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FEDERAL GRANTS TO STATES AND LOCALITIES CUT DEEPLY IN FISCAL YEAR 2007 FEDERAL BUDGET

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Grants to state and local governments have long been an important way in which the federal government supports and administers programs efficiently. The new budget, however, continues to significantly erode those grants. This leaves states and localities the option of either curtailing services or increasing their own taxes to compensate for declining federal funds.

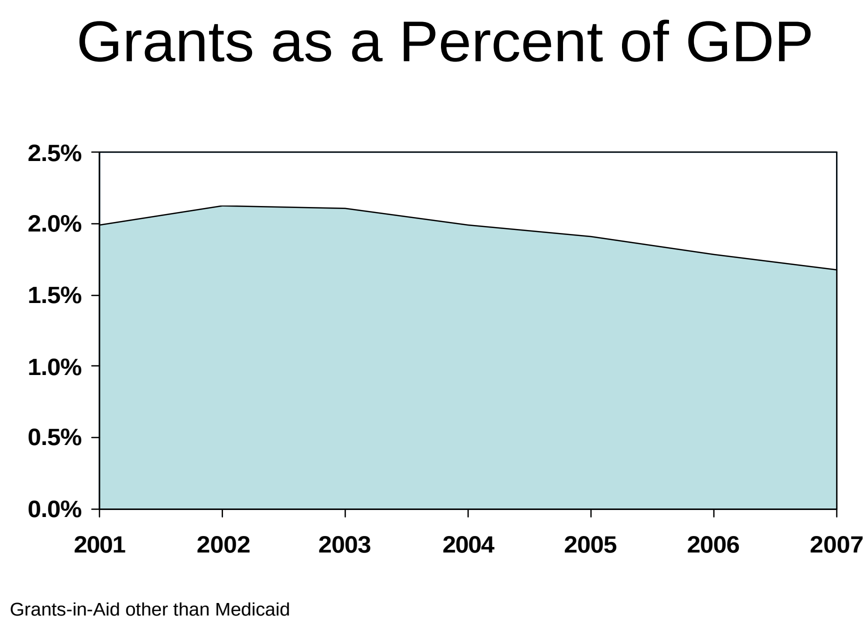
- Under the President's budget, grants to state and local government for all programs other than Medicaid would decline by $6.7 billion or 2.8 percent from fiscal year 2006 to 2007, after adjusting for inflation. This follows a similar decline of 3.1 percent from 2005 to 2006; the fiscal year 2007 request is nearly $14 billion below the fiscal year 2005 level.[1] (Note that grant levels were adjusted to remove the effect of disaster relief in various categories of the budget.)

- The proposed 2007 grants would be significantly lower as a percent of the economy than they were at any time since at least 2001. For 2007, the budget proposes grants to state and local government for all programs other than Medicaid that total just 1.68 percent of GDP. In 2001, such grants were 1.99 percent of GDP. Considering grant levels relative to the economy provides a somewhat better measure of whether the grants would be adequate to maintain the current level of state and local services they support, because the cost of providing services tends to grow in tandem with the economy. If grants for all programs for 2007 were at their 2001 to 2006 average level relative to the economy (1.98 percent), they would be $42 billion, or 18 percent, higher than their proposed 2007 level.

- These shortfalls are difficult for states and localities to handle. Although states are no longer in the depths of a fiscal crisis and revenues have again begun to grow, state and local services still have not returned to their pre-recession levels. With few exceptions, state and local governments would not be able to absorb the proposed continuing reductions in federal aid without instituting program cuts or tax increases.

[1] Medicaid is traditionally excluded from this analysis because changes in Medicaid grants largely reflect inflation in health-care costs in the public and private sectors alike. Considering grants other than Medicaid gives a more accurate picture of the relative level of federal funding for state and local services. Moreover, from 2006 to 2007, there is a decline in budget authority for Medicaid that is an artifact of a change in accounting rules, the movement of people from Medicaid prescription coverage to Medicare part D, and about $2 billion in Katrina costs in 2006 that do not continue into 2007. It would give a misleading picture to include this decline in budget authority for Medicaid in the analysis. There are, however, cuts in Medicaid relative to the amounts required to maintain the program. See box on page 4.

FIGURE 1



Discretionary and Mandatory Grants

The President's 2007 budget proposes cuts both in discretionary grants that are appropriated annually and in entitlement programs.

- Discretionary grants to state and local governments would decline by $3.9 billion from 2006 to 2007. The decline would be $7.5 billion, or 4.4 percent, after adjusting for inflation.

- Grants to states and localities are bearing a disproportionate share of the total proposed cuts in domestic discretionary spending for 2007. The $7.5 billion cut in discretionary grants represents 55 percent of the total $13.7 billion proposed cut in domestic discretionary funding for next year.

- If discretionary grants had remained at their 2001 to 2006 average level relative to the economy, they would be $31.6 billion, or 19 percent, higher than the proposed level for 2007.

- On the entitlement or "mandatory" side of the budget, grants to state and local governments other than for Medicaid would increase by $2.2 billion from 2006 to 2007. The increase would be $0.8 billion, or 1.2 percent, after adjustment for inflation.

