

Challenges in State-Local Expenditures

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What is in this presentation?

- How bad is the current situation?
- What do we spend money on?
- Long term expenditure pressures?
- What is the long term outlook?
- Are there solutions?

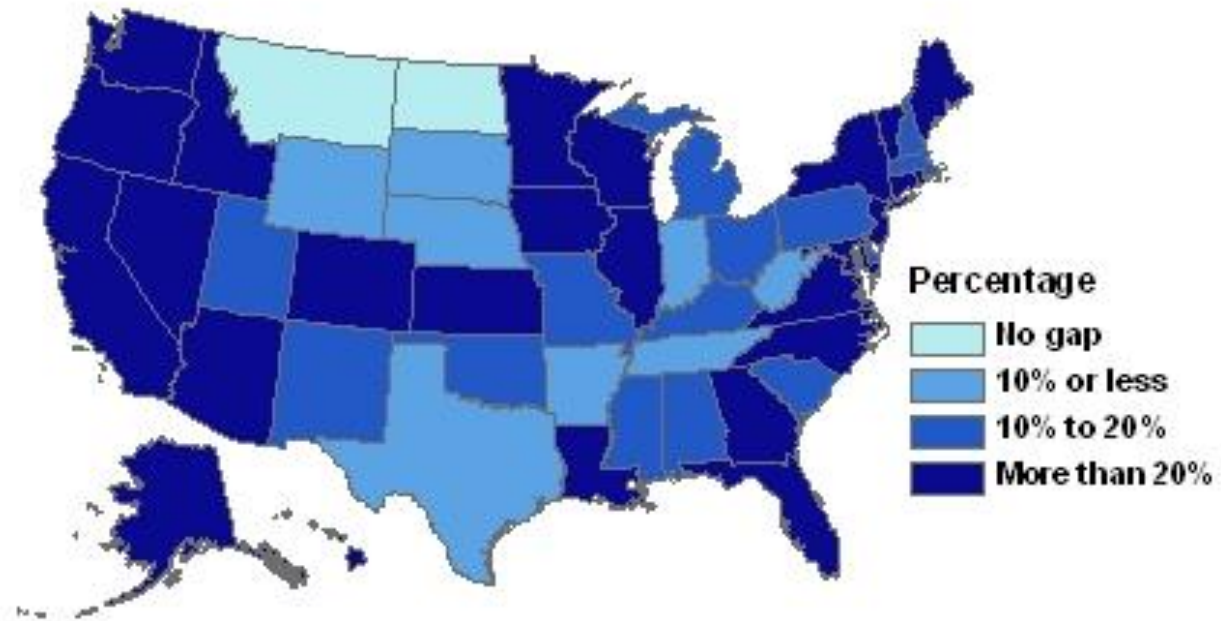
GAO Estimates Find Gap in State and Local Funds

- Report estimated state and local governments would have to raise taxes by 17% or cut spending 14% to keep operating budgets in balance through 2017
- This was before downturn
- Estimate of growth – largely due to rising health care costs
- Assume other funding areas decline as a percent of GDP
 - Not sure this is the case
 - Expect pressures from pensions, prisons, schools, infrastructure

Current budget problems expected to continue for next 4-5 years

- **The current state fiscal situation is dire, nearly unprecedented, at least in recent decades**
- **To date, states have reported a total estimated budget gap of \$382.8 billion (FY 2008 through FY 2012) (NCSL estimates – CBPP higher)**
- **Budget balancing in part through pushing payments into future**
- **What does this mean for long term spending?**

Budget Gap as a Percentage of General Fund Budget, 2010



Source: Center on Budget and Policy Priorities, "Recession Continues to Batter State Budgets; State Responses Could Slow Recovery," Elizabeth McNichol and Nicholas Johnson, October 20, 2009.

