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FAILING TO EXTEND FISCAL RELIEF TO STATES WILL CREATE NEW BUDGET GAPS, FORCING CUTS AND JOB LOSS IN AT LEAST 34 STATES

More Cuts in Health, Education and Other Areas Could Stall Nation's Economic Recovery

By Michael Leachman, Erica Williams and Nicholas Johnson

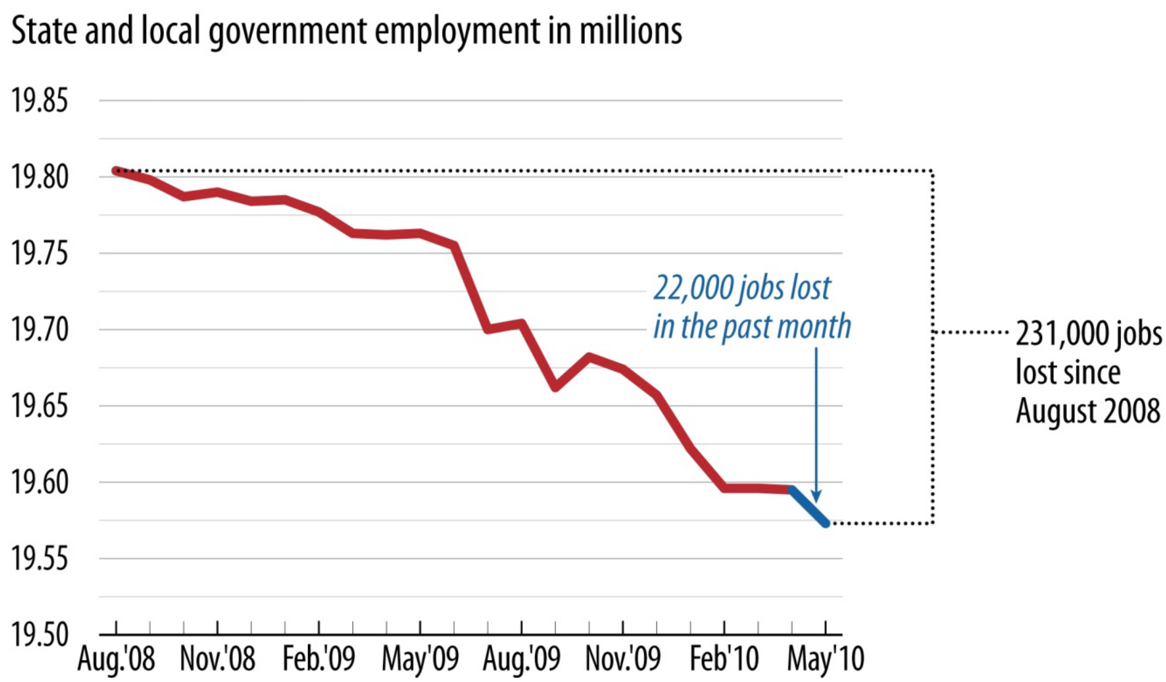
If Congress does not extend the enhanced Medicaid matching funds in last year's Recovery Act, most states will cut public services or raise taxes for the fiscal year that begins July 1 by even more than they are already planning – laying off tens of thousands more teachers and other public employees, cutting education funding more sharply, and further reducing payments to health care providers and other private firms. Without more federal aid, state budget-closing actions could cost the national economy 900,000 public- and private-sector jobs.

These findings — from a review of state budget documents, news articles, and interviews with independent budget experts in most states — come on top of new federal data showing states, localities, and school districts have cut 231,000 jobs since 2008, including 22,000 jobs in May alone. Such cuts slowed the pace of economic growth in the first quarter of 2010 by one-half of one percentage point, federal data show.