- If mandatory grants other than Medicaid were at their 2001 to 2006 average level relative to the economy, they would be $9.9 billion, or 15 percent, higher than the proposed level for 2007.

TABLE 1: GRANTS-IN-AID TO STATE AND LOCAL GOVERNMENTS IN THE FY 2007 BUDGET, EXCLUDING MEDICAID BUDGET AUTHORITY (FUNDING) IN BILLIONS OF DOLLARS			
	FY 2005	**FY 2006**	**FY 2007**
Discretionary Funding	$130.7	$129.4	$122.8
Mandatory Funding	107.1	103.6	112.8
Total Funding	237.7	233.0	235.5
Total Funding adjusted for technical anomalies*	234.5	233.6	231.9
In 2007 dollars (i.e., adjusted for inflation)	246.2	238.6	231.9
Percent change after adjusting for inflation		**-3.08%**	**-2.81%**
Funding as a percent of GDP	**1.91%**	**1.79%**	**1.68%**

* Adjustments were made to exclude disaster relief funding in all years and fiscal relief in 2004, to reflect funding for highways and mass transit as the level of obligations for those programs rather than the level of "contract authority," and to remove distortions that can occur when the level of "advance" appropriations changes from year to year. The TANF grant reflects "obligations" rather than Budget Authority. Up to 30% of states' 2006 TANF block grants were made available to states in 2005 because of Katrina; as a result, using BA would create a misleading picture of trends.

- *Total* discretionary and mandatory grants combined, other than Medicaid, would decline by $1.7 billion. After adjustment for inflation, grants would decline by $6.7 billion or 2.8 percent.

- If all grants other than Medicaid were at their 2001 to 2006 average level relative to the economy, they would be $42 billion, or 18 percent, higher than the proposed level for 2007.

What is Being Cut?

The reductions in grant funds are spread throughout a wide range of budget categories and programs. In some cases nominal funding is slated for a cut. In others, the proposed funding fails to keep pace with the cost of the program. Examples of grants that are being terminated include:

- **HOPE VI** grants, which help to revitalize public housing and nearby communities and promote resident involvement;

- The **Community Services Block Grant**, which provides funding for a range of social services and other types of assistance to low-income families and elderly and disabled individuals;

- The **Preventive Care Block Grant**, which is operated by the Centers for Disease Control and Prevention and provides grants to states for preventive health services for underserved populations;

- The **Commodity Supplemental Food Program**, which provides nutritional food packages for less than $20 a month to more than 400,000 low-income elderly people; and

Medicaid Cuts

This analysis of grants-in aid excludes the Medicaid program. But the budget also contains new legislative and administrative cuts in Medicaid, which provides health insurance to low-income children, parents, seniors, and people with disabilities. At least four-fifths of these Medicaid spending cuts would be achieved by shifting costs from the federal government to the states.

The budget proposes legislative changes in Medicaid that would reduce federal Medicaid funding by $4.9 billion over the next five years, of which $2.9 billion would be achieved by shifting costs to states. The cost shifts include a reduction of the federal matching rate for targeted case management services and an effective reduction of the federal matching rate for Medicaid administrative costs relating to families and children. Some proposed legislative increases, such as extending the current Medicaid coverage for low-income families that are transitioning from welfare to work, grants to states to enroll children in Medicaid and SCHIP, and an increase in spending on vaccines could partially offset the shift to states. It should be noted, however, that most of the increase is attributable to enrolling more children in Medicaid and SCHIP, which assumes that states invest sufficient additional dollars for their share of the matching funds. The net of the proposed legislative changes is a cut of $1.5 billion.

The regulatory changes would reduce federal funding by an additional $12.2 billion over five years. Some 96 percent of those federal savings would be achieved by shifting costs to the states. They include changes relating to payments to government providers, and payments for school-based services and rehabilitation services.

- A variety of education programs, including the **Safe and Drug Free Schools** grant.

Grants that are being cut significantly include:

- The **Child Care Development Block Grant**;
- **Community Oriented Policing Services**;
- The **Community Development Block Grant** formula grant program;
- Other education programs including **vocational and adult education;**
- The Environmental Protection Agency's **State and Tribal Assistance Grants**, which helps states implement air and water quality standards; and
- **Violence against women prevention** and prosecution.

Reductions by State

Table 2 provides an illustration of what cuts of this magnitude would mean for each state. It distributes the reduction in grants other than Medicaid by the percentage of grants (other than Medicaid) that each state is expected to receive in 2007. This analysis does not take into account the distribution by state of the specific program cuts proposed in the budget. It does, nevertheless, provide a reasonable approximation of the amount by which each state might have to reduce services or raise revenues in order to achieve the level of federal deficit reduction the President seeks from cutting grants-in-aid.

The 10 states that could experience the deepest per capita cuts in grant assistance are Alaska, Wyoming, North Dakota, New York, Vermont, Montana, South Dakota, Rhode Island, West Virginia, and New Mexico.

