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Will Workers Survive State Budget Belt-Tightening?

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The current recession is hitting state governments hard. Thirty-eight states plus the District of Columbia are facing budget gaps totaling $30 billion this year, and twenty-six states are projecting shortfalls in their budgets for FY2010 of over $60 billion.[1]

Many states have already enacted measures to partially balance their budgets, and yet the outlook still looks grim for some. New York's budget gap next year is expected to be eight times larger than the shortfall this year, growing from $1.5 billion to $12.5 billion. California, already facing an $8.4 billion deficit, is projecting a $19.5 billion shortfall next year.[2]

State governments must make some tough choices when shoring up gaps in their budgets. They are forbidden by law or tradition from running deficits, so state legislatures are mandated to balance their budgets each year. To do this, they can draw on accumulated reserves in their "rainy day" funds, cut spending in programs like education and health care, or simply increase taxes and fees.

These adjustments may improve the budget situation, but they can be painful for the broader economy. Spending cuts and tax increases both restrict demand and increase unemployment. When people are already struggling, these belt-tightening measures can make things worse. They are said to be "pro-cyclical," since they magnify the downward trends already at work during a recession.

Still, state legislatures must find ways to balance their budgets and so have little choice but to utilize "pro-cyclical" measures. The last time state legislatures faced a similar climate, after the 2001 recession, they relied most heavily on spending cuts (42 percent), with some use of tax increases (14 percent) and rainy day funds (10 percent).[3]

If states react in a similar fashion this time around, how would spending cuts affect the economy? If the states facing deficits in the current fiscal year (FY2009) were to use spending cuts with a similar frequency (40 percent), this would result in the loss of 170,000 jobs, the Center for Economic and Policy

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Research estimates (see **Table 1** below). Looking ahead, if the states facing deficits next year (FY2010) were to respond with similar spending cuts, this would result in the loss of over 350,000 jobs (see **Table 2** below). It should be noted that any tax increases or spending cuts enacted in the current year would presumably carry over to the following year's budget, thereby reducing the overall burden.

However, since the current recession is projected to be much worse than 2001, state governments may face an even harsher climate. They may find their "rainy day" funds depleted, and they may find tax increases too unpopular to enact. In this worst case scenario, state legislatures would remedy their budget shortfalls with *only* cuts in spending. The implied impact on employment would be much worse – 425,000 jobs lost for FY2009 cuts (**Table 1**) and nearly 900,000 jobs lost for FY2010 cuts (**Table 2**).[4] Again, it should be noted that measures to balance the budget this year would carry over to the next fiscal year.

As Congress considers various options to stimulate the economy, revenue sharing with state and local governments should rank high on its list of options. This money can be quickly injected into the economy through important public services such as health care and education, thereby preventing layoffs.

TABLE 1: Implied Job Loss from FY2009 State Budget Cuts

State	FY2009 Shortfall/Cut ($ millions)	Economic Effect ($ millions)[5]	Implied Job Loss w/ 40% Cuts (thousands)[6]	Implied Job Loss w/ 100% Cuts (thousands)
Alabama	123.5	-168	-0.7	-1.7
Arizona	1,235	-1,679.6	-6.8	-16.9
California	8,400	-11,424	-45.9	-114.8
Colorado	99.7	-135.6	-0.6	-1.4
Connecticut	391.8	-532.8	-2.2	-5.4
Delaware	128.7	-175	-0.7	-1.8
District of Columbia	131	-178.2	-0.7	-1.8
Florida	2,142	-2,913.1	-11.7	-29.3
Georgia	2,100	-2,856	-11.5	-28.7
Hawaii	220	-299.2	-1.2	-3
Idaho	27	-36.7	-0.2	-0.4
Illinois	2,300	-3,128	-12.6	-31.4
Iowa	35	-47.6	-0.2	-0.5
Kansas	136.8	-186	-0.8	-1.9
Kentucky	456.1	-620.3	-2.5	-6.2
Maine	140.3	-190.8	-0.8	-1.9
Maryland	138	-187.7	-0.8	-1.9
Massachusetts	1,200	-1,632	-6.6	-16.4
Minnesota	426	-579.4	-2.3	-5.8
Mississippi	85.5	-116.3	-0.5	-1.2
Nebraska	5.3	-7.2	0	-0.1
Nevada	337	-458.3	-1.8	-4.6
New Hampshire	250	-340	-1.4	-3.4
New Jersey	400	-544	-2.2	-5.5
New Mexico	253	-344.1	-1.4	-3.5
New York	1,475	-2,006	-8.1	-20.2
North Carolina	1,200	-1,632	-6.6	-16.4
Ohio	1,180.7	-1,605.8	-6.4	-16.1
Oregon	142	-193.1	-0.8	-1.9
Pennsylvania	2,000	-2,720	-10.9	-27.3
Rhode Island	350	-476	-1.9	-4.8
South Carolina	724.4	-985.2	-4	-9.9
South Dakota	7	-9.5	0	-0.1
Tennessee	800	-1,088	-4.4	-10.9
Utah	354	-481.4	-1.9	-4.8
Vermont	88	-119.7	-0.5	-1.2
Virginia	973.6	-1,324.1	-5.3	-13.3
Washington	413	-561.7	-2.2	-5.6
Wisconsin	281	-382.2	-1.5	-3.8
TOTAL	**31,150.4**	**-42,364.6**	**-170.6**	**-425.8**