Due to the deep and long recession, states have lost tax revenue for the last two years. Revenues are projected to remain at severely depressed levels throughout fiscal year 2011 (which begins July 1 in most states). As a result, states have already laid plans to implement large spending cuts and other measures to keep their budgets in balance, marking the third straight year of budget cuts, and the new cuts will slow the economic recovery and raise the risk of a double-dip recession as the loss of spending power ripples through the economy.

Congress can reduce the economic harm by enacting a six-month extension of enhanced Medicaid matching funds. Those funds would help states pay for dramatic recession-driven increases in Medicaid enrollment in most states and reduce the chances that states will have to cut scarce funds for education and other areas. Because both houses of Congress passed the Medicaid extension separately earlier this year, most states have assumed enactment of this fiscal assistance — worth about $23 billion — in preparing their 2011 budgets, averting some of the most extreme cuts.

FIGURE 1:
State and Local Government Payrolls are Shrinking



Source: Bureau of Labor Statistics, seasonally adjusted data

The House abruptly dropped this extension from the jobs bill it passed in late May. Most recently, Senate leaders released a jobs bill that includes the extension, but the Senate has not yet voted on it; even if the Senate passes it, it will need to return to the House for final consideration.

At least 34 states — two-thirds — will cut jobs and services, with impacts throughout the economy, if the aid isn't enacted.

- Twenty-three states (as of June 10, 2010 and including the District of Columbia) have completed work on FY2011 budgets that rely explicitly on the Medicaid extension. If Congress does not extend the funds, governors and legislatures will have to revisit those budgets and consider new cuts.

- Seven states have not yet passed their budgets but assume extension of the Medicaid funds in the governor's and/or legislature's budget proposals. Failing to enact the extension will make already-difficult budget discussions even more difficult and require more cuts.

- Virginia and Mississippi didn't include the extension in their budgets but explicitly stated that they will reverse job-killing cuts in those budgets if the additional Medicaid funds are approved.

- At least two states, Oregon and Wisconsin, enacted two-year budgets last year that now have large budget gaps. Extension of the Medicaid funds would reduce the size of the cuts these states otherwise must impose.

Governors: Extension Crucial for Saving Jobs and Maintaining Services

In February, 42 governors (26 Democrats and 16 Republicans) signed a National Governor's Association letter urging Congress to extend the Recovery Act's additional Medicaid funding. More recently, a number of governors have sent letters to members of their Congressional delegations urging the extension. Excerpts from these letters describe the importance of the extension to their states' economies:

> "Simply put, this extension is critical to California. We have done the hard work here at home. California leaders have made more than $57 billion in spending reductions in the last three years alone to address the effects of this national recession on our budget…The cuts proposed to close [the] remaining budget gap are devastating. If Congress fails to extend the enhanced FMAP rate in the coming weeks, we will be forced to add another $1.8 billion in spending cuts to make up for the loss of those federal funds. The human impact of [this]…is both cruel and counterproductive."
> **Arnold Schwarzenegger, Governor of California**

> "Without this two-quarter extension our State General Fund budget faces an additional shortfall in the current biennium, which will force even deeper cuts in our already struggling state agencies. The ARRA's enhanced FMAP has played an important part in combating the recession in Nevada. Like you, I stand committed to encouraging job creation and to the further recovery of our economy, and extending FMAP is a critical piece of that strategy." **Jim Gibbons, Governor of Nevada**

> "Last year we cut spending by $1.75 billion eliminating 142 line items from our budget and reducing almost every one of the remaining 657 budget lines. We have eliminated over 4,500 state positions and cut our fleet and energy costs dramatically.… Without this extension of federal fiscal relief, Pennsylvania will be forced not only to cope with a billion less in state revenue, but we will need to address a $2 billion loss in state and federal revenues combined. … Given this reality, the number of jobs lost as a result of our state deficit is likely to double if this FMAP extension is not enacted."
> **Edward Rendell, Governor of Pennsylvania**

