Center on Budget and Policy Priorities

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POLICY POINTS

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RECESSION STILL CAUSING TROUBLE FOR STATES
Federal Economic Recovery Funds Providing Some Relief

The weak economy continues to cause great fiscal distress among states. New budget gaps have opened up in many states for the current fiscal year (July 1 marked the start of 2010 for most states). The budget gaps for this year and next year combined are estimated to total more than $350 billion.

The American Recovery and Reinvestment Act includes roughly $140 billion in fiscal relief for state governments, enough to close 30 to 40 percent of state shortfalls. States are using these funds to help balance their budgets while minimizing harmful cuts in public services.

Although the recovery package is mitigating states' fiscal problems, states are continuing to cut services like education and health care as they implement 2010 budgets. Additional cuts are likely for 2011. To date at least 43 states have addressed their shortfalls by reducing services to their residents, including some of their most vulnerable families and individuals. Cuts to state services not only harm vulnerable residents but also worsen the recession by reducing overall economic activity.

Some 30 states have enacted tax increases this year in response to budget shortfalls caused by the recession, and several more are considering them. Like budget cuts, tax increases remove demand from the economy, by reducing the amount of money people have to spend. But tax increases can be better for state economies than budget cuts because some of the tax increases result in reduced saving rather than reduced consumption.

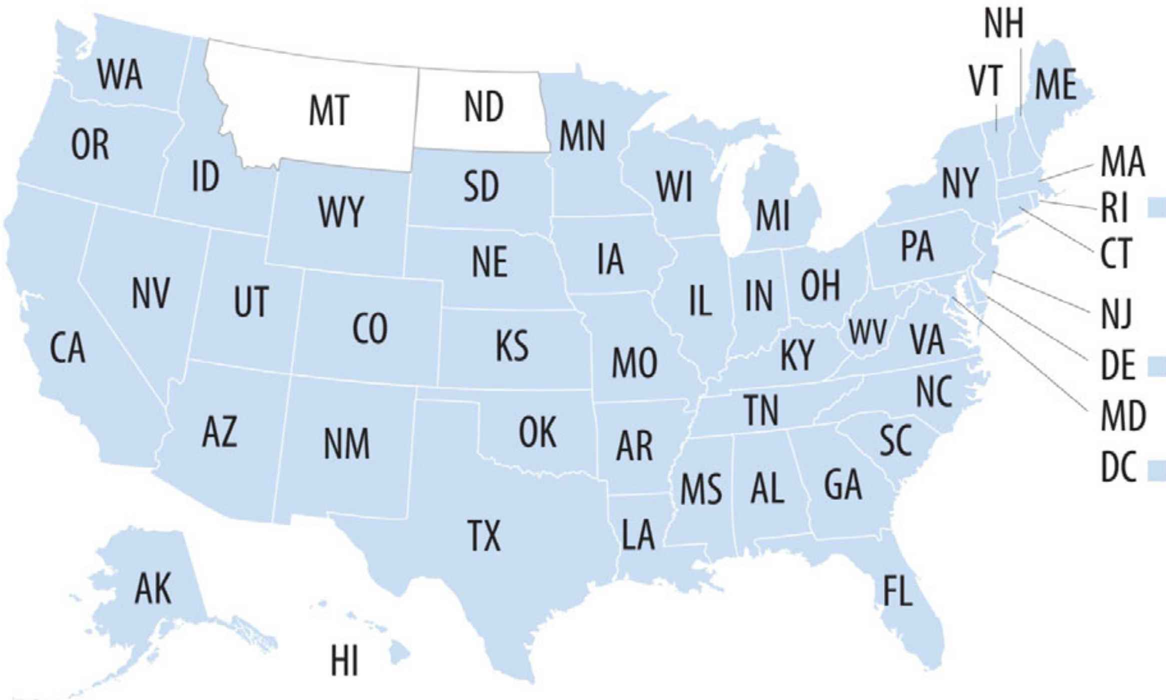
Forty-eight states faced or are facing budget shortfalls.