TABLE 2: Implied Job Loss from FY2010 State Budget Cuts

State	Projected FY 2010 Shortfall ($ millions)	Economic Effect ($ millions)	Implied Job Loss w/ 40% Cuts (thousands)	Implied Job Loss w/ 100% Cuts (thousands)
Arizona	2,600	-3,536	-14.2	-35.5
California	19,500	-26,520	-106.6	-266.6
Connecticut	2,495	-3,393.2	-13.6	-34.1
Delaware	215	-292.4	-1.2	-2.9
Florida	4,650	-6,324	-25.4	-63.6
Georgia	2,100	-2,856	-11.5	-28.7
Hawaii	730	-992.8	-4	-10
Idaho	150	-204	-0.8	-2.1
Iowa	625	-850	-3.4	-8.5
Kansas	959	-1,304.2	-5.2	-13.1
Louisiana	1,300	-1,768	-7.1	-17.8
Maine	412	-560.3	-2.2	-5.6
Maryland	1,226	-1,667.4	-6.7	-16.8
Minnesota	2,600	-3,536	-14.2	-35.5
Nebraska	274	-372.6	-1.5	-3.7
Nevada	750	-1,020	-4.1	-10.3
New Jersey	2,500	-3,400	-13.7	-34.2
New York	12,518	-17,024.5	-68.4	-171.1
North Carolina	900	-1,224	-4.9	-12.3
Oregon	650	-884	-3.6	-8.9
Rhode Island	460	-625.6	-2.5	-6.3
South Carolina	600	-816	-3.3	-8.2
Vermont	118	-160.5	-0.6	-1.6
Virginia	1,500	-2,040	-8.2	-20.5
Washington	2,336	-3,177	-12.8	-31.9
Wisconsin	2,500	-3,400	-13.7	-34.2
TOTAL	**64,668**	**-87,948.5**	**-353.4**	**-884**

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[1] Fiscal Dept. "State Budget Update: November 2008." National Conference of State Legislatures: December 4, 2008. http://www.ncsl.org/programs/press/2008/pr120408SBUDec08.htm

[2] These temporary projections are likely to change in the future, and more states may still come forward with new projections. Dougherty, Conor and Amy Merrick. "States Squeeze Cities, Spreading the Economic Pain." *Wall Street Journal*: December 18, 2008. http://online.wsj.com/article/SB122955325187415831.html?mod=relevancy

[3] McNichol, Elizabeth. "States' Heavy Reliance on Spending Cuts and One-Time Measures to Close their Budget Gaps Leaves Programs at Risk." Center on Budget and Policy Priorities: July 29, 2004. http://www.cbpp.org/7-29-04sfp.htm

[4] For this calculation, we first determined the economic effect of closing each state's budget shortfall with spending cuts (in dollars) proportional to national GDP (in dollars). Assuming that employment is proportional to GDP, we then multiplied this ratio by national employment. To determine the implied job loss with a 40% frequency of spending cuts, this value was then multiplied by a factor of 0.4.

[5] This calculation uses a multiplicative factor for stimulative (or contractionary) policies beyond their nominal value. For federal aid to state governments, Zandi has estimated the stimulative factor to be 1.36, so we have used the inverse value (-1.36) as a working estimate of the contractionary factor. See Zandi, Mark M. "Assessing the Macro Economic Impact

of Fiscal Stimulus 2008." Moody's Economy.com: January 2008. http://www.economy.com/mark-zandi/documents/assissing-the-impact-of-the-fiscal-stimulus.pdf

[6] Data on national employment (144,958,000) available via Bureau of Labor Statistics: http://www.bls.gov/news.release/empsit.nr0.htm. Data on national GDP ($14,420.5 billion) available via Bureau of Economic Analysis: http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm.