THE NELSON A. ROCKEFELLER INSTITUTE OF GOVERNMENT

Recession, recovery, and state-local finances

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A few important points

- Federal gov't raises more revenue than state & local gov'ts, but transfers much to SLGs
- State & local gov'ts actually spend more to *implement* domestic programs than does fed gov't (counting Medicaid spending at SLG level, not fed)
- Demand for services provided by SLGs does not fall – in fact, rises – in recession.
- SLGs finance these services with extraordinarily volatile revenue structures - systems ill-suited to finance stable/rising spending pressures.
- Annual budget-balance requirement plus myopic political and fiscal planning systems encourage states to prop up spending with one-shots, temporary revenue, and measures that stretch problems out well beyond the recession

Recessions and state-local finances

- Most of the “action” – in terms of automatic impact of recession on finances – is on the revenue side of the budget.
- Medicaid an important exception. (One estimate: unemployment rise from 4.6% (2007) to 10% would lead to 3.4m more children enrolled in Medicaid/SCHIP and 2.0m more adults; 5.8m more uninsured. F-S-L gov costs of $25+b annually.) Pensions also an exception. Lagged responses.
- Still, recession-induced sudden declines in tax revenue are usually many multiples of recession-induced spending increases
- Different recessions, different risks, different impacts on states – depends on interaction of economic turmoil with fiscal structures

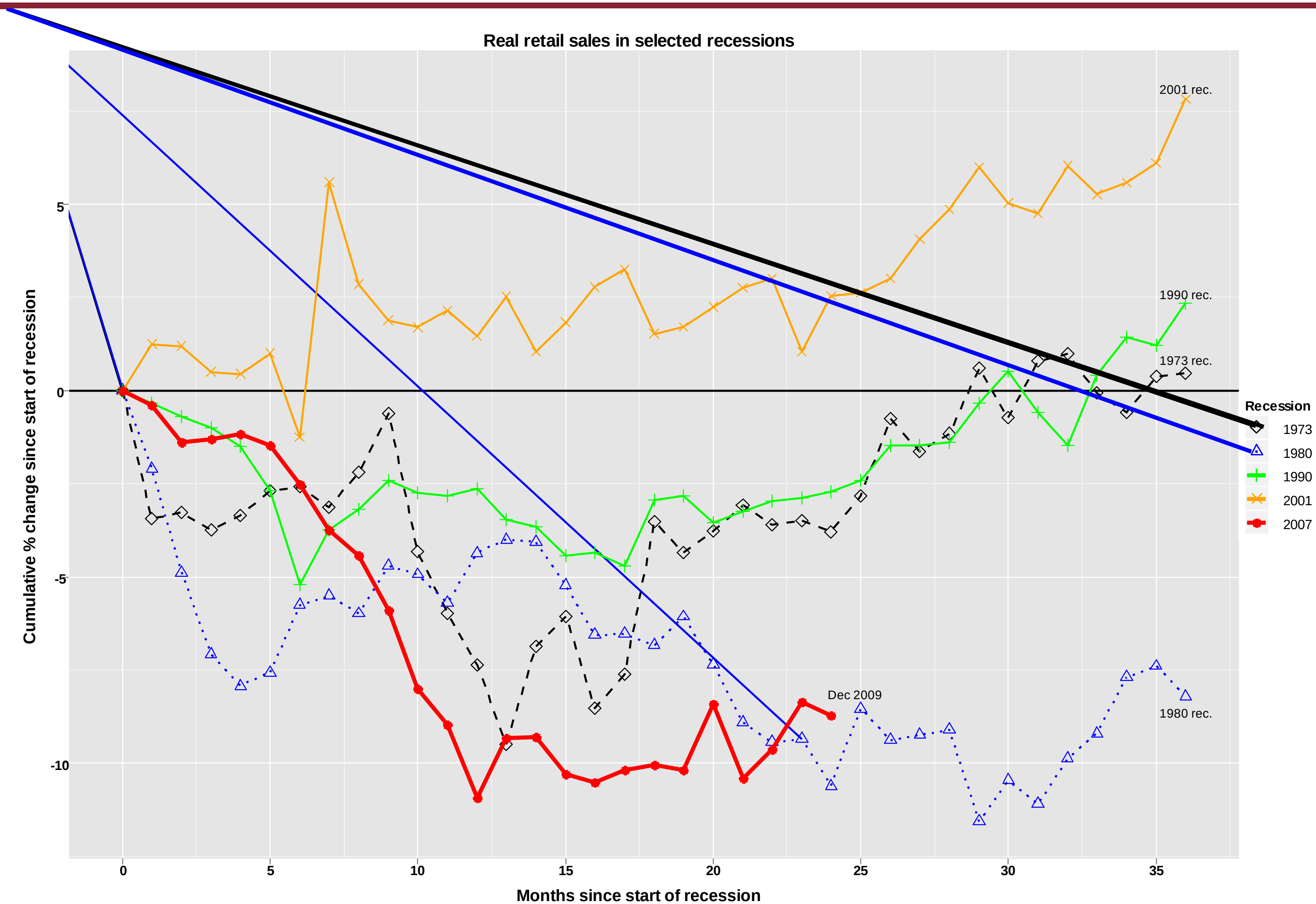
Different revenue structures, different impacts

- Feds: Most volatile revenue structure. PIT and corp income taxes 90+% of revenue. (But who cares? Annual balance not a goal)

- States almost as volatile – and they must balance annual budgets. PIT, corp, and sales average ~55% of own-source revenue. Great variation across states

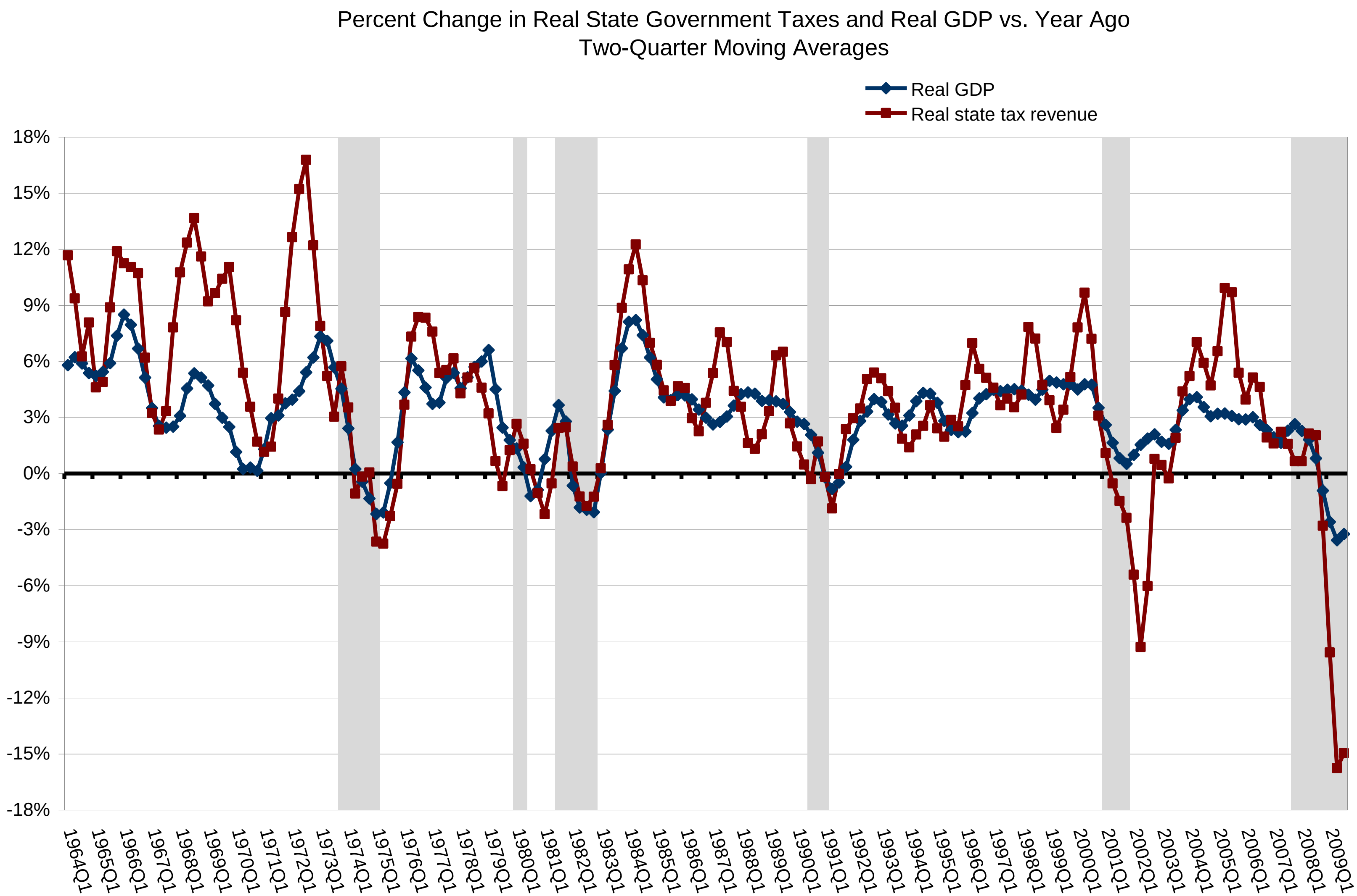
- Local governments generally less volatile. PIT, corp, sales average ~11% of OSR. State aid often a great source of risk and volatility (55% of OSR on average). Great variation…

Real retail sales - a sales tax driver – were hit hard
Improvement recently, but sales remain way below peak



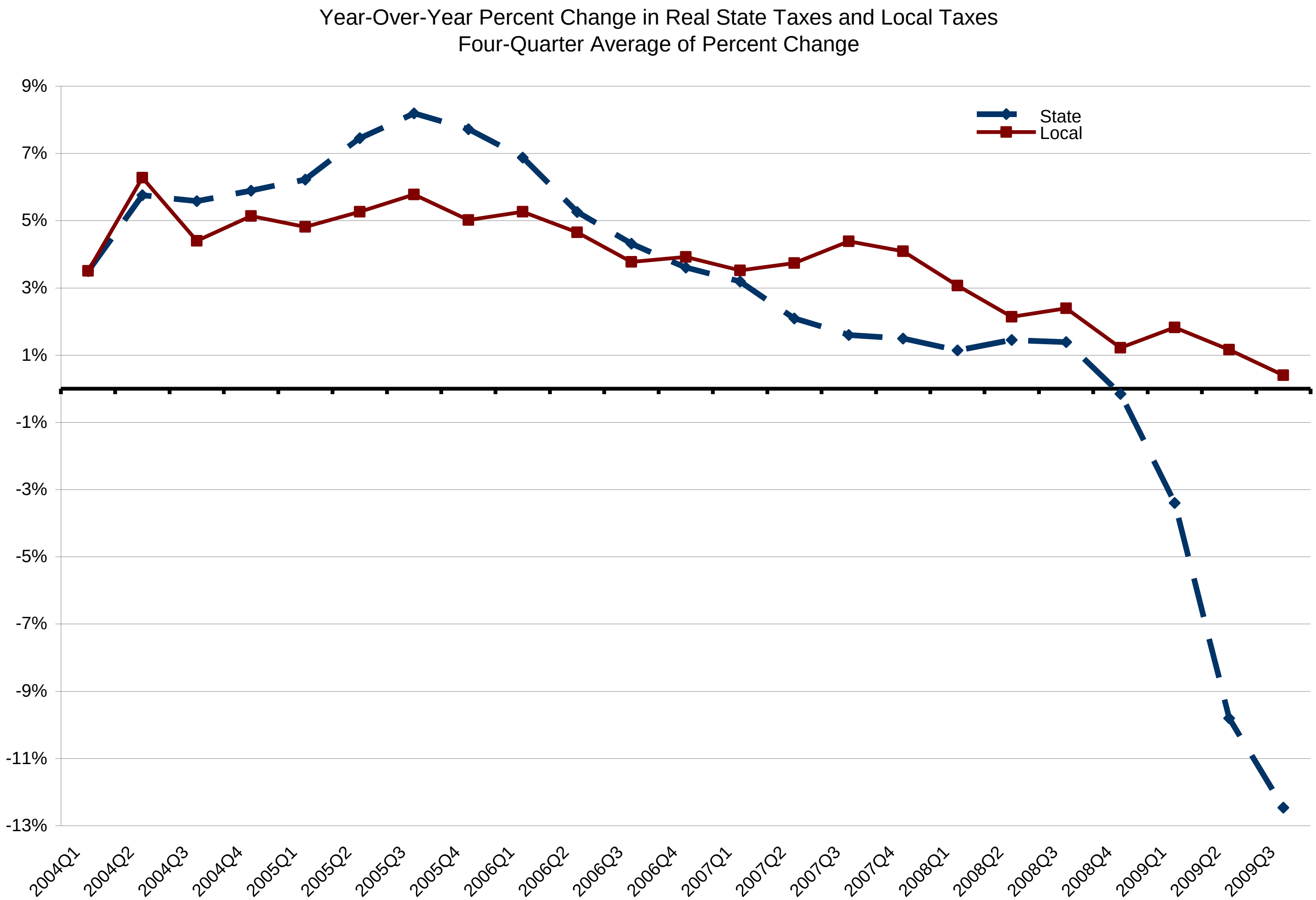
Sources: Cleveland Federal Reserve Bank (pre-1990 retail sales), Census Bureau (1990+), and Bureau of Labor Statistics (CPI)

The last three quarters (2009 Q1-Q3) have been the worst for state government taxes in 5+ decades



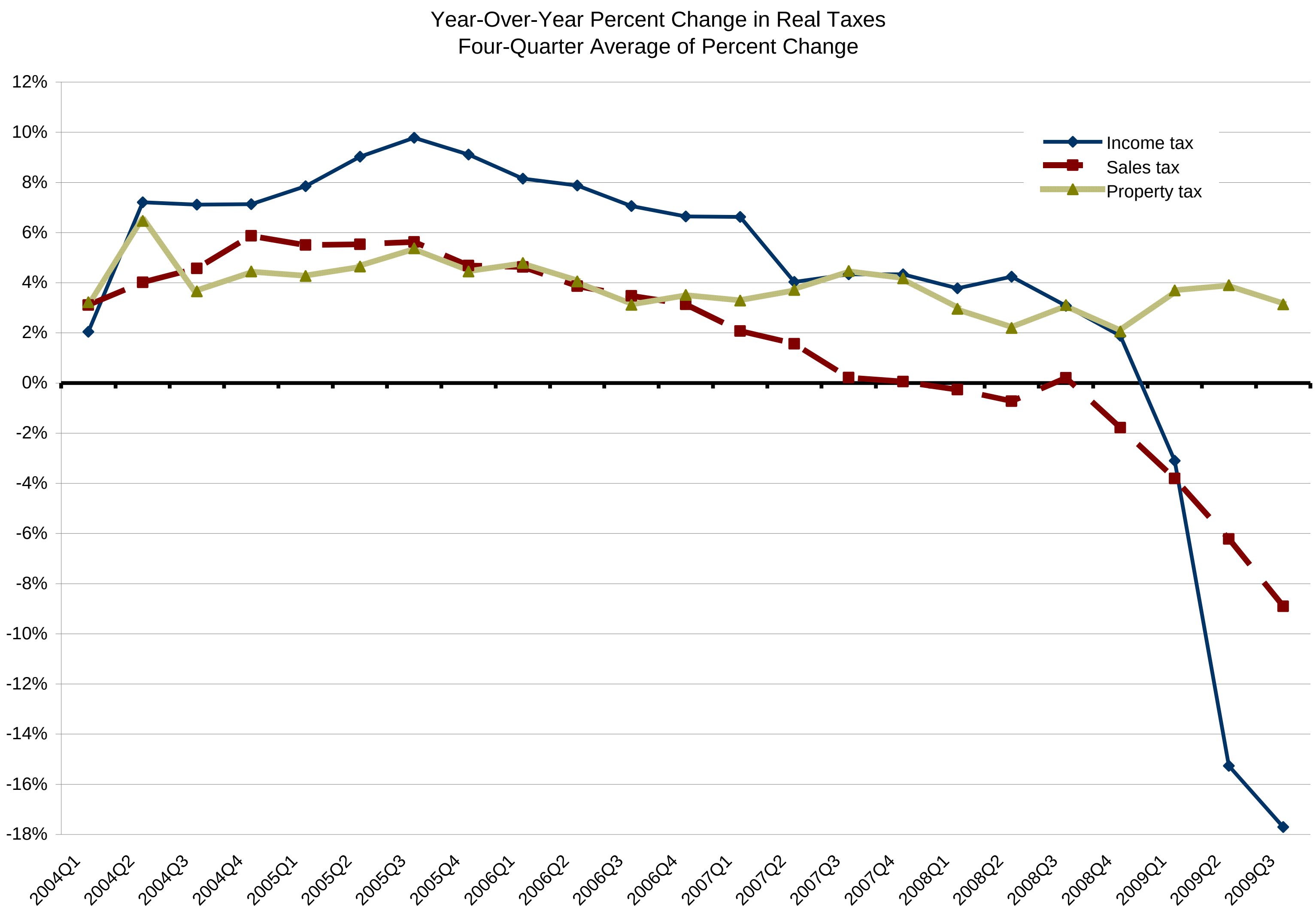
Sources: U. S. Census Bureau (Quarterly tax collections); Bureau of Economic Analysis (real GDP).
Notes: (1) Percentage changes averaged over 2 quarters; (2) No legislative adjustments; (3) Recession periods are shaded.

Local taxes holding up better than state taxes, but have been weakening



Sources: U.S. Census Bureau (tax revenue) and Bureau of Economic Analysis (GDP price index).
Notes: (1) 4-quarter average of percent change in real tax revenue; (2) No adjustments for legislative changes.