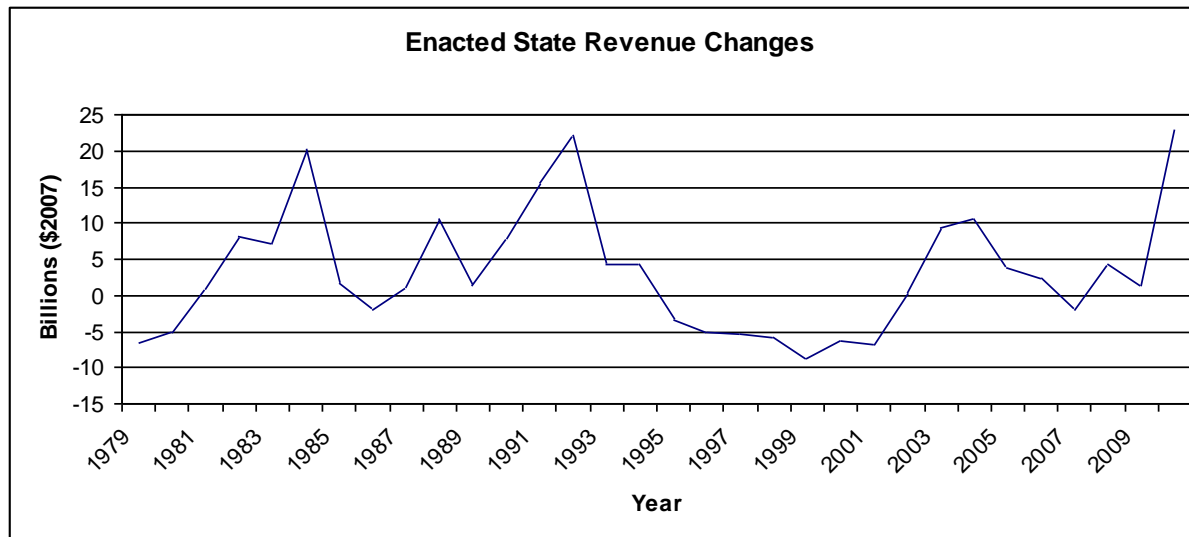
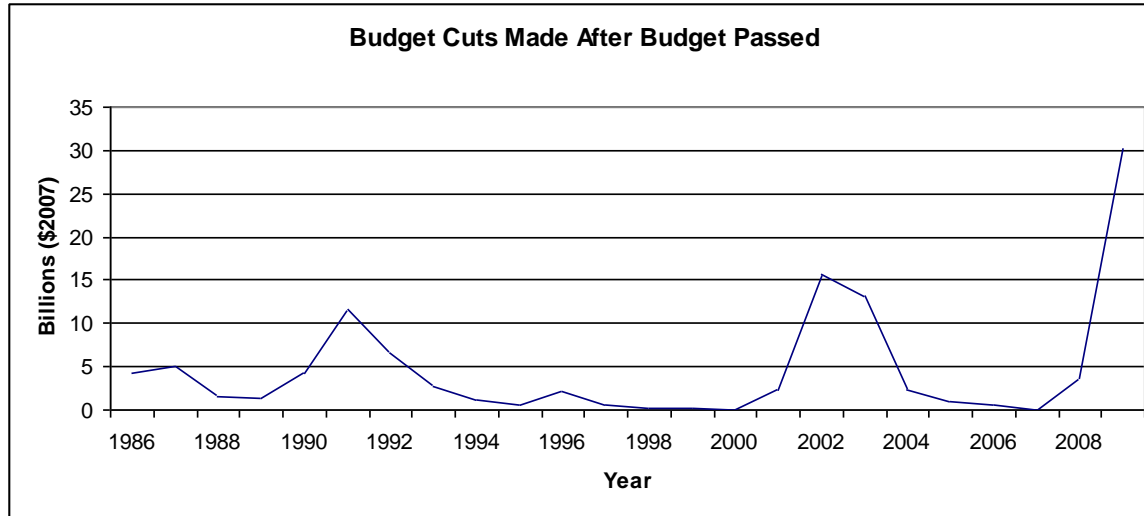


While Revenue Declines First and Cause Shortfalls, Some “Automatic” Spending Responses Can Increase Gap

