## Frontline Materials

### CP Can’t Stimulate The Economy

#### States can’t stimulate the economy—federal action is key.

Bernstein 11 — Jared Bernstein, Senior Fellow at the Center on Budget and Policy Priorities, served as Chief Economist and Economic Advisor to Vice President Joe Biden, holds a Ph.D. in Social Welfare from Columbia University, 2011 (“More Q&A: States Can’t Do Countercyclical Policy and Noise re ‘Unfunded Liabilities’,” *On The Economy*—Jared Bernstein’s economics blog, July 4th, Available Online at http://jaredbernsteinblog.com/more-qa-states-cant-do-countercyclical-policy-and-noise-re-unfunded-liabilities/, Accessed 06-22-2012)

Q: What with the much benighted Washington debate, what can the states do to improve the economy – or more specifically, fight unemployment?

A: The states can’t do much at all. To the contrary, because they have to balance their budgets, when their revenues come in under their spending in a given fiscal year, they have to close those gaps in that year. That means service cuts and/or tax increases, or in econo-jargon, their policy stance has to be procyclical when we need it be countercyclical.

My CBPP colleagues have tracked this problem throughout the recession (this is their most recent review). The figure shows the magnitude of the gaps summed across all the states, compared to the last downturn.

A few points are instructive:

–clearly, this downturn has been much tougher on state budgets (as well as the federal budget) than the last one.

–things are improving; the recovery in GDP that began in mid-2009 has begun to show up in higher state revenues, and states expect their 2013 shortfall to be half as large as their 2012 gap.

–but the hole is deep and the damage severe; over the past three years, state and local governments have shed over half-a-million jobs.

There’s a very important Keynesian punchline here: since states cannot offset their budget gaps with deficit spending, the only countercyclical game in town is the federal gov’t. The state fiscal relief in the Recovery Act was fast-acting, effective stimulus, helping to retain needed jobs in communities, like teachers, cops, firefighters, sanitation workers, etc. As the stimulus has faded, layoffs have accelerated.

#### States can’t act countercyclically—the counterplan hurts the economy.

Attewell 9 — Steven Attewell, Ph.D. student in the history of public policy at the University of California-Santa Barbara, 2009 (“50-State Keynesianism: A Proposal,” *The Realignment Project*, June 8th, Available Online at http://realignmentproject.wordpress.com/2009/06/08/50-state-keynesianism-a-proposal/, Accessed 06-27-2012)

The larger problem is that we’re in a recession and state governments can’t print money to pay their bills, can’t deficit spend due to state laws (usually constitutions), and the bond markets aren’t really snapping up state debt and are charging an arm and a leg to do so. This means that while the Federal government is trying to push a stimulative policy and get the money pumping, the state governments are going to undercut recovery efforts – the Federal stimulus package is about $350 billion/year, and that $150 deficit will cut the effect nearly in half. This policy problem is being compounded by a political problem – bond rating agencies and the bonds markets are ideologically going after public credit ratings. As John Quiggan notes, agencies like Moody’s, Standard & Poor’s, and Fitch which were up to their necks in the current financial crisis, who looked the other way and stamped AAA ratings on garbage CDOs and asset-backed-securities and credit swaps and other financial snake-oils are now aggressively targeting the bond ratings of government entities. While Quiggan’s examples are mostly Australian, you can see the same thing happening in the U.S as states and even the Federal government (all of whom maintain the power of taxation as a guard against permanent insolvency) are being warned or downgraded for actions that are vitally necessary to save our economy. By itself, by shifting state spending away from stimulative spending towards financing higher interest rates and by forestalling the potential for Keynesian borrow-and-spend policies, these agencies are making the crisis worse. Moreover, by pushing the ideological line that balanced budgets are better than increasing spending, they are complicit in the shock doctrine proselytizing going on in state governments (such as in California, where Swartzenegger used the budget crisis to push for the elimination of the state’s SCHIP program, the Calgrants college aid program, and the Calworks welfare program).