Despite housing bust, for nation as a whole property tax continues to be far more stable than PIT and sales. (Some state-specific exceptions)



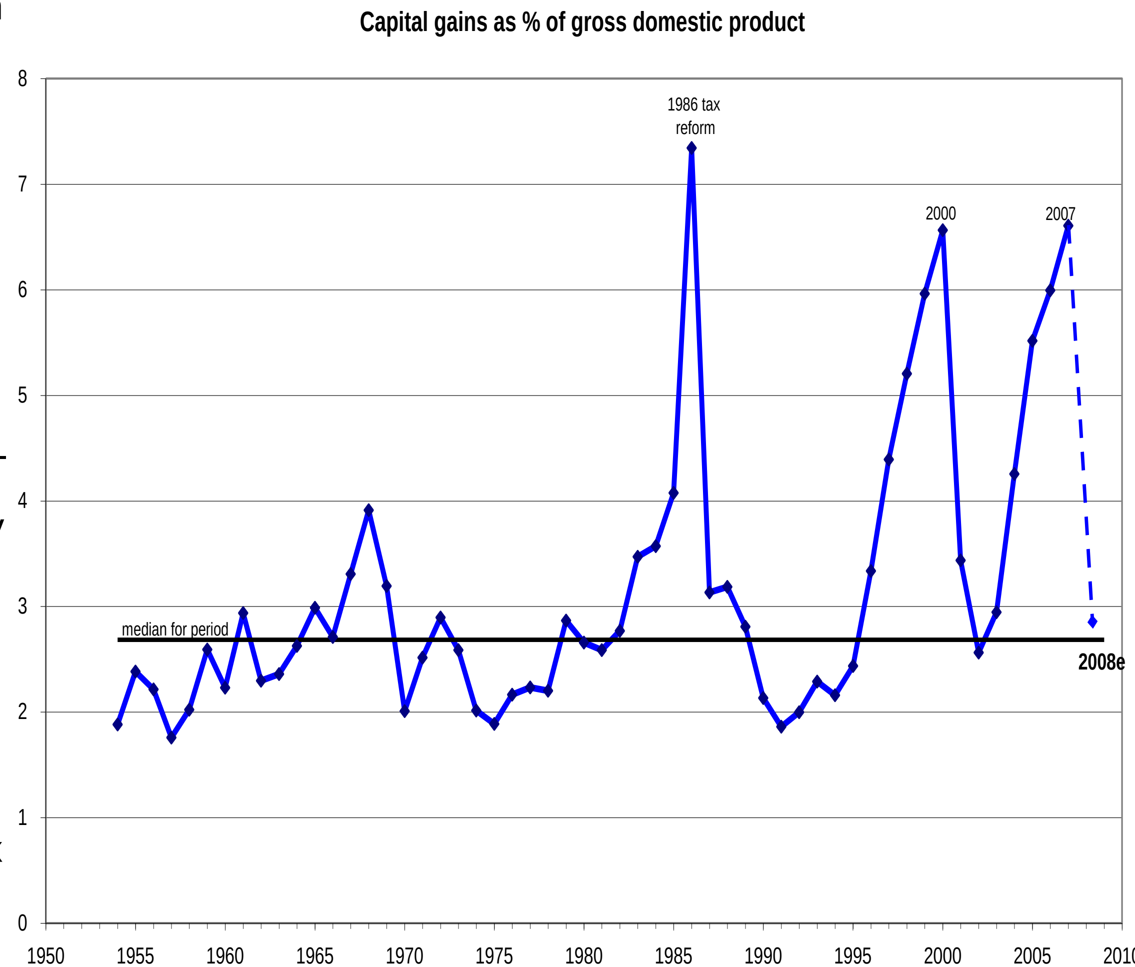
Sources: U.S. Census Bureau (tax revenue) and Bureau of Economic Analysis (GDP price index).
Notes: (1) 4-quarter average of percent change in real tax revenue; (2) No adjustments for legislative changes.

Recent state tax collections

- Jan-Mar 2009 down 11.6% vs. year ago, sharpest decline in 50+ years of recorded data
- Apr-Jun even worse: Tax revenue down 16.4%
- July-Sep Down 10.9%; down in 48 states; double-digits in 22.
  - PIT -11.8%
  - CIT -22.6%
  - Sales tax -18.9%
- Oct-Nov: prelim data for 40 states show PIT down 6.7% (down in 30 of 33 PIT-reporting states), sales tax down 5.2% (down in 29/36 states), and CIT down 18.0% (down in 20/36)

Capital gains – what will happen to 2009+ gains?

- Gains fell 46% in 2001 and again in 2002 (23%)
- Fell significantly (50+%?) in 2008
- Stock market is up 17% since start of year, but YTD average value for 2009 is still about 29% below average for 2008
- Estimated payments fell 31% in April (median); also fell in June; Jul-Sep payment down 28.5%; Fed non-withheld tax down substantially so far in early Jan
- Many forecasters expect 2nd cap gains decline in 2009 (NY -35.1%, CA -15%)
- Additional uncertainty about gains in 2010 and 2011 due to federal tax law changes (NY +58.7%, then -46.7% in 2011; CA+40% in 2010)

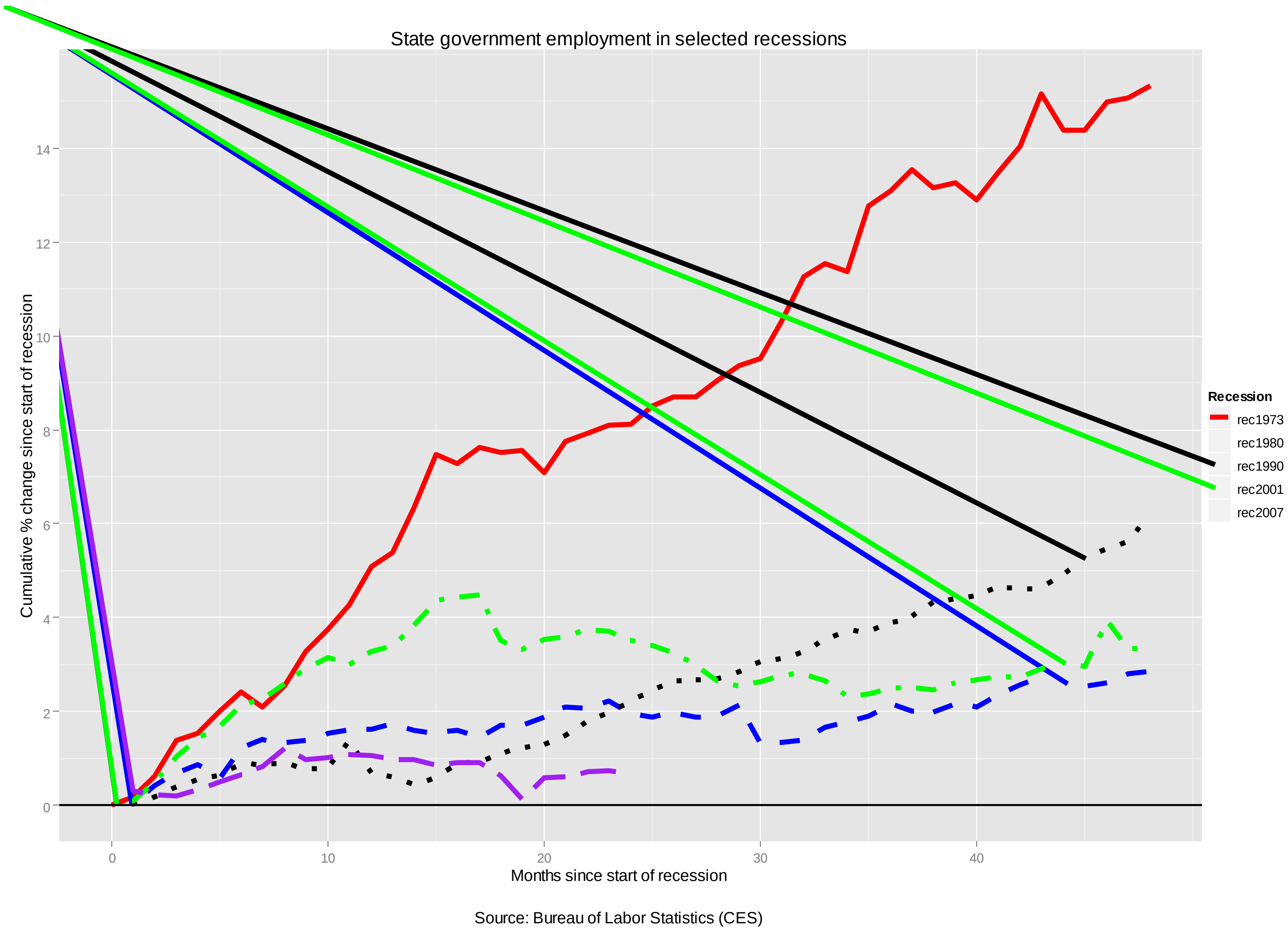


Sources: (1) Capital gains: 1954-1998: Table capgain1-2001.pdf from IRS Statistics of Income web site (www.irs.gov/taxstats); 1999-2007 07in14ar.xls and similar SOI files; (2) Gross domestic product from U.S. Bureau of Economic Analysis