- Medicaid – Mostly funded by state governments (even with stimulus increase pressure on states)
 - About 2/3rds of Medicaid spending for elderly and disabled
 - UI study shows 1%pt increase in unemployment rate would increase Medicaid and SCHIP enrollment by 1 million and cause the number of uninsured to grow by 1.1 million. Increases Medicaid and SCHIP costs by \$3.4 billion, including \$1.4 billion in state spending. 1% increase in total Medicaid and SCHIP
 - \$5.6b for 4 pt unemployment rise
- Depending on structure higher education costs could rise (if guarantee loan programs or funding levels for enrollment)
- K-12 education – mostly financed by state/local largely driven by policy factors not economics
- Pension liabilities – drop in stock market will lead to increase in pension liabilities (revenues smoothed so over 5 year horizon).
- Interest on unemployment insurance – UI from dedicated fund but any interest on federal loans must be repaid from general funds – ARRA canceled interest payments for the 2009/10



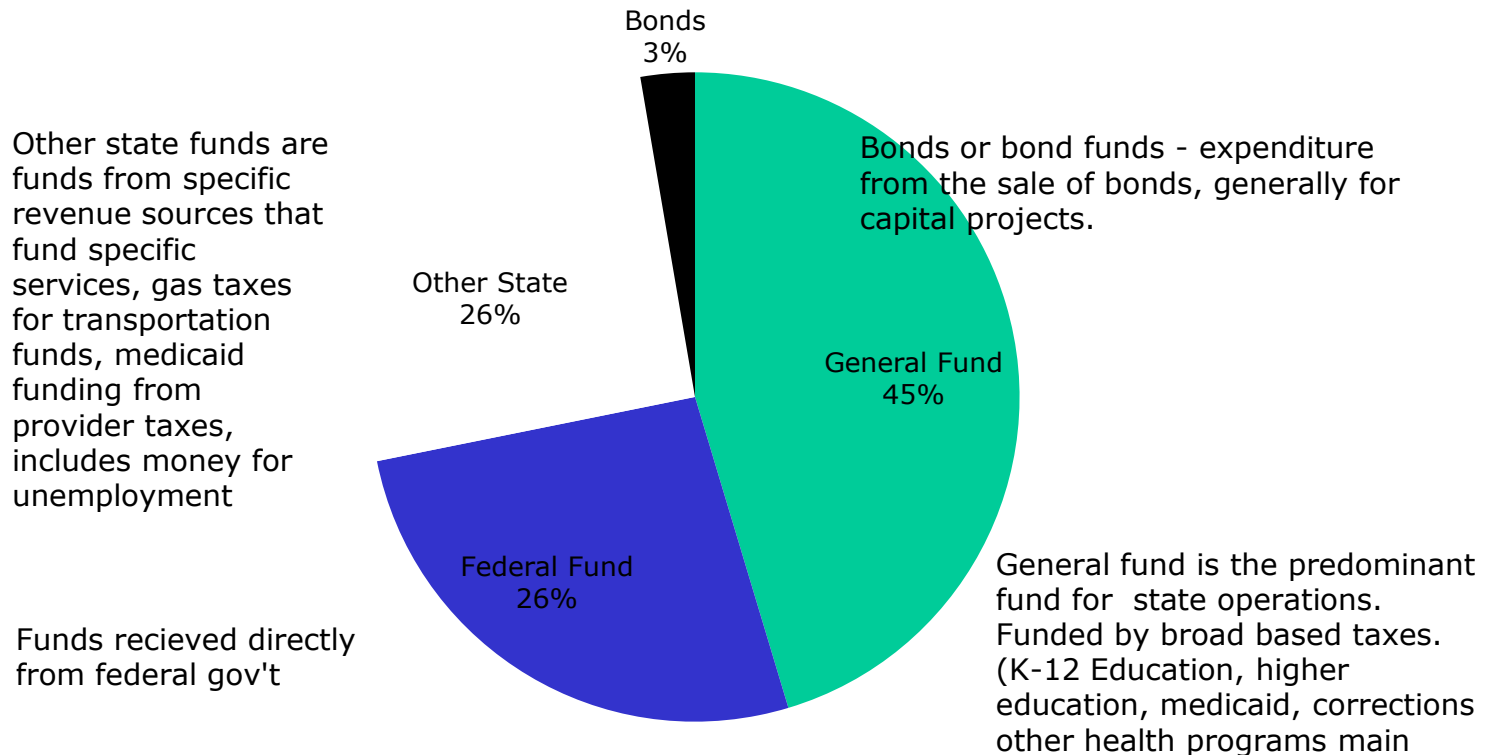
States have cut spending and raised taxes more than in past