> "If the extension is not realized, the state will not only be unable to provide medical services to thousands of families, but would likely see a loss of thousands of jobs as across the board cuts would be a likely response. If FMAP is not extended, I may be forced to call a special session of the legislature to determine how to deal with a new $480 million budget deficit. If we act quickly, we would have to cut 6,000 jobs; but if we wait to act until January, we would have to double that number."
> **Christine Gregoire, Governor of Washington**

Likely specific cuts include the following:

- **Alabama,** which enacted a budget that relied on the funds, likely would cut funding for its state court system, state troopers, and mental health system by over 10 percent, on top of already-enacted cuts in the current fiscal year. In addition, the state would find it difficult to avoid wholly or partially rolling back an October 2009 expansion of the state's children's health insurance program to cover an additional 14,000 children.

- **Arizona's** enacted budget specifies that if the Medicaid funds do not materialize, the state will eliminate health care coverage for 310,000 poor adults. However, the new health care reform law would not allow this cut because the law bars Arizona from cutting people from its

Medicaid program in advance of 2014 when Medicaid is expanded and health coverage is available through new state health insurance exchanges. Thus, Arizona would have to choose whether to flout the law — and lose all its federal Medicaid funding — or find other ways to cut another $385 million out of an already deeply damaged system of services.

- **Colorado's** recently enacted budget would face a $212 million gap if Congress fails to extend the Medicaid funds. Likely cuts include eliminating state aid for full-day kindergarten for 35,000 children, eliminating preschool aid for 21,000 children, and increasing overcrowding in juvenile detention facilities — all budget cuts that the legislature's non-partisan staff suggested during budget negotiations earlier this year.

- **Kansas'** enacted budget would face a $131 million gap, likely leading the governor to reduce state aid for schools, as he proposed in his budget earlier this year. Such a reduction would likely result in more teacher layoffs, on top of 450 positions eliminated due to budget cuts in the past year.

- **New Mexico** could eliminate a wide range of Medicaid services, including emergency hospital services, inpatient psychiatric care, personal care assistance for the disabled, prescribed medications, and hospice care. The legislature is currently considering these cuts for fiscal year 2012, and may accelerate the timeline if the anticipated federal Medicaid support falls through.

- **New York's** not-yet-enacted budget would require even deeper cuts without the federal aid. Local governments would be hit as well, including New York City. The city is already planning some 4,500 layoffs; Mayor Bloomberg estimates that this figure would triple without the expected federal funds.

- **Pennsylvania** has not yet enacted a budget for 2010, but the governor assumed the federal funds in the budget he presented to the legislature. Even with the funding, the governor expects to lay off several hundred state workers to help balance the budget; without the funding, he estimates the layoffs would reach into the thousands. Pennsylvania would also cut funding for domestic violence prevention in half, eliminate all state funds for addressing substance abuse and homelessness, cut funding for child welfare by one-quarter, and cut payments to private hospitals, nursing homes, and doctors across the state — among other steps.

- **Washington** would face a shortfall of $480 million in its already enacted budget. The governor says this could cost the state up to 6,000 jobs.

These likely cuts, and others, are described further below.

State Actions to Close Shortfalls Endanger the Economy

States are required by law to balance their budgets and have limited ability to borrow funds. At this point in the recession, virtually no states have large reserves. Thus, large budget shortfalls force them to lay off workers, cancel contracts with vendors, and raise taxes, fees, and user charges. These actions ripple through the economy by reducing the purchasing power of businesses and families. They may also have long-term economic effects as they reduce states' investments in human capital (e.g., education) and infrastructure.

The importance of the state and local sector to the recovery is underscored by new economic data from two federal agencies.

- New data from the Bureau of Labor Statistics show that state and local governments, including school districts, have cut 100,000 education jobs and 231,000 other jobs since mid-2008, including 22,000 jobs lost in May 2010 alone.[1]

- Newly revised data from the Bureau of Economic Analysis for the first quarter of 2010 show that contraction in the state and local government sector reduced the growth of Gross Domestic Product by one-half of one percentage point, from 3.5 percent to 3.0 percent. [2]

States' aggregate budget shortfall for 2011 is likely to reach $140 billion (excluding any new federal funds) — a gap equal to nearly one percent of GDP. Standard economic multipliers suggest that the spending cuts necessary to close a budget gap of that magnitude would cost the economy 900,000 private- and public-sector jobs.