- At least 48 states addressed or are facing shortfalls in their budgets for the new fiscal year totaling $194 billion or 28 percent of state budgets. This includes $35 billion in shortfalls that have opened up in at least 41 states since they passed their 2010 budgets, forcing these states — all of which took major steps to balance their budgets — to consider further action to address the additional gaps. (Some states have already addressed these new shortfalls.)

- At least 44 states have looked ahead and anticipate deficits for fiscal year 2011. Initial estimates of these shortfalls total some $102 billion for the 41 states that have estimated the size of their projected gaps. As the full extent of 2011 deficits becomes known, shortfalls are likely to equal at least $180 billion.

FIGURE 1:

48 States Face Budget Shortfalls



Note: Includes states with shortfalls in fiscal 2010.

Combined budget gaps for fiscal years 2010 and 2011 are estimated to total over $350 billion.

States are using fiscal relief to balance their budgets.

- The $787 billion American Recovery and Reinvestment Act (ARRA) included approximately $135 billion to $140 billion for states to maintain current programs, which are being squeezed between rising demand for services and sharply declining tax revenues. The federal aid is enough to close, on average, roughly 30 to 40 percent of state budget shortfalls.

- These ARRA dollars closed 31 percent of **New York**'s budget gap and 37 percent of **Virginia**'s. Other states, such as **Georgia, Maryland, Utah, Washington,** and **West Virginia** report similar outcomes. States are closing the remaining gaps with a mix of spending cuts, revenue increases, withdrawals from reserve funds, and other measures.

- Despite these changes, most or all of these states are making other cuts in their budgets, which the federal legislation will be insufficient to reverse.

At least 43 states have cut a range of services, including those aimed at some of their most vulnerable residents. Also, some 30 states have raised taxes and several are considering similar measures.

- At least 29 states have enacted or implemented cuts that will affect low-income families' eligibility for health insurance or reduce their access to health care; at least 24 states and Washington, D.C. are cutting medical, rehabilitative, home care, or other services needed by low-income people who are elderly or have disabilities; at least 28 states are cutting K-12 and early education; and at least 37 states have implemented cuts to public colleges and universities. Also, at least 42 states and Washington, D.C. have proposed or implemented cuts to their state workforce. Since August 2008, state and local governments have eliminated 132,000 jobs.

- Some 30 states already have enacted tax increases, closed loopholes, restricted tax credits, increased tobacco taxes, raised tuitions, or implemented other revenue-raising measures.

- Governors have begun submitting their budget proposals for the upcoming 2011 fiscal year (which begins on July 1, 2010 in most states). Many of these proposals contain additional cuts to core services and state workforces well beyond those already implemented.

The state revenue situation is rapidly worsening.

- To keep pace with the cost of services, state revenues must grow. But overall revenues last year were essentially flat and have weakened dramatically this year. The U.S. Census Bureau reports state tax collections fell 17 percent in the second quarter of 2009 compared with last year — the worst decline ever.

- Sales taxes are the largest source of state tax revenue, and they are declining due to the fall in both personal consumption and business purchases. Income taxes and other taxes are also falling as wages and investment income decline. According to the U.S. Census Bureau, income tax collections during the second quarter of this year fell by 28 percent compared to the same period last year. Continued job losses will depress revenues further.

States face other problems from the weakening economy.

- Employers are reducing jobs and cutting back on employer-provided health coverage. As a result, more families are turning to programs like Medicaid, which provides health coverage to low- and moderate-income families and is jointly funded by Washington and the states.

- State spending levels were relatively low even before this crisis. Aggregate state spending fell sharply relative to the economy during the 2001 recession, and it has remained below the 2001 level ever since. The funding cuts that states will likely make in the coming months will reduce overall spending further below 2001 levels.

- States have already substantially used budget reserves to address funding gaps, but these reserves are limited. States ended fiscal 2006 and 2007 with $69 billion in reserves each year, equal to about 11 percent of their budgets. Those are the largest reserves states have ever accumulated. But now states have used a significant portion of those reserves, and the remaining amount will not be enough to solve state budget problems.

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The Center on Budget and Policy Priorities is a nonprofit, nonpartisan research organization and policy institute that conducts research and analysis on a range of government policies and programs. It is supported primarily by foundation grants.