considering a budget that would greatly trim Medicaid. The House has been considering a bill that would end coverage for about 65,000 low-income people, including 41,000 low-income parents and 21,000 children.
- **New York** - The governor has proposed scaling back eligibility for low-income children and their parents in Medicaid and Family Health Plus. He also proposed restricting eligibility for seniors in Medicaid, restricting the ability of some seniors to obtain long-term care services.
- **Multiple states:** A number of states (including Florida and California) have initiated plans to "redesign" Medicaid using waivers. Such plans aim at longer-term savings, rather than immediate changes. The details are not known at this time, but are expected to reduce the scope of benefits, increase cost-sharing for low-income beneficiaries or scale back eligibility. In some cases, the states appear to be working on arrangements with the Bush Administration that would effectively cap program funding through the use of special federal waivers.

K-12 Education

The amount of state education aid to school districts included in proposed fiscal year 2005 budgets in the following states falls short of the amount needed to maintain current services

or restore cuts made over the last few years: **California, Georgia, Maryland, Massachusetts, Michigan, Mississippi, New York, Oklahoma, and Oregon.** These reductions can result in teacher and staff cutbacks or increased property taxes as schools seek to replace state funds.

- **California** – The amount of school funding proposed by the governor is \$2 billion less than the level guaranteed by Proposition 98. School spending would be reduced \$175 per pupil after adjusting for inflation.
- **Georgia** – The budget passed by the state legislature cuts school funding by \$180 million. This is a smaller cut than the governor’s original proposal which was to cut school funding by \$400 million.
- **Maryland** — The governor’s original budget increased funding for schools, but the amount proposed fell \$42.6 short of current-law funding which includes both the amount needed to maintain current education levels and the expenses of the phase-in of the Thornton education plan. The budget passed by the legislature reduced school funding by an additional \$30 million.
- **Massachusetts** — Although school funding in governor’s proposed budget is increased compared to last year, it remains \$134.6 million (3.6 percent) below fiscal year 2003 levels — a 7 percent drop after accounting for inflation
- **Michigan** — The governor’s proposed budget restores the cut in per-pupil aid made in December for all districts except for those districts that spend more than \$9,000 per pupil. Restoring the cut for all districts would cost \$50 million.
- **Mississippi** — Under the governor’s proposed budget schools are under-funded by \$161 million (10 percent).
- **New York** — The New York Educational Conference Board has estimated that school districts would need \$600 to \$650 million in state aid in fiscal year 2005 to maintain current services without shifting costs to property taxes or cutting services. The governor’s budget only provides \$150 million and of that \$150 million increase, \$100 million is in the form of a special one-time “outside the formulas” matching grant.
- **Oklahoma** — While Oklahoma’s fiscal year 2005 budget would increase funding for teachers’ health insurance coverage, the budget would not fully restore a wide range of programs that were cut or eliminated in fiscal year 2004, including the school lunch program, parenting education for at-risk families, special education assistance, reading sufficiency remediation, and others.
- **Oregon** — Oregon school districts face reduced state support in fiscal year 2005 as well as in fiscal year 2004 as a result of the rejection by voters of a tax increase included in the FY04-05 biennial budget adopted last year.

- **Other cuts** — A number of states have cut school-related programs. For example, **Kentucky**'s budget includes cuts in a childhood literacy program and pre-school funding; **Texas** is reducing health benefits for teachers and cutting state support for textbook purchases.

Higher Education

State funds for public universities or colleges will be reduced or held to a level that will require tuition increases or service reductions in budgets in **California, Maine, Maryland, Massachusetts, and Texas**.

- **California** – The proposed budget would result in fee increases: community college fees would increase from \$18 per unit to \$26; UC and CSU fees would increase by 10 percent for undergraduate and 40 percent for graduate students; no funding would be provided for enrollment growth in the UC or CSU systems and freshmen enrollment could decrease by 10 percent.
- **Maine** – Reductions to funding for higher education in the supplemented budget could result in up to a 9 percent tuition increase or a loss of 200 jobs, according to university officials.
- **Maryland** – The governor proposed a \$47.6 million cut in general fund support compared to current services; this would not require new tuition increases but 9 percent increases are already scheduled for school year 2005 and tuition went up 21 percent for school year 2004. The legislature reduced funding for higher education-related programs by an additional \$14 million.
- **Massachusetts** – The Chancellor of the University of Massachusetts estimates that the Governor's fiscal year 2005 budget proposal is \$280 million below amount needed to fully fund the public higher education system. Although his budget calls for a slight increase from fiscal year 2004 levels, funding for financial aid would remain 10 percent below fiscal year 2003 appropriations for higher education.
- **Texas** – A critical element of the fiscal year 2004-05 biennial budget was the agreement by legislators to give public universities authority to raise tuition in order to make up for inadequate General Revenue support. About 40 percent of universities have already approved tuition increases. For example, University of Austin tuition is going up 13 percent in spring 2004 and another 13 percent in fall 2004; University of Houston tuition increased 12.3 percent in spring 2004; Texas A&M approved a 21 percent increase for fall 2004.