Other Impacts of Budget on States

In addition to the loss of federal grants for programs, states would face the loss of significant amounts of revenue as a result of the federal tax changes proposed in the Bush budget. Federal tax changes often affect state revenues, because most states use federal definitions of income, federal depreciation allowances, and other features of the federal tax code as the basis for their own taxation. The 2007 budget includes a number of tax initiatives that could result in the loss of significant amounts of state revenue, including making permanent the expensing for small businesses, new savings incentives, providing an above-the-line deduction for high-deductible insurance premiums, expanded Health Savings Accounts, and certain incentives for charitable giving, among others.

Future Years

The federal budget only shows the grants-in-aid funding for 2007; it does not provide a five-year projection as is provided in other parts of the budget. Nevertheless, it is reasonable to assume that there would be additional reductions in future years, particularly in discretionary grants. The budget shows that by 2011, overall funding for domestic discretionary programs would be $57 billion, or 13 percent below the level needed to maintain current programs and services.

Grants-in-aid make up about one-third of total discretionary spending. As noted above, the proposed reduction in grants in aid in 2007 is disproportionate, amounting to 55 percent of the total discretionary cut. If grants were to absorb at least their proportionate share of the cuts in 2011 (one-third of the cuts), the reduction would grow from $7.5 billion in 2007 to $19 billion in 2011. If they continued to bear the same disproportionate share of cuts as in 2007 (55 percent of the cuts), the 2011 funding loss would be $31 billion.

TABLE 2: ILLUSTRATION OF POTENTIAL LOSS OF GRANTS-IN AID ALL STATE GRANTS OTHER THAN MEDICAID FY2007 President's Budget Compared to FY 2006 Enacted					
State or Territory	**FY 2007 Percentage of Grants Other than Medicaid**	**Nominal Budget Cut (millions of dollars)**	**Budget Cut After Adjustment for Inflation (millions of dollars)**	**Per Capita Budget Cut After Adjustment for inflation (in dollars)**	**Rank**
All States		**1,685**	**6,707**		
Alabama	1.5%	24.6	98.1	21.5	24
Alaska	0.6%	10.2	40.5	61.1	1
Arizona	1.6%	27.2	180.3	18.2	44
Arkansas	0.9%	15.2	60.5	21.8	22
California	13.7%	230.4	917.1	25.4	11
Colorado	1.2%	19.9	79.1	17.0	48
Connecticut	1.3%	21.4	85.2	24.3	14
Delaware	0.3%	4.8	19.1	22.6	18
Florida	4.5%	76.0	302.7	17.0	47
Georgia	2.8%	47.9	190.7	21.0	28
Hawaii	0.5%	7.9	31.4	24.6	13
Idaho	0.4%	7.3	29.2	20.4	31
Illinois	4.3%	71.9	286.1	22.4	19
Indiana	1.8%	29.6	117.9	18.8	41
Iowa	0.8%	14.3	56.8	19.1	39
Kansas	0.8%	13.2	52.6	19.2	38
Kentucky	1.4%	23.5	93.5	22.4	21
Louisiana	1.6%	27.3	108.6	24.0	15
Maine	0.4%	7.2	28.8	21.8	21
Maryland	1.6%	27.8	110.5	19.7	34
Massachusetts	2.4%	39.9	158.8	24.8	12
Michigan	3.1%	52.0	207.0	20.5	30
Minnesota	1.5%	25.1	99.8	19.4	36
Mississippi	1.0%	17.5	69.7	23.9	16
Missouri	1.7%	29.1	115.6	19.9	33
Montana	0.4%	7.5	29.7	31.8	6
Nebraska	0.6%	9.4	37.4	21.3	27
Nevada	0.6%	9.9	39.6	16.4	50
New Hampshire	0.4%	5.9	23.6	18.0	45
New Jersey	2.8%	46.9	186.8	21.4	26
New Mexico	0.8%	12.8	51.0	26.5	10
New York	9.3%	156.7	623.5	32.4	4
North Carolina	2.4%	40.3	160.5	18.5	42
North Dakota	0.3%	5.7	22.5	35.4	3
Ohio	3.7%	62.5	248.8	21.7	23
Oklahoma	1.1%	19.2	76.3	21.5	25
Oregon	1.1%	18.6	74.2	20.4	32
Pennsylvania	4.2%	71.1	283.1	22.8	17
Rhode Island	0.4%	7.3	28.9	26.9	8
South Carolina	1.2%	19.6	78.1	18.3	43
South Dakota	0.4%	6.0	24.0	30.9	7
Tennessee	1.7%	28.8	114.8	19.3	37
Texas	7.0%	117.8	469.0	20.5	29
Utah	0.7%	11.1	44.3	17.9	46
Vermont	0.3%	5.1	20.2	32.3	5
Virginia	1.9%	31.6	125.7	16.6	49
Washington	1.8%	31.0	123.3	19.6	35
West Virginia	0.7%	12.1	48.1	26.5	9
Wisconsin	1.6%	26.6	105.8	19.1	40
Wyoming	0.3%	4.6	18.1	35.6	2

Notes: Percentage of grants per state from Analytic Perspectives, Tables 8-6 and 8-16
Analysis is illustrative of cuts states would experience if the amount of grant reductions in the budget were distributed over all non-Medicaid grants.