State Budgets Require Extended Medicaid Funding to Maintain Jobs and Services

Of the 43 states, including the District of Columbia, that write budgets annually, thirty are assuming in their final or proposed budget for next year that Congress will extend for six months the Recovery Act's additional Medicaid funding. Most states made this reasonable assumption because both houses of Congress passed the extension in separate bills, and it was in the President's budget proposal.

Twenty-one States Finalized Budgets That Rely on Extended Federal Relief

Of the 34 states, including the District of Columbia, that have passed budgets for the coming year, twenty-two assume that Congress will extend the Recovery Act's Medicaid funding and incorporate those funds into the budget.

If Congress failed to extend this fiscal relief, these states would face new gaps in their recently passed budgets. In some cases, the Governor would impose additional cuts to eliminate the new shortfall. In others, the state legislature would reconvene in special session to decide how to close the new fiscal gap. In any case, additional layoffs and service cuts likely would add to those already enacted for the next fiscal year. For example:

Alabama would face a new $197 million gap in its budget for the next fiscal year. Specifically, this gap would show up in the part of the budget through which the state pays for the court system, state troopers, mental health, and other services outside of education, Medicaid and prisons in the

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[1] Calculated from Current Employment Statistics survey data, released June 4, 2010.

[2] Calculated from National Income and Products Accounts, Table 1.1.2, revised May 27, 2010.

current fiscal year.[3] The cuts in the current fiscal year have led to around 100 court employee layoffs, fewer jury trials, longer waits for divorces, a longer waiting list for community mental health services, and higher caseloads for parole officers, among other reductions. If Congress doesn't come through with the extension, the non-education part of Alabama's budget could sustain another 12.5 percent cut, on top of the 12 percent cuts already made this year, for a total cut of nearly 25 percent over two years. In addition, an October 2009 expansion of a state program providing health care to 14,000 children could be wholly or partially rolled back.

Arizona would face a new $385 million gap in its budget for the next fiscal year. The enacted budget says the state must close this gap by eliminating Medicaid for 310,000 people. Since eliminating Medicaid coverage for these people would not be allowed under the new health care reform law, Arizona would have to choose whether to flaunt the law – and lose all its federal Medicaid funding – or find other ways to cut another $385 million out of an already deeply damaged system of services, or raise that much in new revenue.

Colorado would face another $212 million gap in its budget. The state would likely revisit cuts considered during the recent legislative session, but ultimately rejected. For instance, the legislature's non-partisan staff suggested eliminating state aid for full-day kindergarten for 35,000 children and eliminating preschool aid for 21,000 children. The legislature also considered eliminating a free breakfast program for children at 302 low-income schools, and requiring parents of 10,164 children who receive free lunches to pay 40 cents per meal, about $144 for a family with two children, and requiring 12,926 children receiving free lunches to pay 30 cents per meal, about $108 per year for a family with two kids. In addition, the legislature considered allowing the Department of Youth Corrections to operate its facilities at 120 percent of capacity, instead of 110 percent, despite the safety risks for youth offenders. And, the legislature might be forced to consider additional cuts to Colorado's troubled child welfare system, which has seen 35 children die under its watch in the past three years and still had its funding reduced by $6.7 million in next year's budget. Even all of these cuts would fail to cover the gap, requiring yet more cuts or other state actions.

Kansas would face a new shortfall of $131 million. If this occurs, the Governor could respond by reducing state aid for schools, as he proposed in his budget earlier this year. Such a reduction would likely result in more teacher layoffs, on top of the loss of over 450 teachers due to budget cuts in the past year. Or the Governor could revisit some of his other earlier proposals, including a Medicaid provider rate cut of 10 percent or the elimination of the Parents as Teachers Program, a home-based parent education program that serves over 19,000 children and 15,000 families.