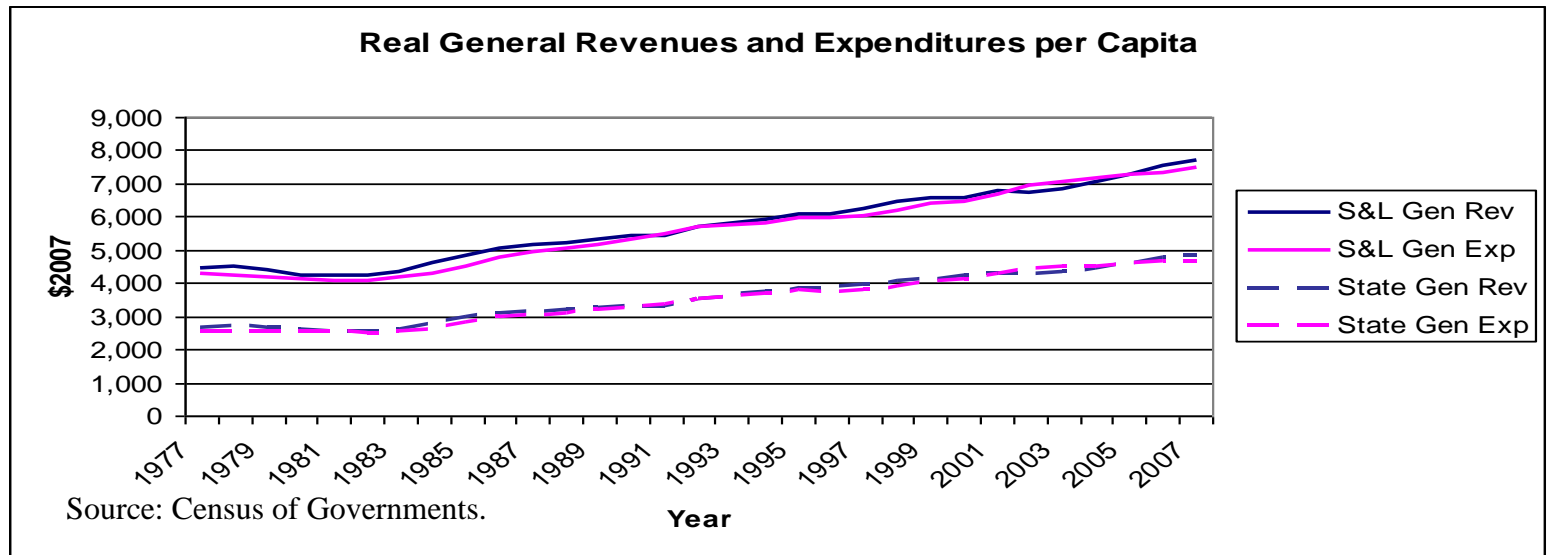
Source: NASBO Significant Features of Fiscal Federalism