- **Other cuts** – Some states are cutting higher education related programs. For example, a **California** program that assists inner city youth prepare for college would be eliminated. The proposed budgets for **California and Michigan** include cuts to subsidies for students to attend private universities.

Child Care

States subsidize child care for low-income families through subsidies to providers or assistance to families with child care costs. Over the past several years, many states made cuts in their child care programs. These included reducing the eligibility criteria for child care subsidy programs, cutting payments to providers, and increasing the co-payments made by low-income families who receive child care subsidies. More than half of all states now have waiting lists for their child care subsidy programs or do not accept new applications at all from non-welfare families seeking help paying for child care. For example, more than 280,000 children are on waiting lists in California alone.

Florida, Massachusetts, and Rhode Island are proposing cuts in child care programs in their FY 2005 budgets.

- **Florida** – Both the Senate and House versions of the Florida budget would reduce funding for the state's child care subsidy program. The Senate version would reduce funding by \$14 million as compared to last year (not adjusting for inflation); the House version would cut funding by \$41 million. To make up for some of this loss in funding, the House bill calls for eliminating funding for the child care resource and referral agencies as well as from several initiatives designed to increase the quality of child care provided. Florida already has a large number of low-income children who need help paying for child care but do not get it because of a lack of funds. The state currently has more than 48,000 children on the waiting list for child care assistance.
- **Massachusetts** — The governor's budget would cut funding for child care subsidies by at least \$4 million as compared to the prior year. The loss in child care slots for low-income working families not receiving cash welfare benefits would be further exacerbated by changes in welfare rules that would increase the number of welfare recipients required to participate in welfare-to-work programs, thereby increasing the number of those families who need child care assistance. The House Ways and Means proposed budget includes \$5 million in as a first step towards much needed salary increases for child care workers, but this will not increase the number of child care subsidies, which would be cut by \$2.1 million. Massachusetts already has 18,000 children on the waiting list for child care subsidies.
- **Rhode Island** — The governor proposes to reduce funding for child care by \$7.1 million in the coming fiscal year. These cuts would be achieved by rolling back the income limit for subsidized child care from 225 percent of poverty to 200

percent, eliminating eligibility for 925 children in 790 families, reducing payments to some child care providers, and increasing the co-payments paid by low-income families with incomes between 150 and 200 percent of the poverty line.

Income Support Programs

Funding for income support and other TANF-funded programs would be reduced in budgets in **California, Louisiana, Massachusetts, New York, and Rhode Island.**

- **California** – The Governor proposes suspending the October 2003 cost of living adjustment and cutting cash grant levels by 5 percent starting April 1, 2004. This would reduce maximum monthly grants for a family of three by \$76 to \$80, depending on the county.
- **Massachusetts** – The governor proposed two significant cuts to the Elders, Disabled, and Children's (EAEDC) program — a program that provides cash assistance to poor elderly individuals, individuals with disabilities, and some children who do not qualify for TANF assistance. First, the governor's budget proposed to narrow significantly the disability-related eligibility criteria so that only those individuals whose disabilities meet SSI medical and vocational criteria (for at least 2 months) would qualify. The governor also proposed terminating assistance to legal immigrants who are ineligible for federal SSI benefits because of their immigration status. This change would result in a loss of assistance to an estimated 2,000 immigrants — most of whom are elderly. The House Ways and Means Committee has proposed the benefit cut-off for non-citizens but not the disability change.
- **New York** — The budget includes a number of changes that would make it more difficult for low-income families to make ends meet. The governor proposes to reduce cash assistance benefits for TANF recipients who work and who have received assistance for more than two years (since December 1996) and to impose even larger cuts in benefits for working families that have received welfare benefits for five years (also since December 1996). This would result in \$51 million in savings over the next two state fiscal years. The governor also is proposing to cut cash assistance benefits across the board for all families that have received assistance for more than 5 years (since December 1996) and individuals and childless couples who have received assistance for more than two years (since December 1996). This is expected to affect 47,000 families and save \$55 million over the next two state fiscal years. Finally, the budget calls for imposing full family sanctions — a policy which terminates all assistance to families, including aid to children, if a parent is found to have failed to comply with work requirements. This proposal is expected to result in \$58 million in savings over the next two state fiscal years.