Maine would face a new shortfall of $85 million. As a result, the state likely would consider making cuts previously proposed but rejected, such as limiting laboratory and x-ray services, out-patient hospital visits, inpatient hospital stays, and mental health outpatient therapy. The state likely would also consider increasing co-payments for prescription drugs for some seniors and people with disabilities receiving both Medicaid and Medicare, cutting Medicaid provider reimbursement rates by up to 10 percent, and cutting domestic violence, victim assault, and family planning programs.

[3] Budget cuts are concentrated in these areas because prisons are already operating at twice-capacity, Medicaid benefits are close to federal minimums, and education in Alabama – unusual for states – is funded from a completely separate area of the budget.

New Mexico would face a gap of $207 million. The state could eliminate a number of Medicaid services not required by federal law, including optometry and eyeglasses, dental services and dentures, emergency hospital services, personal care assistance for the disabled, prescribed medications, inpatient psychiatric care, and hospice care. Currently, the state is considering taking this step a year from now, after the extension would run out. If Congress does not provide the extension, New Mexico could move up the timeline. Cuts to Medicaid of this magnitude would reduce federal funding to New Mexico by an additional $500 million in matching dollars.

Washington would lose $480 million it is counting on in its already enacted budget. Without the funds, the Governor says she may need to call a special session of the legislature and could lay off as many as 6,000 public employees.

Other states that wrote budgets that incorporate the extended Medicaid fund, and thus presumably would have to enact additional cuts or take other measures such as tax increases if the funding is lost, are **Alaska, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Iowa, Kentucky, New Hampshire, Nevada, Rhode Island, South Carolina,** and **Vermont,** plus the **District of Columbia.**

Eleven States Did Not Assume Medicaid Extension and Could Use Funds to Undo Budget Cuts

While most of the 34 states that have already passed budgets this year assume Congress will extend the Recovery Act's additional Medicaid funding, eleven did not. Most of these states faced budget shortfalls for the next fiscal year that they closed largely by cutting spending. If Congress extends the Recovery Act's Medicaid funding, these states will be in a position to restore cuts they've just made to next year's budget or avoid any additional shortfalls that might otherwise emerge in the coming months. At least two of these states – Virginia and Mississippi – have already determined which cuts will be restored if Congress extends the funding.

While **Mississippi's** budget did not assume additional federal aid, the state nonetheless developed a contingency plan for $110 million of the $187 million anticipated from the extension. Nearly $100 million would go to restore cuts in education funding, including $28 million to the Mississippi Adequate Education Program — established to bring per-pupil spending up to adequate levels in every district. This amount is equal to the salaries of 629 teachers. The plan also allocates $53 million for General Education Development programs and $13 million to support Mississippi's public universities, which recently raised tuition for students attending four-year schools this fall.

In **Virginia**, extending the provision would reverse over $400 million in service cuts scheduled to occur in the state's just-enacted two-year budget. One such cut would force 30,000 or more people out of the state's children's health insurance program, which provides health care to low-income children and pregnant women who do not qualify for Medicaid and cannot access or afford private insurance. Another cut would cause at least 2,000 Virginians to lose their eligibility for long-term care coverage through Medicaid. Both of these cuts would be in violation of the new federal health care law, which would mean that Virginia would have to either violate the law — and risk losing all federal Medicaid funding — or find other ways to close the gap.

States that neither assumed the federal money, nor have specifically said how they would allocate it, are **Arkansas, Minnesota, Missouri, Oklahoma, South Dakota, Tennessee, Utah, West Virginia,** and **Wyoming**. While these states did not assume the extension, they nonetheless may find that they need the money to avert more cuts or reverse already-implemented cuts. For example, states may find that due to continued high joblessness more people need state services than the state had projected, or they may find that their revenue projections were too rosy. Such occurrences could require the state to make mid-year cuts to budgets.