2007 Total State Budgets Were Over \$1.4 Trillion



Revenues and Expenditures Tend to Grow Faster Than Population

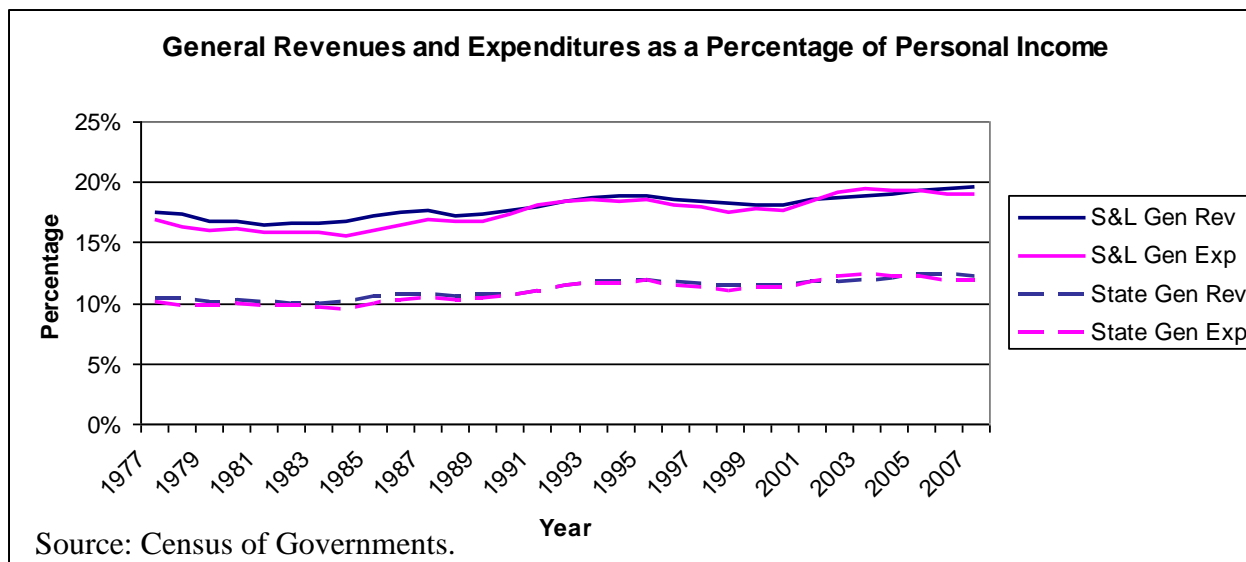


- State and local general revenues and expenditures grew by about 55% from 1980-2000; 82% from 1980-2007; and 16% from 2000-2007.
- State revenues and expenditures increased slightly more in the earlier periods: about 62% from 1980-2000; 86% from 1980-2007; and 14% from 2000-2007.
- Useful to examine state and local budgets due to variation across states in budget systems.

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More Constant as a Percentage of Personal Income or GDP