- **Rhode Island** — The governor has proposed reducing cash welfare benefits by up to \$50 per month for poor families that receive child support payments from noncustodial parents, a policy change that is projected to save \$1.7 million next year. The governor also proposes saving nearly \$4 million by stiffening the penalties on welfare recipients who are found not to be complying with program requirements.

Other Social Services

In addition to cash assistance and subsidized child care states fund a variety of social service programs such as food assistance, programs for the mentally ill, homeless shelters, programs for the disabled and foster care programs either directly or through grants to non-profit agencies. Proposed budgets include cuts in social service programs in **Arizona, California, Illinois, Kansas, Louisiana, and Massachusetts.**

- **Arizona** — The legislature’s budget proposal cuts funds for substance abuse treatment by 60 percent compared to historic levels.
- **California** – The proposed budget would eliminate the new Transitional Food Stamp Benefits Program and rescind two recently enacted changes to the Food Stamp Program which made it easier for recipients who owned cars to qualify for benefits and which reduced the administrative hassles associated with receiving food stamp benefits. These changes would result in \$3.5 million in administrative savings and savings in a companion program that provides food assistance to legal immigrants ineligible for federally funded benefits in the next budget year. However, if the Transitional Food Stamp Benefit Program and the other program expansions were retained, it would bring an estimated \$203 million in federal food stamp benefits low-income California households. The adoption of the governor’s food stamp proposals would eliminate all benefits for 81,000 low-income households.
- **Illinois** — The governor’s budget cuts funding for the Department of Children and Family Services by 4.3 percent.
- **Kansas** – The proposed budget includes a 10 percent cut in funding for facilities that provide care for those with long term mental health problems.
- **Louisiana** - In an attempt to bring spending in TANF funded programs in line with available federal resources, proposed cuts include \$9.5 million in after-school enrichment programs, \$1.5 million in adult literacy funds, \$4 million for drop-out prevention and \$6.5 million for teen pregnancy prevention programs. These cuts were made in part to spare the state's pre-kindergarten programs - which are funded in part with federal TANF funds - from cuts.

- **Massachusetts** – Funding for the department of Mental Health would be cut by \$5.1 million. The governor’s budget proposes to reduce funding for transportation and day work programs, potentially ending these supports for approximately 800 mentally retarded individuals.

Courts, Corrections, and Public Safety

States run prison systems and courts and provide funding to local governments to support juvenile justice systems and local courts and prisons. States have faced increasing costs in these areas in recent years and some states have turned to cutbacks.

- **California** - Funding for county services to at-risk youth and juvenile offenders is eliminated in the governor’s proposed budget.
- **Florida** – The governor has proposed shifting the responsibility for funding juvenile detention from the state to counties.
- **Illinois** — The governor’s budget proposes a 5.2 percent cut in the corrections budget, with two facilities targeted to be closed.
- **Alaska** – The proposed budget includes reduced support for legal aid.

Aid to Localities

One way states can meet their balanced budget requirements is by cutting aid to local governments rather than cutting programs directly funded by the state. Reductions in aid to localities usually lead to cuts in services and programs such as social services or public safety that local governments provide. Alternatively, such cuts may lead to local property tax increases. Proposed budgets in **California, Connecticut, Maryland, Massachusetts, Michigan, and New York** contain reductions in aid to local governments.

- **California** – The governor’s proposed budget would shift \$1.3 billion in property taxes from counties, cities and special districts to schools in order to reduce state spending for education. This proposal would affect counties the most.
- **Connecticut** - Even after a small increase proposed as part of the mid-budget revision, the fiscal year 2005 aid to towns proposed by the governor is \$40 million less than the aid appropriated for fiscal year 2002 in nominal terms. The legislature’s budget would restore some of this aid.
- **Maryland** – The governor’s proposed budget cuts \$17.6 million from support for local services other than education. The legislature did not restore these cuts. In part as a result of reduced state funding, Montgomery County’s budget includes reductions in county services for senior citizens, the elimination of four positions

in next year's police recruit class and a cutback in the hours that libraries will be open.

- **Massachusetts** – State support for school nurses was eliminated completely — a reduction of \$12.6 million.
- **Michigan** – The governor recommended a \$185 million reduction in revenue sharing payments to local units of government. A source of funding intended to substitute for the revenue sharing payments has proven to be infeasible to use; the status of this proposed reduction remains unclear.
- **New York** – The governor has proposed 5 percent cuts in many local aid programs.

State Employment

State jobs and state employee pensions and health benefits have been targets for cutbacks.