### CP Funding Hurts The Economy

#### State fundraising decimates the economy—spending cuts and tax increases undercut demand.

Quinnell 12 — Kenneth Quinnell, political analyst and writer at *Crooks & Liars*, Adjunct Instructor in History at Tallahassee Community College, 2012 (“New Report Shows State Budget Cuts Have Hurt the Economy,” *Crooks & Liars*, April 21st, Available Online at http://crooksandliars.com/kenneth-quinnell/new-report-shows-state-budget-cut, Accessed 06-27-2012)

A new report from the Center on Budget and Policy Priorities, "Out of Balance: Cuts in Services Have Been States’ Primary Response to Budget Gaps, Harming the Nation’s Economy," places a spotlight on the right-wing assault on state budgets and the harmful effects of the growing trend of budget cuts.

The state budget gaps of the last five years led to $290 billion in cuts to public services and $100 billion in tax and fee increases. Those actions lengthened the recession and delayed the recovery. Because spending reductions were dominant, hundreds of thousands of jobs were lost; undermining education, health care and other state priorities, which likely will cause future economic harm to states. Federal aid mitigated the harmful effects of the spending cuts in the early years of the budget crunch, but its expiration last year had a catastrophic effect, making 2012 the worst year since the downturn began for cuts in funding for services.

The study looked at budget data for the last five years and found that more than 640,000 jobs have been cut by the states since 2008, undercutting the economic recovery and helping sustain a high unemployment rate nationally. Because 2012 has been the worst year for cuts since the recession began, further job losses are almost guaranteed.

The cuts have also led states to cancel contracts with vendors, reduce payments to businesses and nonprofits that provide services, and cut benefit payments to individuals — all steps that remove demand from the economy. There are long-term effects as well: By diminishing the quality of elementary and high schools, making college less affordable, and reducing residents’ access to health care, the cuts threaten to make the U.S. economy less competitive in coming decades.

While there has been a recent rebound in the growth of revenue at the state level, if the current rate of growth continues, it will take seven years to get back to where things were before the recession.

Overall, the methods used to balance state budgets — often a legal requirement — were very focused on methods that harm the economy:

\* Spending cuts 44.8 percent

\* Federal relief funds 24.0 percent

\* Tax and fee increases 15.5 percent

\* Raiding of rainy day funds and other dedicated revenue streams 8.7 percent

\* Other miscellaneous methods 7.0 percent

States have engaged in such unsustainable and negative tactics to balance their budgets that many more citizens are in vulnerable situations than before the recession.

#### The counterplan undermines recovery in the short- *and* long-term by reducing aggregate demand.

McNichol 12 — Elizabeth McNichol, Senior Fellow at the Center on Budget and Policy Priorities specializing in state fiscal issues including the economy’s impact on state budgets and long-term structural reform of state budget and tax systems, holds an M.A. in Political Science from the University of Chicago, 2012 (“Out of Balance: Cuts in Services Have Been States’ Primary Response to Budget Gaps, Harming the Nation’s Economy,” Center on Budget and Policy Priorities, April 18th, Available Online at http://www.cbpp.org/cms/index.cfm?fa=view&id=3747, Accessed 06-27-2012)

The state budget gaps of the last five years led to $290 billion in cuts to public services and $100 billion in tax and fee increases. Those actions lengthened the recession and delayed the recovery. Because spending reductions were dominant, hundreds of thousands of jobs were lost; undermining education, health care and other state priorities, which likely will cause future economic harm to states. Federal aid mitigated the harmful effects of the spending cuts in the early years of the budget crunch, but its expiration last year had a catastrophic effect, making 2012 the worst year since the downturn began for cuts in funding for services. More federal aid and a more balanced response, with an equal reliance on revenues and on service cuts, could have mitigated these effects.

These are the findings of a new analysis of state budget data and trends over the last five years. While the broad outlines of this story have been well-known, this is the first attempt to quantify how states collectively balanced their budgets in the face of the worst fiscal problems in at least 70 years. Since 2008, states have enacted almost $3 in spending cuts for every $1 in new revenues. These painful measures, combined with about $160 billion in emergency federal aid, use of $60 billion in reserves that states accumulated before the recession began, and another $50 billion in other measures such as asset sales and payment date shifts, allowed states to balance their budgets in the face of a cumulative $600 billion in budget gaps over a five-year period.[1]

The spending cuts have affected all major areas of state budgets – elementary and secondary education, health care, higher education, and human services.