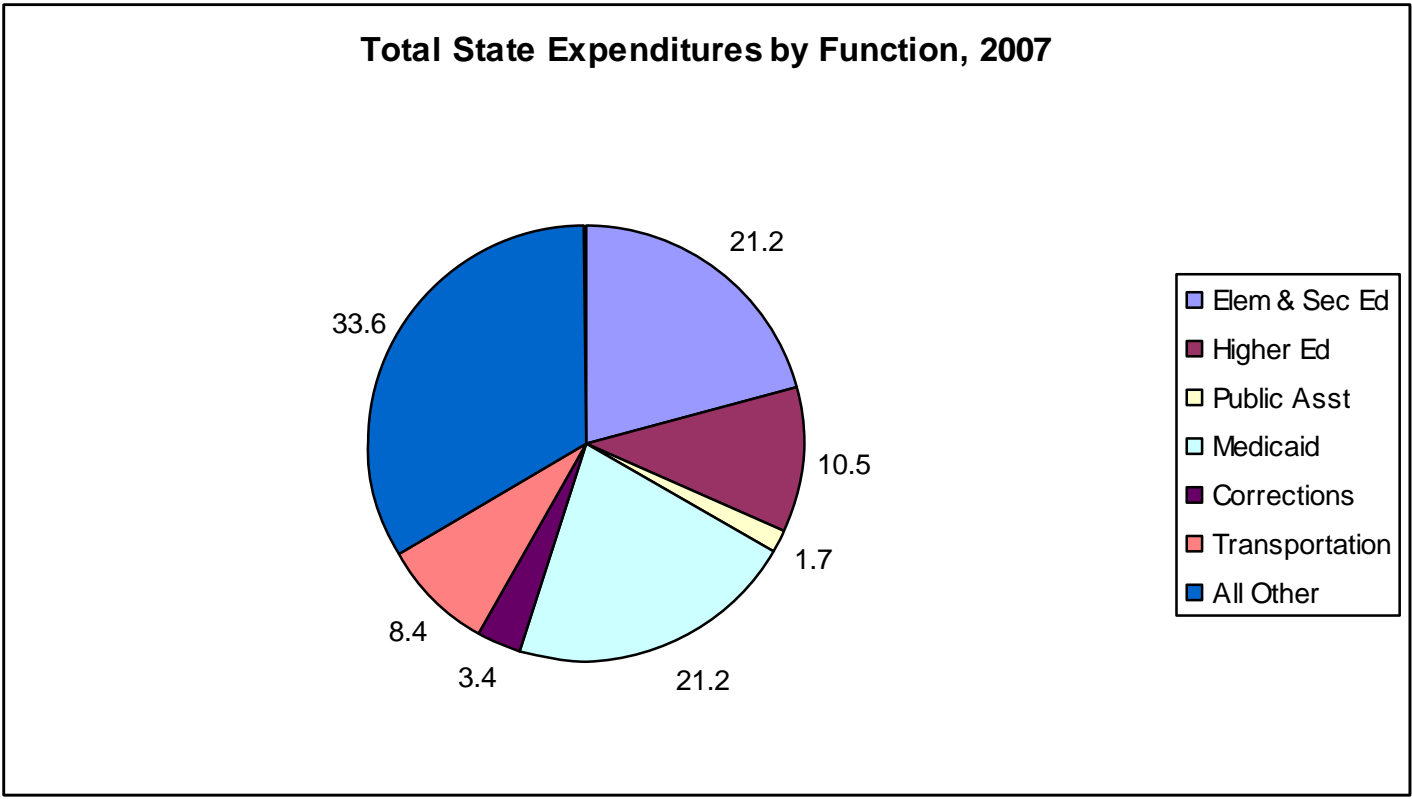


- As a percentage of personal income, revenues and expenditures increased much slower.
- State and local revenues and expenditures increased by about 17% from 1980 to 2007 while state revenues and expenditures increased by about 20%, with local revenues increasing more after 2000.

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Education and Medicaid Make Up About Half of State Expenditures



Source: National Association of State Budget Officers, State Expenditure Report 2007.

Medicaid, corrections make up growing share of state spending

	1985	1990	1995	2000	2005	2007
Total Revenues (Billions 2007\$)	578.3	795.1	978.8	1,139.2	1,313.7	1,438.1
K-12 Education	22%	23%	21%	22%	22%	21%
Higher Education	11%	12%	10%	11%	11%	11%
Cash Assistance Welfare	6%	5%	4%	3%	2%	2%
Medicaid	11%	13%	20%	20%	23%	21%
Corrections	2%	3%	4%	4%	4%	3%
Transportation	11%	10%	9%	9%	9%	8%
All Other	37%	34%	32%	32%	31%	34%

Source: NASBO: All other spending includes SCHIP programs

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Why Did Expenditures Grow?

- State and local employment grew by 28% from 1992 to 2008, but stayed constant as a share of employment
 - Growth in education, police and corrections
- States used additional funds to increase ongoing spending programs
 - decreasing class sizes
 - increasing public sector salaries
 - expanding eligibility rules for health programs
- Question of whether state and local governments can afford current programs



Pension funds and other retiree benefits will put pressure on states

- States have increased pension benefits
 - About half of all states had overfunded pension programs in the 1990s due to stock returns. Following the stock market crash funds were no longer fully funded
 - Only about 1/3 of states fully paid pension liabilities between 1996-2006
 - 10 states consistently contributed less than 80 percent
- Some states also increased non-pension retiree benefits
 - Only six states had fully funded non-pension benefits
 - Eleven states face long term liabilities of more than \$10 billion and the five largest states had put aside no money for retirement benefits
- As of 2006 public sector pensions estimated to be worth \$2.35 trillion with 85% funded (Pew)
- Other retiree benefits estimated to cost \$381 billion – largely unfunded

