States After the Sequester

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With no deal in sight, the cuts associated with sequestration took effect March 1.

Now what?

“The crystal ball here is very hazy. It’s hard to know what’s going to happen,” Michael Leachman, director of state fiscal research at the Center on Budget and Policy Priorities, said during a Council of State Governments’ webinar, “After Sequester: The Road Ahead for States.” “We don’t expect a deal to replace the 2013 sequestration, at least a freestanding bill, anytime soon.”

But one thing is for certain—states will take a hit, and not just from the dollars they’ll lose in federal grant funding.

Chris Whatley, director of CSG’s Washington, D.C., office, said states are concerned about the loss of domestic grants that will affect 42 streams of federal funding into the states, but they’re more worried about what impact the Department of Defense reductions will have on state economies.

Take Hawaii, where there’s a nine-to-one difference on the sequester’s impact on the state economy versus state funds lost, according to an analysis by Federal Funds Information for States. The Aloha State will lose $25 million in grants, but expects a $232 million hit to its economy.

Virginia expects to lose $107 million in federal funding, but will see a $3.3 billion hit to its economy, according to that analysis.

“It’s changed the tenor around the debate,” Whatley said. “You have state budget officers that are more focused on modeling the economic impacts as opposed to thinking about the flow of federal fund dollars into the state and its effect on state general funds.”

The cuts will be spread out over a 10-year period, minus the two months lost with the extension shortly after New Year’s. While Congress and President Obama are expected to talk about the bigger picture of deficit reduction, most expect the cuts from sequestration to hold, at least for now.

“There are so many factors at play here, unanticipated events, what happens with the economy going forward, what happens with tax reform,” said Tad DeHaven, a budget analyst at the Cato Institute and a former deputy director in the Indiana state budget office.

He said many Congressional Republicans aren’t happy about the reductions in military spending and
believes President Obama is content to allow sequestration to continue.

“I think there’s pressure behind the scenes from governors and state politicians to do something there about trying to ameliorate some of these cuts or at least bring some flexibility,” he said.

DeHaven said because the federal government can borrow trillions of dollars to balance their budgets, states have more of an incentive to pay attention to the bottom line.

“We’re in a moment where much of the political courage necessary to deal with our national fiscal problem is being outsourced by default down to the state level,” said Whatley.

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