Center on Budget and Policy Priorities

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CBPP FACT SHEET
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Reducing Federal Deficits Without a Significant Revenue Increase Would Shift Substantial Costs to States

If it fails to include significant new revenues, a major legislative package to shrink federal deficits would almost certainly make substantial cuts in federal funds that support states and localities. These cuts likely would force states and localities to reduce the quality and reach of their basic public systems — schools, clean water facilities, and law enforcement activities, for example — or to raise new revenue or cut other programs to continue meeting these needs. Either way, the result would be a large cost shift from the federal government to states and localities. By contrast, if Congress adopts a balanced deficit-reduction plan that includes significant new revenues, the resulting cost shift to states and localities almost certainly will be smaller.

States Provide Services That Are National Priorities

States and localities provide public services that address national priorities. For example, they educate the nation's children and build and repair the nation's roads, bridges, airports, and public transit systems. They also undertake a wide range of other important functions, including protecting waterways from sewage contamination, protecting public safety, reducing homelessness, revitalizing run-down neighborhoods, providing technical job skills training to community college students and others, and responding after disasters. Some 87 percent of the nation's public employees — teachers, police officers, child abuse case workers, road construction engineers, and many others — work for state or local governments.

States, Weakened by the Recession, Cannot Absorb Large New Cost Shifts

State revenues for these services were deeply damaged by the recent recession, the worst for state finances in 70 years. Since the recession hit, states have closed budget shortfalls totaling well over half a trillion dollars. In the last four years, states and localities have shed more than 600,000 jobs. While state revenues are beginning to recover, they remain about 6 percent below pre-recession levels after adjusting for inflation. It will be several years more before states recover fully.

With their own budgets so seriously damaged, states cannot absorb massive new cost shifts from the federal government. Significant federal funding cuts would force states to lay off still more people and to cut spending for schools, roads, or other public services in others ways or else raise substantial new revenue in-state to continue addressing these needs. Either way, the result would be a large cost shift from the federal government to states and localities, a cost shift that would hit states hard at a time when their budgets already are deeply wounded.

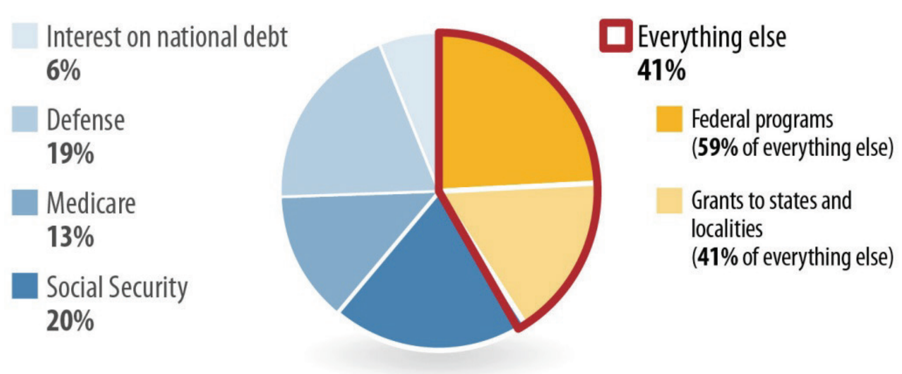
Federal Deficit Reduction That Does Not Include Significant Revenue Likely Would Shift Substantial Costs to States

Many federal policy makers agree in broad terms that, as they seek to reduce the deficit, cuts in Social Security and Medicare that affect *current* beneficiaries should be limited and defense spending should not be cut much, if at all, below the spending caps imposed by the 2011 Budget Control Act. If the savings from Social Security, Medicare, and defense — which together account for well over half of non-interest federal spending — are limited and the deficit plan does not include significant revenues, federal support for programs operated by state and local governments will stand out as one of the few remaining sources of large potential savings.

That's because a large part of the federal budget *outside of* Social Security, Medicare, defense, and interest payments on the national debt — *41 percent* of what's left — consists of grants to states and localities. Hence, if significant new revenue isn't included, a major legislative package to shrink federal deficits almost certainly will cut deeply into state and local aid, shifting to the states more of the costs for educating children and providing other public services.

Figure 1

State and Local Aid Accounts for 41 Percent of the Federal Budget Outside of Social Security, Medicare, Defense, and Interest Payments



Note: The "Federal programs" portion of the "Everything else" category contains small amounts of mandatory defense spending and discretionary Medicare and Social Security spending.

Source: CBPP analysis of Office of Management and Budget data.

Federal Funding for State and Local Aid Already Was Cut Significantly in 2011

The 2011 Budget Control Act imposed caps on the part of the federal budget that includes most state and local aid outside of Medicaid (the part of the budget known as "non-defense discretionary" programs).[1] Unless federal policy makers take action to protect state and local aid from its share of the cuts under these

[1] The Budget Control Act caps apply to all non-defense discretionary state aid programs, except for federal funding for transportation projects.

caps — an extremely unlikely scenario — discretionary federal aid to states and localities will fall to its lowest levels in four decades, measured as a share of the economy, even without the automatic, across-the-board cuts that are scheduled to start taking effect on January 2, 2013 and are known as sequestration.

Sequestration Would Do Additional Damage to States

Sequestration would cause a major problem for state governments' ability to serve their residents by imposing steep additional cuts in funding for schools and other discretionary state and local aid programs (a major exception is transportation programs). In 2013, under sequestration, federal funding for education and most other state and local aid outside of Medicaid would be cut by about 8.2 percent, on top of the cuts already imposed by the 2011 Budget Control Act.

A Deficit Plan That Does Not Include Substantial New Revenues Likely Would Be Much Worse For States Than Sequestration

A deficit reduction package that fails to include significant new revenue likely would do even more damage than sequestration. As an illustration, the budget passed by the House in the spring of 2012 seeks to reduce the deficit without raising any revenue. Cuts to non-defense discretionary funding under the House budget would be *three times* deeper in 2014 than the cuts from sequestration. In later years, the difference would be even larger.

Medicaid Cuts Would Shift Further Costs to States

Cuts to federal funding for states and localities likely would entail either further reductions in non-defense discretionary funding, cuts to federal funding for Medicaid, or both. Medicaid is the federal-state public insurance program that provides health coverage to nearly 65 million low-income Americans, including children, parents, seniors, and people with disabilities. Significant cuts in federal funding for Medicaid would force states to make up for the lost federal funds with higher state taxes, cuts in medical services for low-income people, cuts in other state services and programs, or a combination of such actions. Because Medicaid is already lean — it costs much less per beneficiary than private insurance does — and states already exercise considerable flexibility, claims that states could somehow manage large federal funding cuts simply by providing Medicaid coverage more efficiently are highly unrealistic.