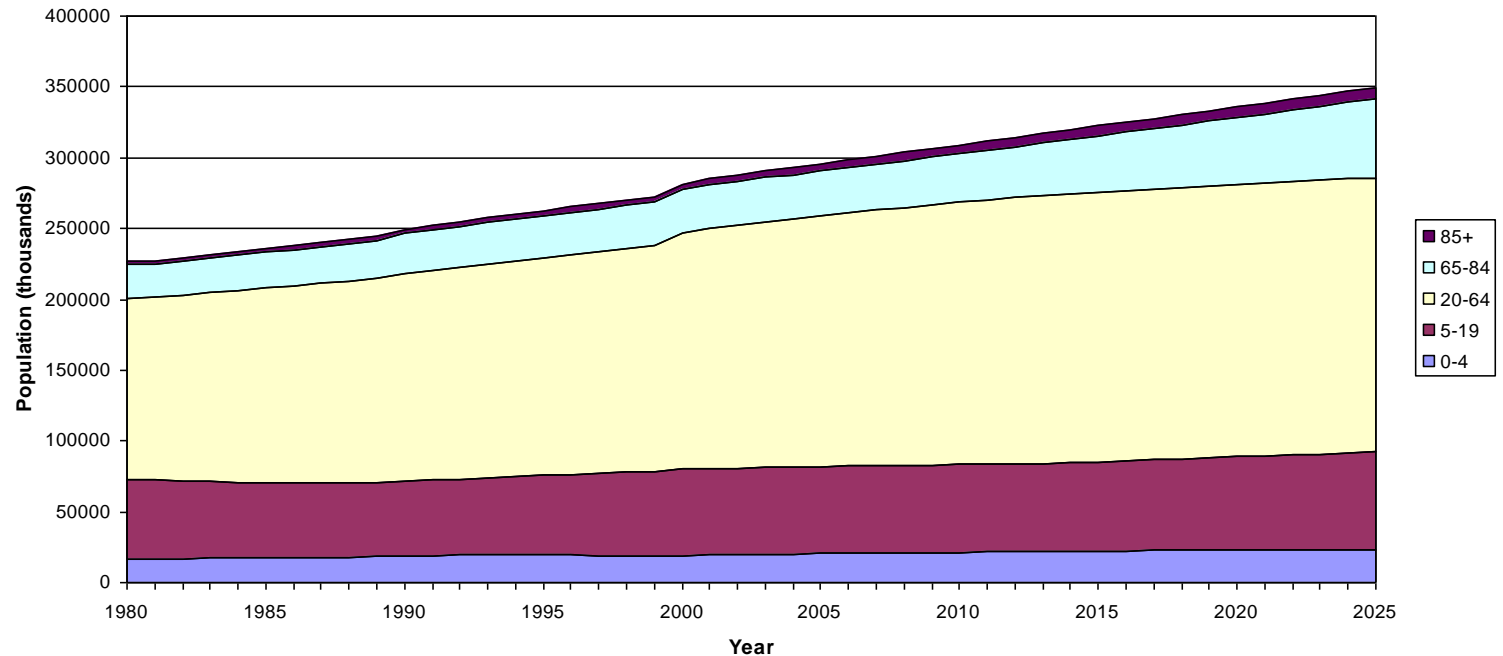


Other Long-term Pressures on State Budgets

- Questions about expenditures come down to what services governments want to provide
- Current increases in health care costs likely to put pressure on budgets
- Pension funds will need to be topped off
- Pressure to improve schools and increase per pupil spending
- Will current cuts be restored?

Growth in U.S. Population, 1980-2025

US Population, 1980-2025



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Dramatic Changes in the Age Profile of the U.S.

- We are getting older:
 - In 1980, 11% of the population 65+
 - In 2025, over 18% will be 65+
 - Due to aging of the baby boom and increased longevity
- We are also getting younger:
 - Number of school aged children will increase 22% from 1980 to 2025
 - Due to echo of the baby boom and sharply higher immigration
 - Growth is uneven:
 - Across time
 - Across states

So What Are States to Do?

- What services should government provide?
 - Have raised higher ed tuition – should students pay more?
 - Infrastructure needs also growing – but debt payments also put pressure on budgets
- What level of government should provide services?
 - Should we move to regional collaboratives, combine small places?
- What to do about pension systems?
 - Moving to defined contribution tougher than ever

No easy answers, legislatures need to make decisions and try and get voters to understand tradeoffs