The lack of balance between revenues and spending was most pronounced in fiscal year 2012, as reserves dwindled, federal aid largely expired and states enacted even fewer tax and fee increases. In 2012, spending cuts totaled nearly $140 billion, almost as much as the combined total for the previous four years. Tax and fee increases were just $20 billion, and federal aid and the use of reserves accounted for close to $15 billion.[2]

Continued heavy reliance on spending cuts to close budget gaps will slow the recovery and weaken the nation’s economy over the long term. State and local governments already have shed 641,000 jobs since August 2008; additional rounds of cuts will lead to further job losses in the months ahead. The cuts have also led states to cancel contracts with vendors, reduce payments to businesses and nonprofits that provide services, and cut benefit payments to individuals — all steps that remove demand from the economy. There are long-term effects as well: By diminishing the quality of elementary and high schools, making college less affordable, and reducing residents’ access to health care, the cuts threaten to make the U.S. economy less competitive in coming decades.

## Links

### CP Requires Spending Cuts or Tax Increases

#### States will slash spending or raise taxes to fund the counterplan—massive budget shortfalls.

Reuters 12 — Reuters, 2012 (“Budget Gaps To Exceed Revenues In Over Half Of U.S. States By July,” Byline Lisa Lambert, January 9th, Available Online at http://www.huffingtonpost.com/2012/01/09/new-us-state-budget-gaps-exceed-revenues-states-july\_n\_1195138.html, Accessed 06-27-2012)

More than half the U.S. states will not have enough revenues to cover spending demands in the fiscal year starting in July, according to a think tank report released on Monday.

Altogether, the budget gaps for 29 states will total $44 billion, the Center on Budget and Policy Priorities found. Among them are California and Texas, the two most populous states in the United States.

"This number is almost certain to grow as governors release new gap projections along with their proposed budgets in the coming months," said the liberal-leaning group, which monitors states' fiscal conditions.

Over the past four years, states have had to close more than $530 billion in budget gaps, according to CBPP. All states except Vermont must end their fiscal years with balanced budgets, which has forced them to slash spending, raise taxes, borrow and turn to the federal government for help.

### CP Requires Spending Cuts

#### State budgets are overstretched—the counterplan requires cuts to existing programs.

McNichol et al. 12 — Elizabeth McNichol, Senior Fellow at the Center on Budget and Policy Priorities specializing in state fiscal issues including the economy’s impact on state budgets and long-term structural reform of state budget and tax systems, holds an M.A. in Political Science from the University of Chicago, et al., with Phil Oliff, Policy Analyst with the State Fiscal Project at the Center on Budget and Policy Priorities, previously served as the Hugh L. Carey Fellow in Governmental Finance with New York State’s Division of Budget, holds an M.A. in Public Policy from Harvard University’s John F. Kennedy School of Government, and Nicholas Johnson, Vice President for State Fiscal Policy at the Center on Budget and Policy Priorities, holds a graduate degree from Duke University's Terry Sanford Institute of Public Policy, 2012 (“States Continue to Feel Recession’s Impact,” Center on Budget and Policy Priorities, May 24th, Available Online at http://www.cbpp.org/cms/index.cfm?fa=view&id=711, Accessed 06-27-2012)

States continue to face a major fiscal challenge. Thirty states have projected (and in many cases have already closed) budget gaps totaling $54 billion for fiscal year 2013. (See Figure 1.) These shortfalls are all the more daunting because states' options for addressing them are fewer and more difficult than in recent years. Temporary aid to states enacted in early 2009 as part of the federal Recovery Act was enormously helpful in allowing states to avert some of the most harmful potential budget cuts in the 2009, 2010 and 2011 fiscal years. But the federal government allowed that aid to largely expire at the end of fiscal year 2011, leading to some of the deepest cuts to state services since the start of the recession. Far from providing additional assistance to states, the federal government is now moving ahead with spending cuts that will very likely make states' fiscal situation even worse.