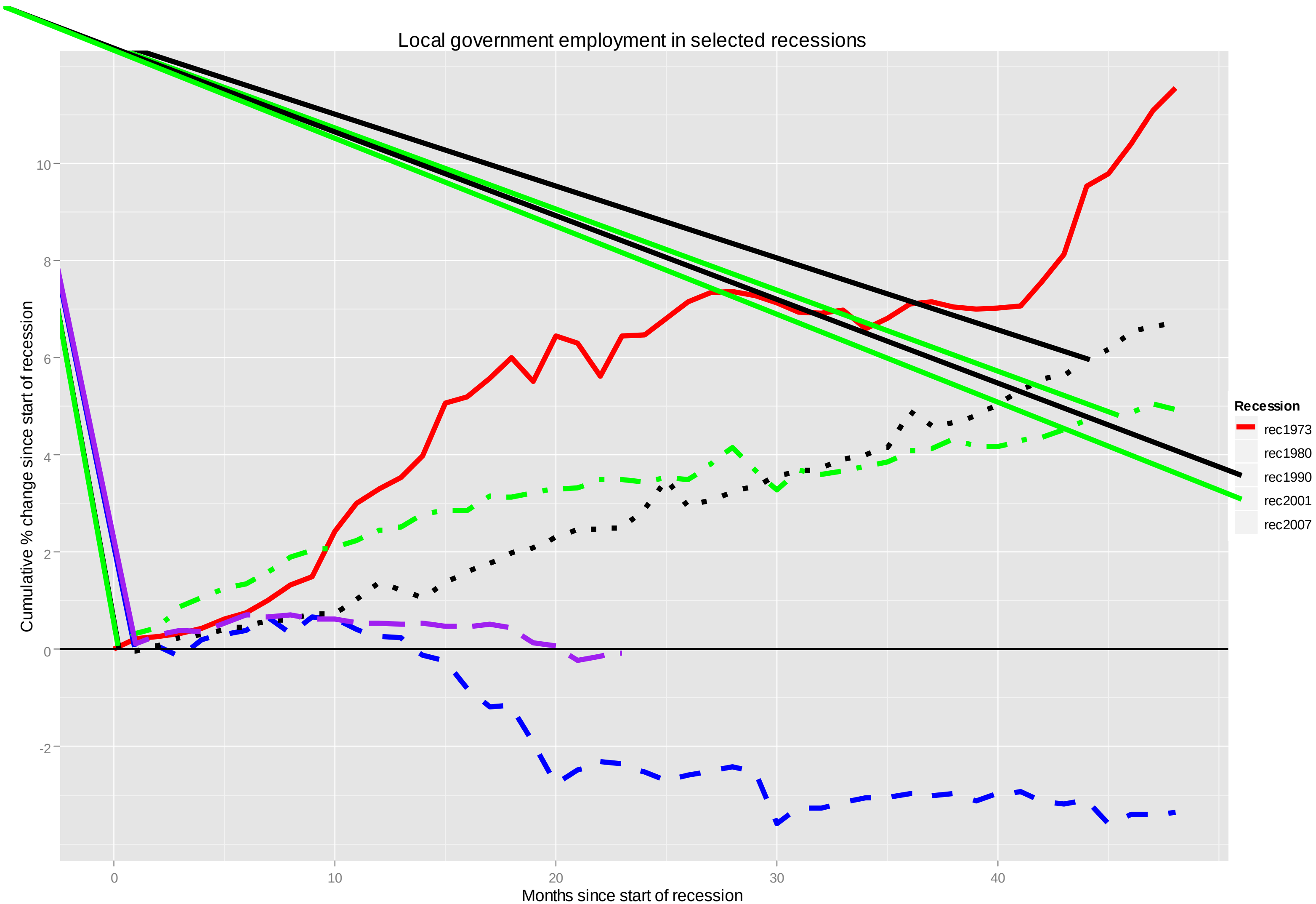
Early policy responses

- Tax and fee increases for FY 2010 of $23.9b; $10.7b was PIT.
- Fund balances drawn down 8.6% of expenditures year-end FY 2008 to 4.8% year-end 2009 (and lower after certain adjustments)
- Widespread reported midyear budget cuts in 2009, proposed cuts for FY 2010
- Employee furloughs widespread

State government employment more restrained than recent recessions



Local government employment more restrained than most recent recessions



Source: Bureau of Labor Statistics (CES)

Looking ahead

- Shortfalls still emerging in 2010
- CBPP estimates $97b of budget gaps for 2011, virtually every state
- Additional considerations
  - Loss of federal stimulus
  - OPEB and pensions
  - Medicaid – demographic & cost pressures
  - Tax structures
- On the other hand, we are nearing the point at which revenue will start to grow y-o-y – albeit will be far below prior peak

TABLE 3: STATES WITH PROJECTED FY2011 GAPS

	FY11 Shortfall (States with Biennial 09-11 Budgets)	Current FY11 Gap Projected?	Total Shortfall Amount	Total Shortfall Percent of FY10 Budget
Alabama	0	Yes	DK	
Alaska	0	$677 million	$677 million	15.3%
Arizona	0	$2.5 billion	$2.5 billion	25.7%
California	0	$14.4 billion	$14.4 billion	14.6%
Colorado	0	$1.8 billion	$1.8 billion	24.1%
Connecticut	$4.4 billion	$287 million	$4.7 billion	26.7%
Florida	0	$4.7 billion	$4.7 billion	18.1%
Georgia	0	$1.0 billion	$1.0 billion	5.8%
Hawaii	0	$529 million	$529 million	10.3%
Illinois	0	$12.8 billion	$12.8 billion	34.3%
Indiana	0	$316 million	$316 million	2.2%
Iowa	0	$1.1 billion	$1.1 billion	18.1%
Kansas	0	$264 million	$264 million	4.3%
Kentucky	0	$598 million	$598 million	6.2%
Maine*	$765 million	$174 million	$940 million	31.4%
Maryland	0	$2.0 billion	$2.0 billion	14.5%
Massachusetts	0	$2.2 billion	$2.2 billion	8.0%
Michigan	0	$2.7 billion	$2.7 billion	11.9%
Minnesota	$2.8 billion	$1.2 billion	$4.0 billion	26.4%
Mississippi	0	$716 million	$716 million	14.4%
Nebraska	$150 million	$179 million	$329 million	9.3%
Nevada	$1.3 billion	0	$1.3 billion	43.4%
New Hampshire	$250 million	0	$250 million	16.2%
New Jersey	0	$8.0 billion	$8.0 billion	27.2%
New Mexico	0	$318 million	$318 million	5.8%
New York	0	$6.8 billion	$6.8 billion	12.3%
North Carolina	$4.4 billion	0	$4.4 billion	21.0%
Ohio	$2.5 billion	$637 million	$3.2 billion	11.8%
Oklahoma	0	$725 million	$725 million	12.7%
Oregon	Yes	0		See Table 2
Pennsylvania	0	$4.1 billion	$4.1 billion	15.4%
Rhode Island	0	$197 million	$197 million	6.4%
South Carolina	0	$450 million	$450 million	7.8%
Tennessee	0	$1.0 billion	$1.0 billion	9.6%
Utah	0	$700 million	$700 million	13.9%
Vermont	0	$182 million	$182 million	16.3%
Virginia	0	$1.3 billion	$1.3 billion	8.0%
Washington*	$2.1 billion	Yes*	$2.1 billion	13.3%
West Virginia	0	$100 million	$100 million	2.6%
Wisconsin	$3.4 billion	0	$3.4 billion	24.6%
Wyoming	0	$147 million	$147 million	8.0%
States Total	**$22.0 billion**	**$74.8 billion**	**$96.9 billion**	**16.1%**

Note: Maine and Washington have two-year budgets. See Table 2 for gap information. An entry of "DK" means that an estimate of the size of the projected gap in that state is not yet available.

Table Source: McNichol, Elizabeth and Johnson, Nicholas, *Recession Continues to Batter State Budgets*, Center on Budget and Policy Priorities, December 18, 2009

Why won't economic recovery feel like fiscal recovery?

- Sales taxes & withholding nearly contemporaneous with underlying economic activity so payment lags for these major sources are NOT the source of a fiscal lag
- Employment and wages can lag GDP recovery (last 3 recessions, real wages took 3 to 16 quarters longer than GDP to reattain prior peak); so can non-wage income
- Capital gains, after a crash, can recover sharply and still be far below their prior peak. And some (not all) tax payments on capital gains and other nonwage income can lag the income – e.g., in April-June 2011 taxpayers will settle up on gains earned in 2010
- Pension contributions generally increasing as economy is recovering, creating fiscal pressure
- ARRA money goes away
- Fiscal lag is partly perception and policy choice - spending rarely declines along with tax revenue, and states patch the gaps. After tax revenue resumes growth, can take years to reach prior peak. Growing revenue can be far below levels needed to support spending commitments.

Fiscal and policy implications

- State fiscal troubles far from over. In "normal" recovery tax revenue can take 3-5 years to reattain prior peak. In slow-growth economic recovery, fiscal recovery will take longer still.
- States tend to take easiest actions first, harder actions later. 1980-82 and 1990 recessions saw 3 consecutive years of tax increases, including increases as recovery was well underway. Govs' budgets for 2010-11 still being unveiled but many will have tax increases
- Local governments feel recession with a lag, as states cut aid
- Gimmicks will continue to be attractive. 37 governors and 46 legislatures up for election in 2010. Suggests 2010-11 solutions may not be of high quality. Implications for 2011-12…

