NEWS RELEASE

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CENTER ON BUDGET AND POLICY PRIORITIES

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HOW WELL ARE STATES COPING WITH THE SLOW ECONOMY AND STRUCTURAL BUDGET PROBLEMS?

With budgets squeezed both by the current economic downturn and, in many cases, by longer-term structural problems, states are responding with a mixture of short-term fixes, spending cuts, and tax increases, according to a new study from the Center on Budget and Policy Priorities.

The Center's study, ***State Responses to Tight Fiscal Conditions***, looks behind the data on how states are faring in the slow economy to examine how states' budgetary responses could affect their fiscal stability if a robust economic recovery does not occur soon. It also provides a more in-depth look at four states — **Indiana, Minnesota, Texas,** and **Virginia** — to illustrate the range of issues states are facing and the range of policies they have adopted.

"If the slowdown continues or deepens, more and more states will face budget shortfalls and problems in states already affected could intensify," noted Kevin Carey, a Policy Analyst with the Center's State Fiscal Project and lead author of the report. He added that this year's federal tax cuts will worsen states' fiscal situation by reducing revenue from state income and estate taxes and possibly requiring cuts in future federal grants to states.

"With all these uncertainties, it's important to examine whether states are handling the slowdown in ways that won't cause bigger problems later — especially for low-income and other vulnerable populations, which often are the hardest hit by a weak economy," said Carey.

The budget imbalances some states face are temporary and reflect the slow economy. However, other states — including **Tennessee** and **Texas** — have structural problems: their tax systems don't raise the amount of money the state needs over the long term. (Some states face both temporary and structural problems.) Budget-balancing strategies that make sense for states with temporary imbalances could be ineffective or harmful for states with structural problems.

In particular, short-term fixes are a popular alternative to raising taxes or cutting programs, and a number of states are using them to close fiscal gaps. At least seven states (**California, Indiana, Kentucky, Michigan, Mississippi, Ohio,** and **Washington**) have begun to tap state "rainy day" funds or other reserves to balance their budgets, for example. In addition, states such as **Indiana, New Hampshire, Texas,** and **Virginia** have used accounting gimmicks like artificially shifting expenditures to a later fiscal year or simply raising their revenue estimates without economic justification. "For many states, today's budget gimmick can create tomorrow's budget crisis," said Center Deputy Director Iris Lav, a co-author of the report.

The use of certain short-term measures — such as drawing down rainy day funds or enacting temporary tax increases — may be appropriate in some cases, enabling states to maintain vital services until revenue growth rebounds. However, if an economic slump is prolonged, or if the state's budget imbalance primarily reflects structural problems, these measures will only make it harder for states to balance their budgets in future years.

While some states are adopting short-term fixes to balance their budgets, seven states (**Arizona, Indiana, Maine, Nevada, New Hampshire, New Jersey,** and **West Virginia**) have raised revenues significantly. **Mississippi, Ohio,** and **South Carolina** have enacted across-the-board spending cuts, while **Indiana** and **Kentucky** have set the stage for cuts in Medicaid spending by appropriating less money than the programs are projected to require.

In some cases, states' budget problems highlight the need for better budget information. "Some states may have adopted tax cuts or spending increases in the 1990s without taking into account their ultimate cost," noted Liz McNichol, director of the Center's State Fiscal Project and a co-author of the report. "This made them more vulnerable to budget problems when the economy slowed." Such states, she added, should consider adopting budget process reforms to give policymakers and the public a clearer view of the consequences of policy choices.

A full text of the Center report, *State Responses to Tight Fiscal Conditions,* is available at the CBPP website, www.cbpp.org.

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