### CP Requires Tax Increases

#### States can’t fund the counterplan without raising taxes.

McNichol et al. 12 — Elizabeth McNichol, Senior Fellow at the Center on Budget and Policy Priorities specializing in state fiscal issues including the economy’s impact on state budgets and long-term structural reform of state budget and tax systems, holds an M.A. in Political Science from the University of Chicago, et al., with Phil Oliff, Policy Analyst with the State Fiscal Project at the Center on Budget and Policy Priorities, previously served as the Hugh L. Carey Fellow in Governmental Finance with New York State’s Division of Budget, holds an M.A. in Public Policy from Harvard University’s John F. Kennedy School of Government, and Nicholas Johnson, Vice President for State Fiscal Policy at the Center on Budget and Policy Priorities, holds a graduate degree from Duke University's Terry Sanford Institute of Public Policy, 2012 (“States Continue to Feel Recession’s Impact,” Center on Budget and Policy Priorities, May 24th, Available Online at http://www.cbpp.org/cms/index.cfm?fa=view&id=711, Accessed 06-27-2012)

States' fiscal conditions are improving along with the broader economy. But states are coming out of a very deep hole. Figure 3 illustrates the magnitude of the problem. State revenues have begun to rebound. State tax intake grew 8.3 percent in the 12-month period ending in June 2011 — the 2011 fiscal year for most states. This encouraging growth offers a glimmer of hope that states are beginning to climb out of the fiscal hole caused by the recession. Unfortunately, that hole was so deep that even if revenues continue to grow at last year's rate — which is highly unlikely, as explained below — it would take seven years to get them back on a normal track.

In other words, revenues probably won't come close to what states need to restore the programs that they cut during the recession unless states raise taxes, at least temporarily, or receive additional federal aid while the economy slowly recovers. As noted below, additional federal aid is unlikely.

### Federalism Hurts Recovery

#### Federalism undermines economic recovery—prevents effective stimulus.

Meyerson 9 — Harold Meyerson, Editor-at-Large at *The American Prospect*, Columnist for *The Washington Post*, 2009 (“Fed Up With Federalism,” *The American Prospect*, November 19th, Available Online at http://prospect.org/article/fed-federalism-0, Accessed 06-30-2012)

But even though federalism is more often the refuge of reactionaries than of visionaries, it has an even deeper flaw: setting the nation at cross-purposes with itself, and never more so than during a recession.

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There is a classic algebra problem in which water pours into a bathtub from the tap at a specified rate but also exits the tub at a different rate because someone has neglected to stop the drain. If you know the rates, you should be able to figure when the water will rise to a certain level. During a recession, the United States becomes a version of that bathtub. The federal government is the tap. The state and local governments are the drain.

That's no way to fight a recession. When investment, production, and consumption are all in decline, the only way to keep the economy from shrinking is for the federal government to deficit spend and create a stimulus. But while the federal government pours money in, the state and local governments, which cannot deficit spend, see their tax revenue shrinking, so they cut spending, raise taxes, or both – taking money out of the economy. America's distinct brand of federalism inherently impedes an economic recovery.

#### Federalism reverses the benefits of federal stimulus, undermining recovery.

Surowiecki 9 — James Surowiecki, Staff Writer at *The New Yorker*, has previously written for *Slate*, *Fortune*, the *Wall Street Journal*, *Wired*, the *New York Times Magazine*, the *Washington Post*, and *Lingua Franca*, 2009 (“Fifty Ways To Kill Recovery,” *The New Yorker*, July 27th, Available Online at http://www.newyorker.com/talk/financial/2009/07/27/090727ta\_talk\_surowiecki, Accessed 06-30-2012)

If you came up with a list of obstacles to economic recovery in this country, it would include all the usual suspects—our still weak banking system, falling house prices, overindebted consumers, cautious companies. But here are fifty culprits you might not have thought of: the states. Federalism, often described as one of the great strengths of the American system, has become a serious impediment to reversing the downturn.