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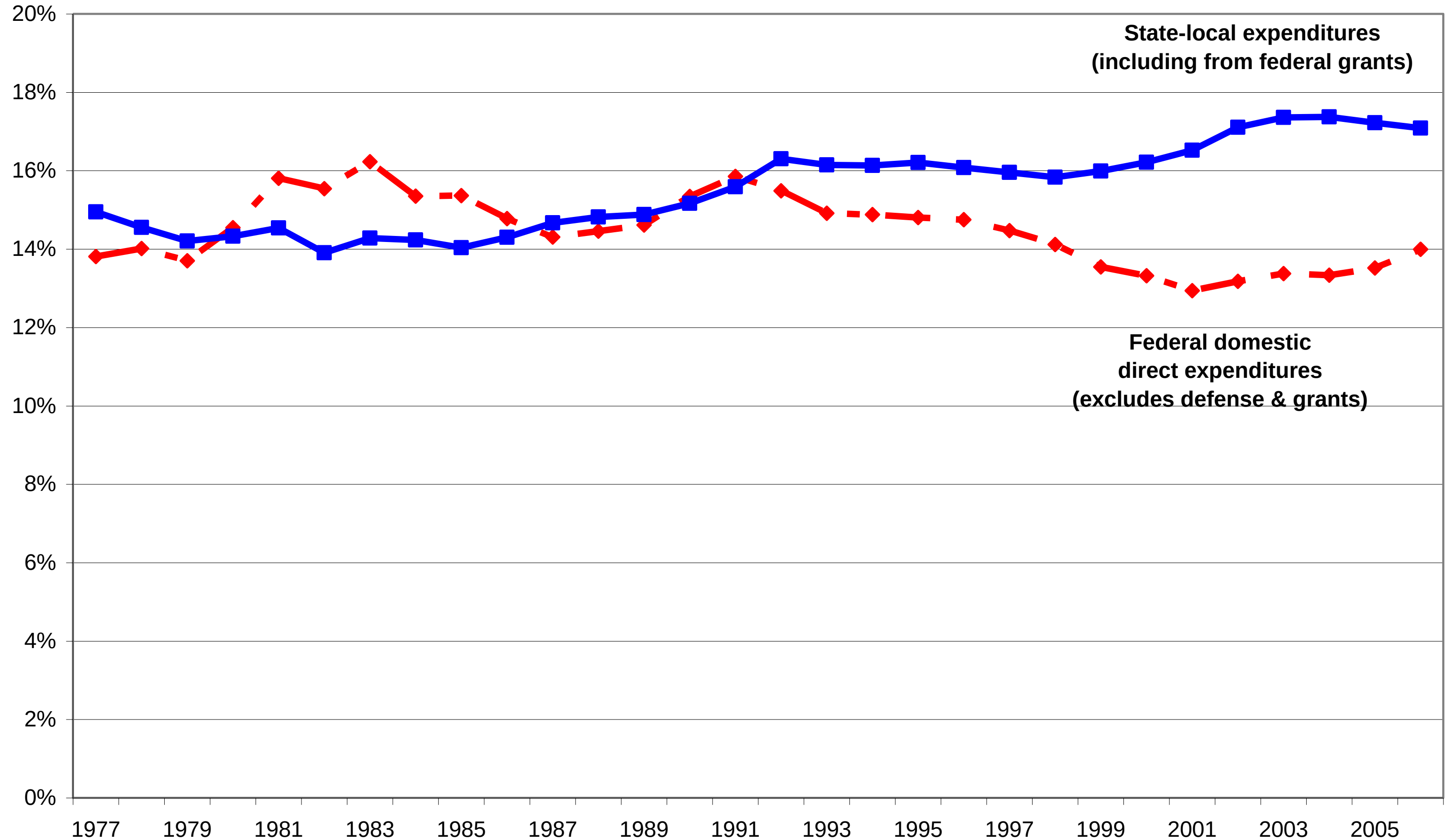
Appendix

State & local governments' role as implementers of domestic policy has grown. Larger than feds, and now about 55% of domestic spending

Government Direct Domestic General Expenditures as % of GDP
(Grants counted in government that finally spends them)



Sources: Federal Budget for Fiscal Year 2010 (Historical Table 3.1 outlays in total and by category; Table 12.1 grants)
Census Bureau Government Finance data (direct general expenditures)

Feds: Revenue oriented toward income taxes
States: Income and sales (with significant exceptions!)
Locals: Property tax and non-tax revenue
- Great variation across states -

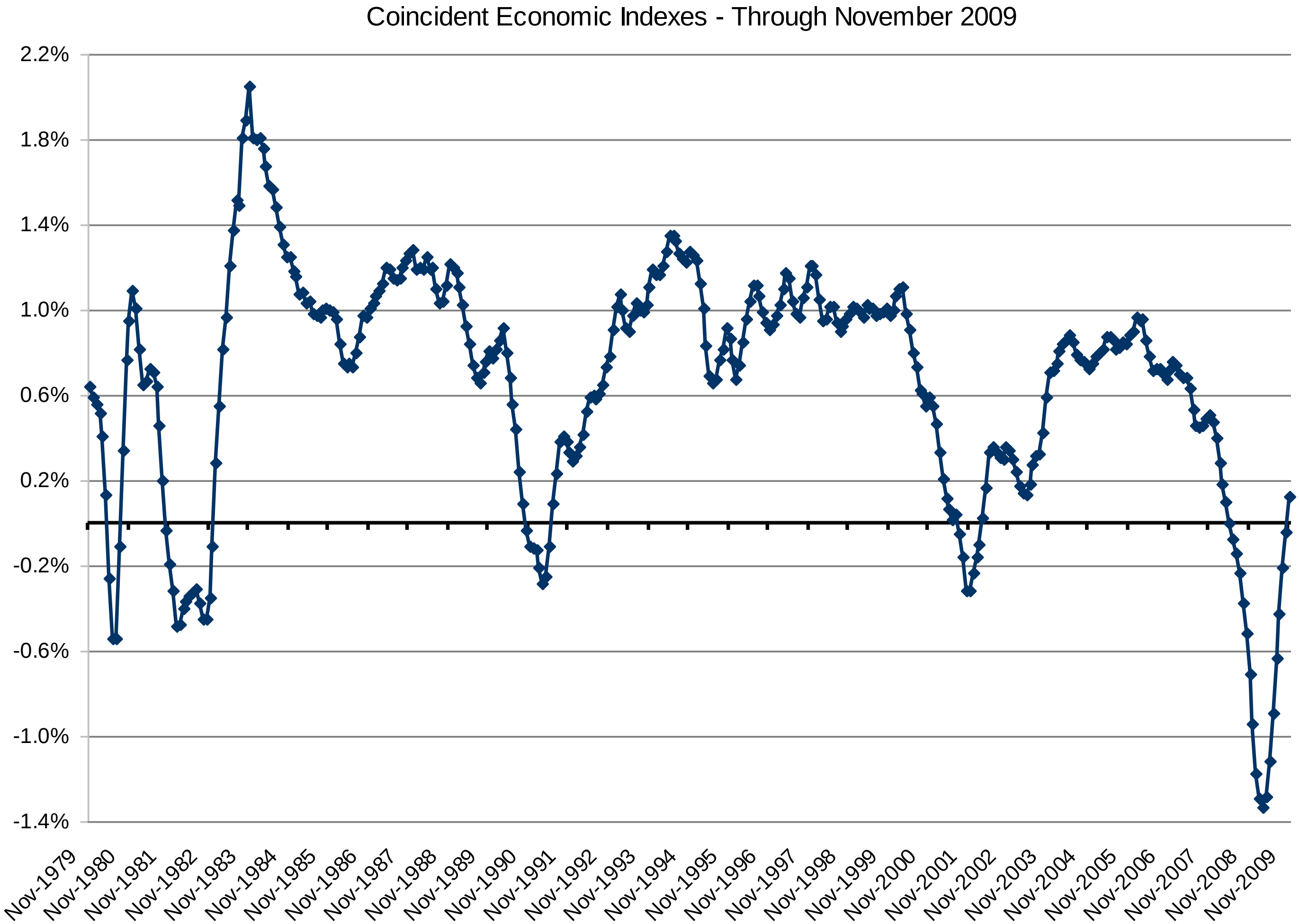
Government revenue in fiscal year 2006

	Revenue in $ billions			Revenue components as % of own-source total		
	Federal	**State**	**Local**	**Federal**	**State**	**Local**
General revenue	$2,399.4	$1,391.1	$1,241.4	100.0	143.2	162.2
Intergovernmental revenue	n/a	419.6	476.0		43.2	62.2
From federal government	n/a	398.2	54.7		41.0	7.1
From state government	n/a	n/a	421.3		n/a	55.0
Own-source revenue	2,399.4	971.5	765.4	100.0	100.0	100.0
Nontax	101.8	255.5	282.7	4.2	26.3	36.9
Total Taxes	2,297.6	716.0	482.7	95.8	73.7	63.1
Individual income tax	1,846.1	245.6	22.7	76.9	25.3	3.0
General sales tax	0.0	229.6	55.5	0.0	23.6	7.2
Property tax	0.0	12.3	346.3	0.0	1.3	45.2
Corporate income tax	350.0	47.5	5.6	14.6	4.9	0.7
Other taxes	101.5	180.9	52.6	4.2	18.6	6.9

Sources: Federal - U.S. Department of the Treasury Financial Statements for 2006, re-categorized by Rockefeller Institute; State and local - U.S. Bureau of the Census

Notes: Federal individual income tax includes FICA and other payroll taxes. Federal, state, and local taxes exclude unemployment insurance taxes.

Percent change in state economies versus 3 months earlier
- Signs of improvement -



Source: Federal Reserve Bank of Philadelphia.
Note: Percent change is for the median state.