- **Arizona** – The legislature's budget fails to fund \$32 million in increased employee health costs, requiring state agencies to find the money in their budgets.
- **California** – The budget includes a proposal to create a two-tier pension system for new state employees. New workers would be covered by a defined contribution plan rather than a defined benefit plan. In addition, the state would issue new pension obligation bonds and cover part of debt service by increasing state employees' pension contributions from, in most cases, 5 percent to 6 percent.
- **Illinois** — The governor's proposed budget would eliminate 2,300 positions, dropping state employment to its lowest level since at least 1972.
- **Mississippi** – The governor proposes cutting a couple of hundred state jobs.
- **Michigan** – The governor has proposed \$76 million in general fund cuts in state employee costs.
- **New York** – The governor has proposed a cap on annual increases in employer contributions to the state retirement fund. (The comptroller regards this as unconstitutional.)
- **Texas** – The FY04-05 biennial budget eliminates funding for 4,900 state jobs by FY005. These include 2,722 in health and human services, 1,267 in public safety/criminal justice and 907 in education agencies.

Appendix

Methodology for Figure 1 State Spending as a Percent of Gross Domestic Product

Data Sources

The state spending data in this paper for fiscal years 2002 and earlier were published by the National Association of State Budget Officers in their annual Fiscal Survey of the States. The figures for fiscal years 2003 through 2005 were compiled by the State Fiscal Project staff of the Center on Budget and Policy Priorities. The data were in published budget documents or supplied by legislative or administration budget officials through a phone survey.

Use of General Fund Spending

The information presented is on general fund spending. All states maintain other funds in addition to the general fund. The other funds are used to account for spending from specific revenue sources such as federal funds or tobacco settlement revenues, or to account for spending on specific purposes such as state employee pensions or transportation projects that are supported by dedicated taxes or bonds. State general fund spending makes up about half of total state spending on average. Trends in general fund spending are particularly important to tracking and understanding state finances for a number of reasons.

- In the typical state major non-dedicated taxes such as income and sales taxes are deposited in the state's general fund.
- The general fund is usually used to finance the state's share of health programs, grants to local government for education and other purposes, the costs of higher education and the costs of other government services common to most states. By contrast, special funds tend to have dedicated revenue sources that must be spent for narrowly defined purposes.
- The general fund is the part of a state's budget over which policymakers have the most discretion. It also is the part of the budget to which balanced budget requirements usually apply.
- Current information is more readily available on general fund spending than on spending from all state funds.
- Moreover, while general fund spending comprises only a portion of all state spending, historical studies show that changes in general fund spending over time follow very similar patterns to trends in spending from all funds.¹

¹ See, for example, *Sources of Data About State Government Revenues and Expenditures*, David Merriman, Urban Institute, 2000; "Receipts and Expenditures of State Governments and Local Governments," 1959-2001; *Survey of Current Business*, Bureau of Economic Analysis, June 2003.

Occasionally, a state will put revenues or expenditures in a special fund that more appropriately belong in the general fund. For example, New Jersey places its income tax collections in a fund that is used for aid to local governments. Both this revenue source and spending would be in the general fund in most states. In most cases, if the state treats this type of special fund as an add-on to the general fund in its budget deliberations and published budget documents, we and the other two organizations that track general fund spending — the National Conference of State Legislatures and the National Association of State Budget Officers — treat the sum of spending from these funds and the general fund as general fund spending. Other situations where a special fund exists that should be part of the general fund are not sufficiently frequent or large as to suggest that analysis of general fund spending trends materially distorts the picture of state spending.

Spending figures are shown as a percent of Gross Domestic Product. The GDP figures for 2003 and earlier are from the Bureau of Economic Analysis. The Congressional Budget Office GDP projections were used for 2004 and 2005.

Why Spending is Shown as a Percent of Gross Domestic Product

While state spending changes from year to year often are compared using nominal dollars, such comparisons do not accurately measure the ability of states to continue providing their current level of services. That ability is steadily eroded both by inflation (which increases the number of dollars needed to provide a given service to a given individual) and by population growth. Population growth — especially growth in specific expensive-to-serve populations such as school-age children and the elderly — increases the number of individuals who are eligible for programs and services or who otherwise must be served.

Thus, the appropriate measure of changes in state spending is one that assesses whether a given state can continue to provide existing services. The simplest way to look at the buying power of state dollars is to adjust spending for overall inflation and total population changes, as is often done. However, inflation plus population is only a partial adjustment for the true cost of providing a constant level of public services. It also is conceptually possible but difficult in practice to adjust more precisely for buying power by using specific inflation rates — for expenditures such as healthcare, since a large proportion of state spending goes for health care and health care inflation has been much more rapid than general inflation — or to adjust for growth in specific population segments relative to the services that must be provided to those population groups. One proxy for this type of adjustment is to look at state spending relative to the size of the economy. Figure 1 shows state spending as a percent of Gross Domestic Product — a widely used measure of the size of the country's economy.