In States Still Working on Budgets, Most Proposals Assume the Extension, Too

Another nine states have yet to finalize their budgets for the upcoming fiscal year. In seven of these states, governors and legislators have been assuming that Congress will extend the Recovery Act's enhanced Medicaid funding, and the budget proposals put forward to date reflect this assumption. If Congress does not come through, these states will impose more layoffs and deeper service cuts. Examples include:

In his proposed budget earlier this year, **Massachusetts'** governor assumed the extension. Congress' failure to enact the extension would require another $608 million in cuts or new revenue to close a shortfall totaling $2.7 billion. On June 8, fearing the funds would not be secured before the start of the next fiscal year on July 1, the governor proposed an additional 3.6 percent across-the-board reduction for FY2011 in services outside of public schools and unrestricted aid to local governments. This could lead to the working parents of about 1,750 children losing access to child care and the loss of 100 shelter beds for homeless people, among a wide array of other reductions including cuts in health care services, services that help seniors and disabled people, and public safety programs. These cuts would come on top of those already planned for next year, which are substantial. For example, the budgets that have passed the House and Senate both suggest a $174 million reduction in Medicaid provider rates and the elimination of restorative dental services such as fillings and root canals for 200,000 adults. If Congress does not enact the extension, and the state cuts services across the board as the Governor has proposed, the Medicaid program would absorb another $350 million funding cut.

In **Michigan**, the governor's budget assumes the extension. If the funding doesn't come through, the state will face an additional shortfall of $500 million. A number of cuts have been proposed recently, all of which are more likely to be enacted if an extension of the enhanced FMAP falls through. They include a reduction in funding for community mental health services; a 15 percent reduction in cash assistance to poor families; a cut in daycare provider rates; an 83 percent cut in state funding for tutoring, school support services, early childhood programs, and other programs for at-risk schools; the elimination of adult education categorical grants; and the elimination of state disability assistance.

New Jersey's governor assumes the extension in his budget as well. Without it, the state will face an additional shortfall of roughly $500 million. It appears likely that one consequence would be that the state would cut funding to hospitals that provide medical care to people who have no insurance. These reimbursements were not cut in the Governor's budget for next year even as many other programs were cut significantly. A severe cut in these reimbursements could cause some hospitals to close, as others in New Jersey already have, causing more job losses.

In **New York**, the failure to extend Medicaid funding would require another $1 billion in budget cuts or tax increases to close a gap totaling $8.5 billion for the fiscal year that began April 1. (New York is operating under temporary spending rules until the budget is finalized.) Because New York is required to share the Recovery Act's Medicaid funding with New York City and the counties, these local governments would also face additional shortfalls. The additional gap in New York City would total about $600 million over time.

The State could react to an additional $1 billion shortfall by further reducing state aid for education, as the governor has already proposed in dealing with the state's existing deficit. If this happens, the reduced state aid likely would lead to thousands more layoffs in New York City and counties across the state, on top of any layoffs the City and counties would impose in response to their own loss of funds from the extension's failure. New York City's mayor estimates that losing the extension would mean laying off "something like nine or 10,000 employees." Moreover, these layoffs would come in addition to the over 4,500 city employees the mayor *already* proposes to lay off next year to deal with the existing shortfall, and in addition to the mayor's plan to freeze teacher salaries for two years. If the state chose to absorb the new $1 billion shortfall by laying off its own employees, rather than impose deeper reductions in state aid for education at the local level, the layoffs would total in the 15,000 to 16,000 range, according to a calculation by the independent Fiscal Policy Institute.