It’s easy enough, of course, to mock state governments nowadays, what with California issuing I.O.U.s to pay its bills and New York’s statehouse becoming the site of palace coups and senatorial sit-ins. But the real problem isn’t the fecklessness of local politicians. It’s the ordinary way in which state governments go about their business. Think about the $787-billion federal stimulus package. It’s built on the idea that during serious economic downturns the government can use spending increases and tax cuts to counteract the effects of consumers who are cutting back on spending and businesses that are cutting back on investment. So fiscal policy at the national level is countercyclical: as the economy shrinks, government expands. At the state level, though, the opposite is happening. Nearly every state government is required to balance its budget. When times are bad, jobs vanish, sales plummet, investment declines, and tax revenues fall precipitously—in New York, for instance, state revenues in April and May were down thirty-six per cent from a year earlier. So states have to raise taxes or cut spending, or both, and that’s precisely what they’re doing: states from New Jersey to Oregon have raised taxes in the past year, while significant budget cuts have become routine and are likely to get only deeper in the year ahead. The states’ fiscal policy, then, is procyclical: it’s amplifying the effects of the downturn, instead of mitigating them. Even as the federal government is pouring money into the economy, state governments are effectively taking it out. It’s a push-me, pull-you approach to fighting the recession.

### Link Magnifier: Emergency Cuts

#### The unexpected expense of the counterplan results in emergency cuts.

Backman 11 — Daniel Backman, Staff Writer for the *Harvard Political Review*, undergraduate political science student at Harvard University, 2011 (“The State Budget Squeeze,” *Harvard Political Review*, December 10th, Available Online at http://hpronline.org/united-states/the-state-budget-squeeze/, Accessed 06-27-2012)

When states make emergency cuts, they often proceed without carefully considering the long-term consequences. Most budget yearly, which, when coupled with balanced budget requirements, offers little incentive for long-term focus. Gordon points out, “There is a lot of push now to improve forecasting on the state level and engage in longer- term planning.” Additionally, state revenues vary considerably between years and work poorly under short-term restrictions. The income and capital gains taxes prove substantially cyclical, plunging states into deficits during recessions. Thus, to prevent shortsighted emergency policies, states should project both revenues and outlays over longer periods. As Elizabeth McNichol of the Center for Budget and Policy Priorities maintains, “Long-term, multi-year forecasting on both the spending and revenue sides… gives the states the opportunity to figure out the impact…on spending programs or tax systems for the long-term balance of their budget.”

### Link Magnifier: Constitutional Constraints

#### States can’t stimulate the economy—constitutional constraints.

Attewell 9 — Steven Attewell, Ph.D. student in the history of public policy at the University of California-Santa Barbara, 2009 (“Fifty-State Keynesianism - Part Deux,” *The Economic Populist*, July 31st, Available Online at http://www.economicpopulist.org/content/fifty-state-keynesianism-part-deux, Accessed 06-27-2012)

Lest this be seen as merely a California problem, a recent report by the National Governors Association notes that the collective budget shortfalls of the fifty states comes to a collective $200 billion shortfall. Given that the total Federal economic stimulus for this year only comes to about $400 billion, we are forced to recognize that our system of state government budgeting and finance is creating a massive economic undertow, weakening the impact of Keynesian stimulus by cutting spending and raising taxes (although they've been doing a lot more of the former than the latter).

Background: Why is it the case that America's state governments have become so strongly pro-cyclical? The basic reason is that all but one state in the Union (Vermont being the exception) have some form of a balanced budget or debt limitation requirement, which makes it impossible to deficit spend during recessions.

### A2: Rainy Day Funds

#### Rainy Day Funds are insufficient—they’ve already been depleted by the downturn.

McNichol 12 — Elizabeth McNichol, Senior Fellow at the Center on Budget and Policy Priorities specializing in state fiscal issues including the economy’s impact on state budgets and long-term structural reform of state budget and tax systems, holds an M.A. in Political Science from the University of Chicago, 2012 (“Out of Balance: Cuts in Services Have Been States’ Primary Response to Budget Gaps, Harming the Nation’s Economy,” Center on Budget and Policy Priorities, April 18th, Available Online at http://www.cbpp.org/cms/index.cfm?fa=view&id=3747, Accessed 06-27-2012)

States initially turned to their rainy day funds and other general fund balances to close budget gaps. Together, use of these reserve funds accounted for $57 billion (9 percent) of the measures taken to close the cumulative budget gaps that states faced in fiscal years 2008 through 2012.

[Table Omitted]

During and immediately following the recession that began in late 2007, 39 states reported using their rainy day funds to address budget shortfalls.[3] States had acted quickly after the 2001 recession to rebuild reserves. By the end of fiscal year 2006, total ending balances, which include both general fund balances and rainy day fund balances, had reached $69.0 billion (11.5 percent of budgets) — higher than the level of reserves prior to the 2001 recession.

These reserves played an important role in allowing states to maintain programs without large spending cuts and revenue increases, especially at the start of the fiscal crisis. Reserve balances declined from 11.5 percent to a projected 6.2 percent at the end of fiscal year 2012 according to the National Association of State Budget Officers. The amount expected to remain in reserves by the end of 2012 is even smaller for most of the states (only 3.7 percent of budgets on average) if you factor out Alaska and Texas – two states that by themselves account for almost half of the funds in reserves.[4]

But even reserves of this size proved much too small to address a downturn as deep as the 2007-09 recession. One lesson of this downturn is that states would be well-served to increase the size of reserves once the economy recovers sufficiently to allow restocking.

### A2: State Budgets Recovering

#### Slow growth ensures a long-term state budget crisis.

McNichol et al. 12 — Elizabeth McNichol, Senior Fellow at the Center on Budget and Policy Priorities specializing in state fiscal issues including the economy’s impact on state budgets and long-term structural reform of state budget and tax systems, holds an M.A. in Political Science from the University of Chicago, et al., with Phil Oliff, Policy Analyst with the State Fiscal Project at the Center on Budget and Policy Priorities, previously served as the Hugh L. Carey Fellow in Governmental Finance with New York State’s Division of Budget, holds an M.A. in Public Policy from Harvard University’s John F. Kennedy School of Government, and Nicholas Johnson, Vice President for State Fiscal Policy at the Center on Budget and Policy Priorities, holds a graduate degree from Duke University's Terry Sanford Institute of Public Policy, 2012 (“States Continue to Feel Recession’s Impact,” Center on Budget and Policy Priorities, May 24th, Available Online at http://www.cbpp.org/cms/index.cfm?fa=view&id=711, Accessed 06-27-2012)

Another major obstacle to recovery is sluggish economic growth. Unemployment remains above 8 percent, and many economists expect it to stay at high levels throughout 2012 and beyond. Continued slow job growth will restrain the rise in state tax receipts. This is especially true for the sales tax. High unemployment and economic uncertainty, combined with households' diminished wealth due to fallen property values, will continue to depress consumption, keeping sales tax receipts at low levels. If, as in past recessions, the incomes of the wealthy recover faster than those of low- and middle- income individuals and families, this would mitigate somewhat the effect of a sluggish job market on tax receipts, especially in states with progressive income taxes. Beyond depressing state revenue collections, the weak economy increases demand for Medicaid and other essential services that states provide. These factors suggest that state budget gaps will continue to be a problem for states for some time to come.

#### Cuts are still required to fund new programs.

McNichol 12 — Elizabeth McNichol, Senior Fellow at the Center on Budget and Policy Priorities specializing in state fiscal issues including the economy’s impact on state budgets and long-term structural reform of state budget and tax systems, holds an M.A. in Political Science from the University of Chicago, 2012 (“Out of Balance: Cuts in Services Have Been States’ Primary Response to Budget Gaps, Harming the Nation’s Economy,” Center on Budget and Policy Priorities, April 18th, Available Online at http://www.cbpp.org/cms/index.cfm?fa=view&id=3747, Accessed 06-27-2012)

The measures that states used to close their budget gaps, combined with the severity of the fiscal crisis that states faced, suggest that state services will remain at risk for a number of years. During the 1990s state spending grew at the same pace as the economy. States had sufficient revenue to accommodate rising health costs, growing school enrollments and other cost increases. In addition, in response to public demand, many states were able to increase their investment in elementary and secondary schools, reduce reliance on local property taxes, expand health coverage for low-income children and their families, and expand access to higher education. Much of this progress was rolled back as states cut their budgets in response to the recession of the early 2000s. The deeper recession that followed in 2007 resulted in further painful spending cuts before the states had recovered fully from the earlier recession.

The steep spending cuts of the last few years have caused declines in virtually all services provided by states. Even if state revenues begin to grow much faster than average, states will not be able to restore these cuts for a long time. The bottom line is that states will face significant shortfalls for a number of years in funding for education, health care, and other services unless they raise taxes or receive additional federal assistance.

## Impacts

### Spending Cuts and Tax Increases Bad

#### The counterplan chokes off the recovery—state spending cuts and tax increases compound shortfalls in aggregate demand.

Backman 11 — Daniel Backman, Staff Writer for the *Harvard Political Review*, undergraduate political science student at Harvard University, 2011 (“The State Budget Squeeze,” *Harvard Political Review*, December 10th, Available Online at http://hpronline.org/united-states/the-state-budget-squeeze/, Accessed 06-27-2012)

As America’s economic recovery crawls forward, its states suffer from depleted revenues and large spending commitments. Experts project between $30 billion and $40 billion in combined state budget deficits for fiscal year 2012. Though the federal government runs deficits during recessions to fund expansionary policies, many states are constrained by constitutional balanced budget requirements. They must close deficits by cutting spending and raising taxes, choking recovery with behaviors that compound macroeconomic problems.

### Spending Cuts Bad

#### States will fund the counterplan through budget cuts that drag down the economy—federal action is key.

McNichol et al. 12 — Elizabeth McNichol, Senior Fellow at the Center on Budget and Policy Priorities specializing in state fiscal issues including the economy’s impact on state budgets and long-term structural reform of state budget and tax systems, holds an M.A. in Political Science from the University of Chicago, et al., with Phil Oliff, Policy Analyst with the State Fiscal Project at the Center on Budget and Policy Priorities, previously served as the Hugh L. Carey Fellow in Governmental Finance with New York State’s Division of Budget, holds an M.A. in Public Policy from Harvard University’s John F. Kennedy School of Government, and Nicholas Johnson, Vice President for State Fiscal Policy at the Center on Budget and Policy Priorities, holds a graduate degree from Duke University's Terry Sanford Institute of Public Policy, 2012 (“States Continue to Feel Recession’s Impact,” Center on Budget and Policy Priorities, May 24th, Available Online at http://www.cbpp.org/cms/index.cfm?fa=view&id=711, Accessed 06-27-2012)

State budget estimates for the upcoming fiscal year continue to show that states face a long and uncertain recovery. For fiscal year 2013, the fiscal year that begins July 1, 2012, 30 states have addressed or have projected shortfalls totaling $54 billion.[1]

The Great Recession that started in 2007 caused the largest collapse in state revenues on record. Since bottoming out in 2010, revenues have begun to grow again, but states are still far from fully recovered. As of the fourth quarter of 2011, state revenues remained 7 percent below pre-recession levels, and are not growing fast enough to recover fully soon.

Meanwhile, states' education and health care obligations continue to grow. Next year, states expect to educate 350,000 more K-12 students and 1.7 million more public college and university students in the upcoming school year than in 2007-08.[2] And some 5.6 million more people are projected to be eligible for subsidized health insurance through Medicaid in 2012 than were enrolled in 2008, as employers have cancelled their coverage and people have lost jobs and wages.[3]

Consequently, even though the revenue outlook is trending upward, states have addressed large budget shortfalls by historical standards as they considered budgets for the upcoming year. As the start of the new fiscal year draws near in most states, many of these shortfalls have been closed through spending cuts and other measures scheduled to take effect in the next fiscal year. Other states will soon close these shortfalls in order to meet balanced-budget requirements. To the extent these shortfalls are being closed with budget cuts, they are occurring on top of past years' deep cuts in critical public services like education, health care, and human services.

The additional cuts mean that state budgets are poised to continue to be a drag on the national economy, threatening hundreds of thousands of private- and public-sector jobs, reducing the job creation that otherwise would be expected to occur. Potential strategies for lessening the impact of deep spending cuts include more use of state reserve funds in states that have reserves, more revenue through tax-law changes, and a greater role for the federal government.

#### Spending cuts negate stimulus—the counterplan is *at best* a zero-sum game.

Lav 10 — Iris J. Lav, Senior Advisor and former Deputy Director of the Center on Budget and Policy Priorities, Founding Director of the State Fiscal Analysis Initiative—a network of nonprofit organizations that work on state budget issues, currently teaches state and local finance at Johns Hopkins University School of Government, holds an MBA from George Washington University and an AB from the University of Chicago, interviewed by Shannon Spillane, 2010 (“Podcast: States Can’t Stimulate Their Economies By Cutting Taxes,” Center on Budget and Policy Priorities, March 23rd, Available Online at http://www.cbpp.org/cms/index.cfm?fa=view&id=3120, Accessed 06-27-2012)

1. Iris, with so many states facing fiscal crisis, policymakers in a number of states are eager to find ways to boost their economies. Many of them have called for tax cuts they claim will provide economic stimulus. Your recent report, The Zero-Sum Game, finds that claim is false.

That’s exactly right: States cannot stimulate their economies by cutting taxes.

Let me explain why. Almost every state is required to balance its budget. That means that a tax cut usually would have to be offset by a cut to a program or service to keep the budget balanced. When states cut spending, they lay off public employees, cancel contracts with private-sector vendors, and eliminate or lower payments to nonprofit organizations that provide direct services. This is likely to reduce demand in the state just as much as the reduction in taxes may stimulate demand. It is at best a zero-sum game, where the gains in one area are offset by the losses in another.

#### Spending cuts offset stimulus benefits—it’s zero-sum.

Lav 10 — Iris J. Lav, Senior Advisor and former Deputy Director of the Center on Budget and Policy Priorities, Founding Director of the State Fiscal Analysis Initiative—a network of nonprofit organizations that work on state budget issues, currently teaches state and local finance at Johns Hopkins University School of Government, holds an MBA from George Washington University and an AB from the University of Chicago, and Robert Tannenwald, Senior Fellow at the State Fiscal Project of the Center on Budget and Policy Priorities, holds a Ph.D. from Harvard University, 2010 (“The Zero-Sum Game: States Cannot Stimulate Their Economies by Cutting Taxes,” Center on Budget and Policy Priorities, March 2nd, Available Online at http://www.cbpp.org/cms/index.cfm?fa=view&id=3100, Accessed 06-27-2012)

State balanced-budget requirements prevent states from stimulating their economies by cutting taxes. If a state cuts a tax, it generally has to make an offsetting cut to expenditures for a program or service in order to maintain balance. This spending cut is likely to reduce demand in the state just as much as the reduction in taxes may stimulate demand.[1] It is at best a zero-sum game, where the gains in one area are offset by the losses in another.

Moreover, a tax cut designed to induce the hiring of additional private-sector workers may also cause the layoff of other workers in the public or private sector because of the loss in state or local revenue. When states cut spending, they lay off public employees, cancel contracts with private-sector vendors, and eliminate or lower payments to nonprofit organizations that provide direct services. Such steps lead to job losses in the private and nonprofit sectors, as well as the public sector. Thus, state-level tax cuts may shift employment from one sector (or business) to another, but the net effect is unlikely to be positive.

Because of this dynamic that occurs under a balanced budget requirement, a state cannot stimulate its economy during a fiscal crisis by cutting taxes — either through a general tax cut or one targeted to specific sectors of the economy.

#### Cuts create a drag on the economy.

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Given states’ balanced budget requirements, neither a broad-based tax cut nor a jobs credit can do much to increase overall economic activity in the state. If the state pays for a tax cut by reducing other spending, then the private-sector job induced by the credit replaces a job in the public sector, in a nonprofit organization that contracts with the state, or in another private-sector company that provides goods and services to the state. There is little or no net gain to the economy. Indeed, a state-level effort to stimulate the economy in this way can inadvertently create a fiscal drag on the state and national economy.