Jul-Sep tax revenue 11%; down in 48 states

Quarterly Tax Revenue by Major Tax

July-September, 2008 to 2009, Percent Change

	PIT	CIT	Sales	Total
United States	**(11.8)**	**(22.6)**	**(8.9)**	**(10.9)**
New England	**(12.6)**	**(21.9)**	**(2.9)**	**(8.1)**
Connecticut	(12.0)	(39.9)	(9.2)	(11.8)
Maine	(11.8)	2.4	(9.9)	(0.3)
Massachusetts	(13.1)	(24.6)	2.5	(10.0)
New Hampshire	(39.0)	(2.0)	NA	1.4
Rhode Island	(6.7)	(47.2)	(5.4)	1.7
Vermont	(13.7)	(25.0)	(6.5)	(6.9)
Mid-Atlantic	**(8.3)**	**(22.7)**	**(7.0)**	**(8.6)**
Delaware	(10.6)	(67.2)	NA	(17.5)
Maryland	(10.9)	(38.4)	(8.8)	(7.9)
New Jersey	(8.9)	(20.5)	(4.7)	(9.6)
New York	(7.4)	(21.0)	(8.2)	(9.2)
Pennsylvania	(8.9)	(11.1)	(7.2)	(6.2)
Great Lakes	**(12.6)**	**(26.8)**	**(9.9)**	**(10.3)**
Illinois	(11.7)	(27.6)	(11.6)	(12.5)
Indiana	(19.9)	(42.4)	(11.4)	(16.5)
Michigan	(11.6)	(23.3)	(9.2)	(7.6)
Ohio	(13.8)	(59.2)	(8.5)	(8.8)
Wisconsin	(8.1)	9.2	(8.7)	(7.5)
Plains	**(10.0)**	**(28.6)**	**(7.1)**	**(8.7)**
Iowa	(5.7)	(67.3)	0.0	(9.1)
Kansas	(10.2)	(22.7)	(5.8)	(10.4)
Minnesota	(11.8)	(22.4)	(9.3)	(7.0)
Missouri	(10.7)	(15.5)	(6.0)	(7.2)
Nebraska	(7.1)	(31.9)	(16.6)	(12.0)
North Dakota	(6.3)	(58.2)	(9.8)	(19.1)
South Dakota	NA	(21.5)	(3.8)	(2.5)
Southeast	**(10.3)**	**(7.0)**	**(8.9)**	**(7.5)**
Alabama	(26.7)	(3.9)	(13.0)	(15.6)
Arkansas	(6.9)	(21.5)	(9.7)	(4.3)
Florida	NA	(11.1)	(8.2)	(6.1)
Georgia	(14.6)	(10.5)	(14.7)	(13.9)
Kentucky	(7.1)	(15.6)	(7.7)	(4.7)
Louisiana	(0.7)	(5.6)	(16.5)	(12.1)
Mississippi	(12.2)	(19.1)	(12.5)	(12.1)
North Carolina	(6.3)	(0.5)	(2.7)	(3.3)
South Carolina	(13.0)	41.4	1.7	(5.8)
Tennessee	(29.5)	8.2	(9.5)	(5.7)
Virginia	(10.2)	(7.7)	(6.4)	(5.3)
West Virginia	(6.7)	(7.2)	(4.6)	(6.9)
Southwest	**(18.5)**	**(58.3)**	**(12.6)**	**(19.4)**
Arizona	(14.0)	(38.4)	(14.1)	(7.7)
New Mexico	(46.1)	(98.4)	(9.6)	(40.0)
Oklahoma	(15.3)	(52.1)	(14.8)	(25.6)
Texas	NA	NA	(12.2)	(19.1)
Rocky Mountain	**(11.7)**	**(49.5)**	**(15.9)**	**(15.3)**
Colorado	(14.5)	(24.6)	(11.5)	(13.6)
Idaho	(4.9)	(39.1)	(13.4)	(8.9)
Montana	(14.4)	(61.5)	NA	(22.8)
Utah	(7.9)	(76.0)	(20.0)	(18.0)
Wyoming	NA	NA	(23.1)	(18.8)
Far West	**(16.0)**	**(22.3)**	**(7.5)**	**(13.3)**
Alaska	NA	(74.1)	NA	(64.5)
California	(16.1)	(13.3)	(5.8)	(9.2)
Hawaii	(6.8)	(56.2)	(12.8)	(10.1)
Nevada	NA	NA	(14.4)	(8.9)
Oregon	(17.4)	(26.1)	NA	(15.1)
Washington	NA	NA	(9.2)	(6.1)

Source: U.S. Census Bureau.

Wages and consumption of goods – important to state revenue – have recovered more slowly than GDP in most recessions

Real per-capita GDP, wages, and goods consumption in recent recessions

Recession beginning in:	# quarters after GDP recovery began before prior peak was reattained			% decline, peak quarter to trough quarter		
	GDP	Wages	Goods	GDP	Wages	Goods
1948	1	2	0	(3.2)	(4.1)	(1.0)
1953	3	4	2	(3.2)	(4.2)	(2.0)
1957	3	4	4	(4.5)	(5.3)	(3.9)
1960	2	3	7	(2.0)	(2.1)	(3.8)
1969	1	4	1	(1.4)	(2.1)	(2.2)
1973	4	10	4	(4.3)	(6.7)	(4.4)
1980	3	5	8	(3.3)	(3.6)	(7.3)
1990	6	13	14	(2.0)	(3.8)	(5.5)
2001	1	17	1	(0.1)	(3.9)	(0.3)
2007				(4.9)	(7.1)	(10.1)

Source: Bureau of Economic Analysis. Real wages and goods consumption are nominal amounts deflated by personal consumption expenditure price index.

Note: Table treats April-June 2009 as trough quarter in current recession, but actual trough may occur later

Hard to catch up with a crisis: Three consecutive years of shortfalls in last 2 recessions. Now?

State tax revenue shortfalls in periods near recessions

Adopted-budget projections compared with actual results (or, for 2009, most-recent estimates)

1991 recession period

	Shortfall in $ millions				Shortfall as % of tax source			
Fiscal year	**Sales tax**	**Income tax**	**Corporate tax**	**Sum of major taxes**	**Sales tax**	**Income tax**	**Corporate tax**	**Sum of major taxes**
1989	557	2,769	n/a	3,326	0.6%	3.2%	n/a	1.9%
1990	(1,100)	(1,027)	(3,148)	(5,275)	-1.2%	-1.1%	-12.6%	-2.5%
1991	(4,502)	(4,803)	(3,269)	(12,574)	-4.6%	-4.6%	-13.4%	-5.6%
1992	(2,408)	(4,847)	(1,125)	(8,380)	-2.3%	-4.4%	-4.9%	-3.5%
1990-1992 Sum	(8,010)	(10,677)	(7,542)	(26,229)	-2.7%	-3.4%	-10.4%	-3.9%
1994	1,492	(764)	1,178	1,906	1.4%	-0.7%	4.8%	0.8%

2001 recession period

Fiscal year	**Sales tax**	**Income tax**	**Corporate tax**	**Sum of major taxes**	**Sales tax**	**Income tax**	**Corporate tax**	**Sum of major taxes**
2000	4,756	7,020	615	12,391	2.7%	3.9%	1.9%	3.2%
2001	542	944	(1,759)	(273)	0.4%	0.6%	-7.2%	-0.1%
2002	(5,450)	(27,504)	(6,177)	(39,131)	-3.3%	-12.8%	-21.3%	-9.5%
2003	(5,866)	(19,285)	(1,135)	(26,286)	-3.4%	-9.7%	-4.1%	-6.6%
2001-2003 Sum	(10,774)	(45,845)	(9,071)	(65,690)	-2.3%	-8.0%	-11.2%	-5.8%
2004	877	3,210	2,090	6,177	0.5%	1.7%	7.7%	1.6%

2007 recession period

Fiscal year	**Sales tax**	**Income tax**	**Corporate tax**	**Sum of major taxes**	**Sales tax**	**Income tax**	**Corporate tax**	**Sum of major taxes**
2007	730	10,046	5,916	16,692	0.3%	4.0%	12.6%	3.3%
2008	(3,638)	5,714	(1,282)	794	-1.7%	2.1%	-2.5%	0.1%
2009	(12,304)	(26,432)	(9,096)	(47,832)	-5.6%	-9.3%	-17.4%	-8.6%

NOTES: (1) FY 2009 based on spring responses, before shortfalls in income tax returns and sharp deterioration in sales tax, (2) **Actual shortfalls for FY 2009 will be much larger than the numbers shown above** (reported by NASBO in Spring 2009), (3) FY 2001 does not include California

Source: NASBO/NGA Fiscal Survey of the States, fall of relevant year for prior recessions; spring 2009 for 2007 current recession

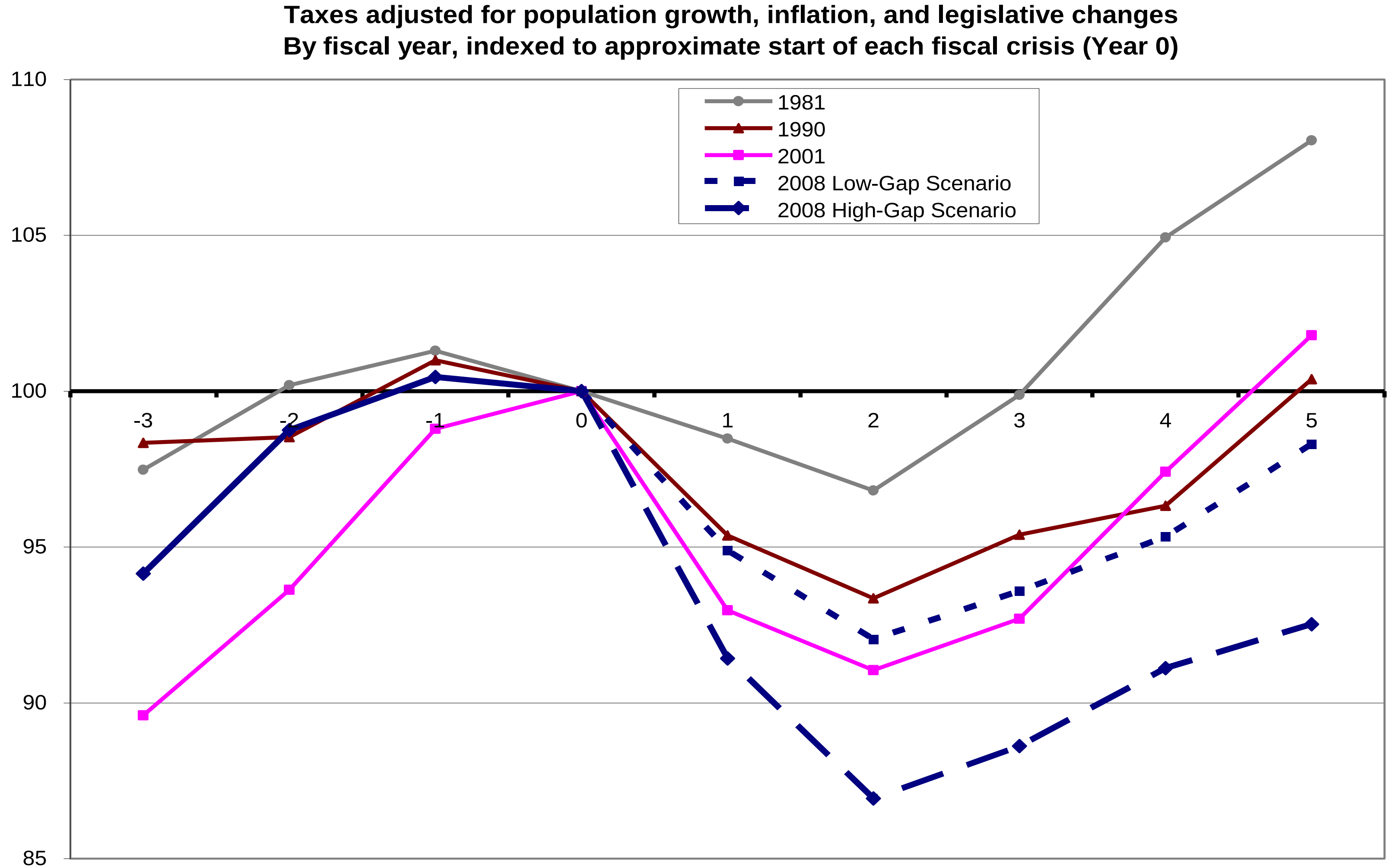
Timing of policy response to the 2001 crisis

Timing of state government response to the 2001 fiscal crisis

	Indicators of the magnitude of the crisis		Responses as % of tax revenue (Positive numbers reduce the budget gap)			What happened to total spending?
Fiscal year	Real per-capita tax revenue growth	Revenue shortfall (income, sales, and corporate taxes)	Use of fund balance	Midyear budget cuts	Tax and revenue enactments	Growth in real per-capita spending financed from own sources
2001	0.1%	-0.1%	0.8%	0.3%	-1.0%	3.4%
2002	-7.0%	-9.5%	4.8%	2.6%	0.1%	2.0%
2003	-0.6%	-6.6%	0.3%	1.5%	1.5%	0.3%
2004	3.6%	1.6%	-1.9%	0.4%	1.6%	-2.2%
2005	5.3%	4.2%	-2.9%	0.1%	0.5%	2.7%

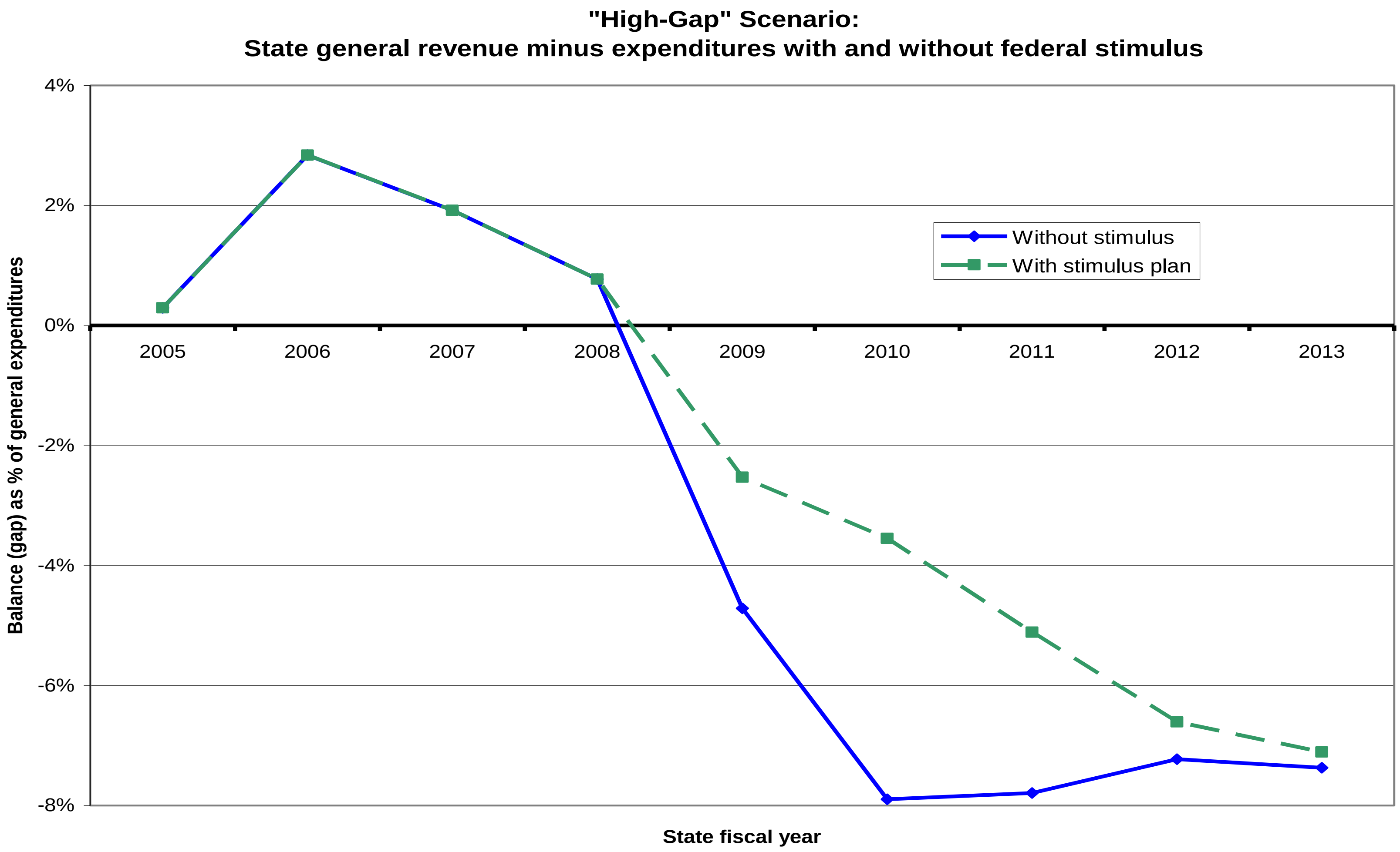
Sources: Rockefeller Institute analsis of (1) data on fund balances, midyear budget cuts, and tax and revenue enactments from NASBO/NGA Fall Survey of the States, and (2) Tax and expenditure data from the Census Bureau.

Taxes can take 3-5 or more years to re-attain prior peak (absent tax increases)



Sources: Tax revenue (Census Bureau and Rockefeller Institute estimates), Inflation (BEA GDP price index), Legislative changes (NGA/NASBO Fiscal Survey of States Fall 2008)

The cliff: Baseline gaps of >$100b re-emerge under "high-gap" assumptions (absent recurring budget actions)



Historically, states face budget gaps and raise taxes well after recovery is underway

Enacted tax changes as % of tax revenue, four fiscal crises

Recession(s) of: Jan 1980 to Nov 1982		***Recession of: Jul 1990 to Mar 1991***		***Recession of: Mar 2001 to Nov 2001***		***Recession of: Dec 2007 to ????***	
1980	-1.4%	**1989**	0.3%	**2001**	-1.0%	**2009**	0.2%
1981	0.3%	**1990**	1.7%	**2002**	0.1%	**2010**	3.4%
1982	2.4%	**1991**	3.4%	**2003**	1.5%	**2011**	?
1983	2.1%	**1992**	4.7%	**2004**	1.7%	**2012**	?
1984	5.4%	**1993**	0.9%	**2005**	0.5%	**2013**	?

} means economic recovery underway

Notes: (1) Fiscal year is year in which change took effect, not year of enactment; (2) positive numbers are tax increases, negative numbers are tax cuts; (3) In almost all states, fiscal year ends on June 30 of year shown above; (4) Recession dates are month of start to month of end; (5) Jan 1980 to Nov 1982 recession period is combined period of two consecutive recessions

Sources: NGA/NASBO Fall 2009 Fiscal Survey of the States (tax change estimates); Census Bureau (tax collections); Rockefeller Institute (estimated 2009 and 2010 collections); National Bureau of Economic Research (recession dates)

State-local government employment down, year over year, in 29 states (reductions are far smaller than in private sector)

State-local government employment % change
October-December 2009 quarter versus year ago

Arizona	(5.2)	Indiana	(0.3)
Hawaii	(4.9)	Washington	(0.2)
Nevada	(4.9)	Tennessee	(0.1)
Massachusetts	(2.5)	Maryland	(0.1)
Rhode Island	(2.4)	Louisiana	(0.0)
Idaho	(2.4)	Illinois	0.1
Connecticut	(2.3)	Missouri	0.3
Maine	(2.2)	Alabama	0.4
Michigan	(2.1)	Pennsylvania	0.4
California	(2.0)	Delaware	0.5
Georgia	(1.9)	Utah	0.5
Kentucky	(1.9)	West Virginia	0.5
Kansas	(1.1)	Montana	0.7
Minnesota	(1.0)	Wyoming	0.7
New York	(0.9)	Colorado	1.1
Oregon	(0.9)	New Mexico	1.1
Florida	(0.7)	Mississippi	1.3
Iowa	(0.7)	Alaska	1.4
South Carolina	(0.7)	Oklahoma	1.4
Virginia	(0.5)	South Dakota	1.9
Wisconsin	(0.4)	North Carolina	2.0
New Hampshire	(0.4)	North Dakota	2.2
New Jersey	(0.4)	Arkansas	2.3
Vermont	(0.4)	Nebraska	2.3
Ohio	(0.4)	Texas	5.2

Source: Bureau of Labor Statistics, Current Employment Statistics, Not seasonally adjusted

State "health" spending about 1/3 of total budget, 1/4 of own funds. Medicaid 60% of own-funds health, state employees about 14%.

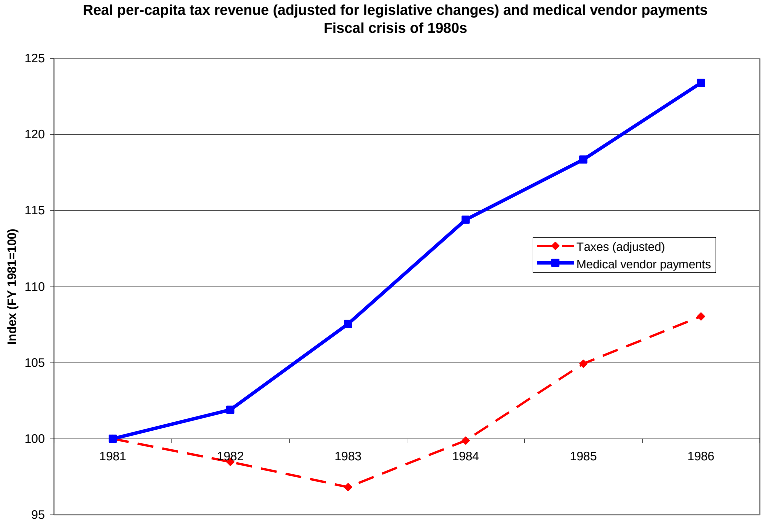
State government health expenditures in 2002-03

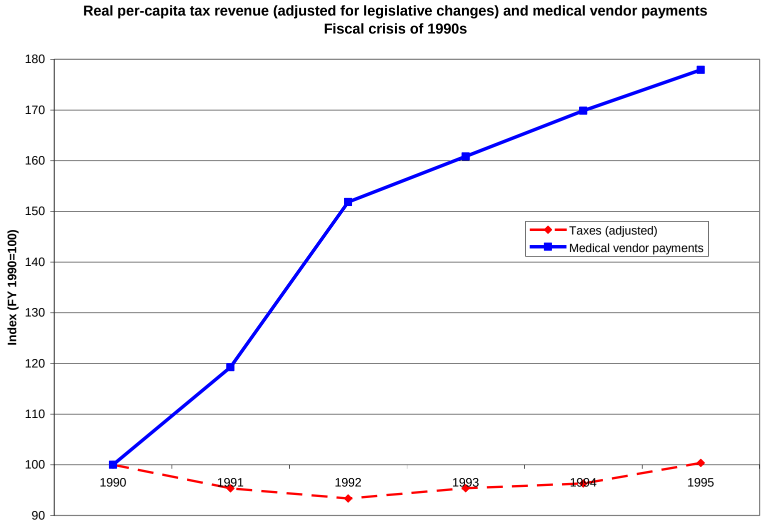
	$ billions			*As % of total*		
	State funds	Federal & other funds	Total	State funds	Federal & other funds	Total
Total State Health Expenditures	$175.4	$182.4	$357.8	100.0%	100.0%	100.0%
Medicaid	$104.7	$150.4	$255.0	59.7%	82.4%	71.3%
State Employees & Retirees	$24.0	$5.4	$29.4	13.7%	3.0%	8.2%
Community-Based Services	$13.3	$3.8	$17.1	7.6%	2.1%	4.8%
Population Health Services	$10.0	$9.2	$19.2	5.7%	5.1%	5.4%
State Facility–Based Services	$8.4	$1.0	$9.4	4.8%	0.5%	2.6%
Public Health Services	$5.0	$5.6	$10.7	2.9%	3.1%	3.0%
Corrections	$4.3	$0.0	$4.3	2.5%	0.0%	1.2%
Higher Education	$2.5	$2.8	$5.3	1.4%	1.6%	1.5%
SCHIP	$1.9	$4.0	$5.9	1.1%	2.2%	1.7%
All other	$1.2	$0.2	$1.3	0.7%	0.1%	0.4%
Total State Expenditures	$775.5	$361.2	$1,136.7			
Health as % of total expenditures	22.6%	50.5%	31.5%			

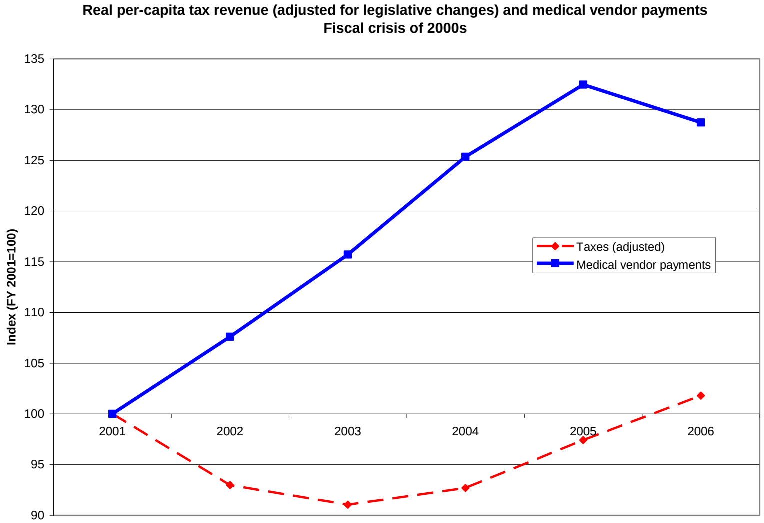
Source: Millbank Memorial Fund, NASBO, Reforming States Group, 2002-2003 State Health Expenditure Report

Medicaid and the business cycle (1)

- Tax revenue falls in recessions (in current one, real per capita tax revenue down over 10%)
- But Medicaid spending pressures continue – and in fact rise, with a lag.







Medicaid and the business cycle (2)

- Sustained rise in unemployment leads to fewer workers covered by employer-sponsored insurance, increase in Medicaid/SCHIP enrollment, and increase in costs of uncompensated care for uninsured adults
- Holahan & Garrett estimate unemployment rise from 4.6% (2007) to 10% would lead to <u>3.4m more children enrolled in Medicaid/SCHIP and 2.0m more adults</u>; 2009 annual costs of $7.4b and $11.2b respectively, $18.6b total. <u>State share of this is about $8b annually</u>.
- In addition, they estimate 5.8m more uninsured adults, and <u>increase in uncompensated care costs of $7.2b</u> (federal/state/other split not clear).
- Total, all levels of gov't, about $25.8b annual rate.

Holahan, John and Bowen Garrett, *Rising Unemployment, Medicaid and the Uninsured*, The Urban Institute, For Henry J. Kaiser Family Foundation, January 2009.

Medicaid and the business cycle (3)

- Lessons:
  - Hard to finance spending that has stable/rising demand/cost-pressures in recessions when you rely on revenue sources that are volatile and fall significantly in recessions
  - Harder still to finance this spending if new responsibilities are added to existing responsibilities
  - Even harder still (from budget-balancing perspective) if new responsibilities come with maintenance-of-effort requirements limiting flexibility to cut in hard times. Balanced budget requirement meets health care reform.

Health care and longer-term pre-reform outlook (1)

- Sisko et al.:
  - Project average-annual growth rate for national health expenditures of 6.2% over next decade, vs. GDP growth of 4.1%
  - And project AAGR for state-local gov't health expenditures of 6.9% (8.5% Medicaid, 4.9% other)
  - Growth accelerates toward end of decade as population ages
- GAO estimates that (absent policy changes) state & local gov'ts will face structural budget gaps that rise from 1+% of GDP in 2010 to around 2% by 2020, 2.5% by 2030, and 3.5% by 2040. (2009 state cyclical gaps were around 1.3%) Gaps driven by health care:

  > Rapidly rising health care costs are not simply a federal budget problem. Growth in health-related spending also drives the long-term fiscal challenges facing state and local governments. The magnitude of these pressures presents vexing long-term sustainability challenges for all levels of government. (GAO-09-210T)

Health care reform and state budgets (2)

- Lewin estimates House bill would save SLGs $24b and Senate bill save SLGs of $83b over 2010-2019:
  - Medicaid expansions under House bill cost states about $59b in large part because states would finance 10% of cost of newly eligible people. Under Senate bill, states would save $30b due to increase in federal matching rate for CHIP.
  - Health benefit costs for SLG workers would increase $61b under Senate bill, increase $20b under House bill, due to excise taxes on “Cadillac plans” (Senate only) and costs of covering uninsured workers or paying employer penalty
  - Other minor provisions relating to taxes ($2b cost to in Senate, $9b cost in House)
  - Savings to states of $113b (S) to $115b (H) for uncompensated care and other programs for uninsured, due to decline in number uninsured. These savings more than offset net cost increases of other provisions.

Health care reform and state budgets (3)

- Council of Economic Advisors analysis of health care reform proposals that were under discussion in September argued that:
  - States will receive considerable relief from the cost of uncompensated care and cost of providing non-Medicaid programs for uninsured above 133% FPL (or, if House billl, 150%)
  - And relief from the “hidden tax” on state employee health premiums (higher premiums needed to help finance cost of uncompensated care)
  - CEA appears to estimate these savings to be in the range of $11b to $17.5b annually
  - CEA argues these savings are several times larger than the state share of cost for coverage expansions

Health care reform and state budgets (4)

- But states remain worried:
  - Health care reform could lead many people currently eligible for Medicaid but not enrolled to enroll – big numbers, potentially big costs
  - Maintenance of effort provisions could limit flexibility
  - Concern that states that previously had been most generous with Medicaid will benefit least (or be harmed most)
  - Concern about “cliff” when ARRA FMAP extension runs out
  - Hard to know what secondary and tertiary effects there will be – e.g., insurance tax impacts if there is a successful public option; possibility of “bending the curve”

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