The budget proposed by **Pennsylvania's** governor also assumes Congress will extend the Recovery Act's Medicaid funding. Without it, Pennsylvania would face an added fiscal gap of $850 million. The governor says thousands of public employees would be laid off. Even without the funding, the state is facing layoffs in "the hundreds," the Governor says. Pennsylvania would also cut funding for domestic violence prevention in half, eliminate all state funds for addressing substance abuse and homelessness, cut funding for child welfare by one-quarter, and cut payments to private hospitals, nursing homes, and doctors across the state — among other steps.

The two other states that have not yet enacted budgets but where the aid is assumed in current discussions are **California and North Carolina.** The budget cuts that are on the table even with the federal funds are drastic in California and damaging in North Carolina. For example:

- **California's** governor proposed deep reductions to Medicaid services, a $1.5 billion reduction in K-12 and community college funding; a 5 percent to 10 percent cut in state employee salaries; a reduction in monthly grants to low-income people who are elderly or have disabilities; elimination of the state's Calworks program (which provides employment services and basic cash assistance for very poor families with children) and a number of other human service programs; and elimination of the state's child care subsidy program, leaving the low-income working parents of 142,000 children without a crucial support that helps them keep their jobs.

- **North Carolina's** State Senate included $482 million in enhanced FMAP dollars in its budget; the House's version included $489 million. Both proposals make significant cuts in a wide range of basic public services. For example, the House proposal would cut prekindergarten spending by $6.5 million, eliminating as many as 600 slots for low-income children. The House bill also imposes a cap on university enrollment at its current level, and provides inadequate funding to cover increased enrollment in the children's health care program, which could lead to an enrollment freeze.

Other States Are Not Enacting New Budgets, but Nonetheless Need the Relief Extended

Eight states are not enacting new budgets this year but rather are mid-way through two-year budgets that were enacted in 2009. Since these states enacted their budgets long before Congress considered extending the Medicaid funds, none of them assumed an extension. Several of these states continue to face difficult fiscal conditions and may have to enact deeper cuts to keep their current two-year budgets in balance. Extending the Medicaid funds would help these states avoid laying off employees and imposing additional service cuts. Examples include:

Oregon faced a fiscal gap of $4.2 billion before it adopted its biennial budget last year, about half of which was closed with deep cuts in services and a smaller tax increase that covered about a fifth of the shortfall. Since then, the state's revenues have continued to weaken. Oregon currently faces a new $577 shortfall for the remainder of the biennium. As a result, the Governor is imposing nine percent across-the-board cuts to all General Fund programs, mainly education, human services, and public safety. The governor has also said that "layoffs will happen," has instituted a pay freeze for non-union state employees, and has asked unions to re-open their contracts. If Congress extends the Recovery Act's Medicaid fiscal relief, the funding would cover about a quarter of Oregon's total shortfall. The funds probably would be used specifically for human services, allowing the state to maintain health care services, senior programs, mental health services, and welfare-to-work programs without cuts beyond those already enacted. If Congress does not enact the extension, the Governor plans to eliminate child care subsidies that help 4,658 low-income working parents keep their jobs, reduce access to medications and crisis services for 1,462 mentally ill people, and eliminate home-delivered meals for 940 seniors and people with physical disabilities, among a wide range of other cuts.

Wisconsin faced a roughly $6 billion shortfall before it enacted its biennial budget, which as in Oregon was closed with a combination of cuts and a modest tax package. Since then, the state's Department of Human Services has reduced payment rates to doctors and hospitals and delayed payments to providers until the next biennium to close a shortfall internal to the Medicaid program, the cost of which has grown rapidly as people hurt by the recession seek public health coverage. However, the initial round of cost-cutting (estimated to save $625 million in state and federal funds) has not been enough to cover fully the Medicaid program's budget shortfalls. The state estimated in March that it has a $273 million General Fund shortfall in the Medicaid budget, which could require far deeper provider rate cuts. If Congress extends the enhanced Medicaid match, the additional funds would allow Wisconsin to avoid choosing between additional cuts across the whole state budget, more tax increases, or a second round of Medicaid rate cuts and payments delays of as much as $750 million in combined state and federal funds.