Scaling back spending: As revenue plummets, states make variety of budget cuts

By Tim Anderson [1]
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This edition of Firstline Midwest is Part 2 of a two-part series on state responses in the Midwest to the budget crisis. Part 1 focuses on the revenue side, particularly proposals in 2009 to close budget gaps through tax increases or gambling expansions. Part 2 examines short- and long-term strategies to control spending.

Prior to the last two fiscal years, state budgets were being passed and balanced with fairly robust increases in state spending: on average, about 6 percent annually between 1979 and 2008.

But then came the “Great Recession,” and the collapse of major state revenue sources that followed.

According to a November study by the Rockefeller Institute of Government, overall tax collections have declined for four consecutive quarters. And the drops have been precipitous.

In the third quarter of 2009, state revenue was down 10.9 percent compared to the same period in 2008. Record declines were reported in the first and second quarters of 2009 — 11.7 percent and 16.6 percent, respectively.

With revenue falling, and most Midwestern states thus far rejecting broad-based tax increases to make up for this loss, deep spending cuts have become inevitable.

State general-fund expenditures fell by 3.4 percent in fiscal year 2009 and are expected to drop another 5.4 percent in FY 2010, according to the National Association of State Budget Officers. Most states in this region have followed this expenditure trend. In Illinois, for example, general-fund spending dropped 7.9 percent between FY 2009 and 2010. It fell 8.9 percent in Kansas.

An influx of money to states from the federal economic stimulus package has helped make these cuts less painful, at least over the short term. However, money from the American Recovery and Reinvestment Act begins to dry up for states in FY 2011, and very little will be available by FY 2012. The hope is that state revenue will pick up in order to make up for at least part of the loss of federal dollars.

But even with an upturn in tax collections (which is expected to occur sometime in 2010), states will face some very challenging budget problems for years to come.

During the latter part of 2009, the National Governors Association released an analysis on state budget conditions titled “The Lost Decade,” referring to the amount of time it is expected to take
before states recover from such a deep, and long, national recession.

Last summer, budget expert Scott Pattison predicted that “quite a few states will have to wait until [fiscal years] 2012 and 2013 to return to 2008 [revenue] levels.”

“That shows how bad this period has been. ... Some states will be lucky to get to 2006 levels by 2012,” Pattison, executive director of NASBO, told the Midwestern Legislative Conference. He also cautioned legislators to prepare for what he called “a new normal” in state spending patterns. The days of yearly expenditure growth averaging 6 percent may be over, he said.

What if, for example, over the next decade or two, state spending increases 3 percent a year? Are states prepared to deal with the policy and budget implications?

Inside this issue of Firstline Midwest, we detail some of the spending-reduction strategies that have been employed by states. This month’s edition also highlights some of the proposals in the Midwest to control spending and reform state government over the long term.

States make overall cuts, reduce spending in key areas

Across-the-board cuts and furloughs
One common short-term strategy to close budget gaps is an across-the-board cut of state agency appropriations (either through legislative action or a governor’s executive order).

In November, during a special session called by the governor, the Nebraska Unicameral Legislature adopted an across-the-board cut of 2.5 percent for fiscal year 2010-2011 and 5 percent for the next biennium.

That same month, in Indiana, with revenue collections falling 7.4 percent below forecasts for the first four months of FY 2010, Gov. Mitch Daniels ordered state agencies to cut budgets by 10 percent. Iowa Gov. Chet Culver ordered an across-the-board reduction this fall of 10 percent.

According to a December report of the National Association of State Budget Officers, 29 states used across-the-board cuts to help balance FY 2009 budgets, and 23 have done so in FY 2010. The reductions have ranged anywhere from 1 percent to 15 percent.

One potential consequence of this approach is that state agencies must lay off workers. But there is a “middle ground” of sorts that some states have chosen: requiring employees to take unpaid days off, or furloughs. In Iowa, for example, Culver and union leaders reached agreement this fall on a plan that they say will protect nearly 500 state jobs that were at risk due to the across-the-board cut. The plan includes a requirement that workers take five unpaid days off before June.

During the past fiscal year in Michigan, the governor and legislative leaders implemented a plan requiring many state employees to take six furlough days. As a result, most government operations were shut down on six different days between June and early September. (The state has also laid off workers.)

Under an agreement reached in Ohio between union leaders and state negotiators, employees must take 10 days of unpaid leave annually through 2011. In return, state workers will not have their base salaries cut.

In other states, unions have not agreed to furlough proposals; as result, the requirement that workers take unpaid days off only applies to non-union employees.
Four main spending areas of state government

According to NASBO data, four areas of state government make up nearly 70 percent of total general-fund expenditures: K-12 education (34.5 percent), Medicaid (16.3 percent), higher education (11.3 percent) and corrections (7.0 percent).

As a result, state strategies (long- or short-term) to control spending usually touch on some or all of these areas.

Federal dollars from the American Recovery and Reinvestment Act have been used in large part to help fill funding gaps in Medicaid or K-12 education. Still, the sheer size of budget gaps has forced reductions in some states.

In Michigan, for example, the FY 2010 budget includes a $165 per-pupil cut in state aid to school districts. Ever deeper reductions are possible in 2010 and beyond. At the higher-education level, several scholarship programs were scrapped, need-based grant programs were cut, and no funding was included for Michigan Promise, a program that has provided $4,000 scholarships to students who complete two years of post-secondary education.

In all, more than half of the U.S. states have reduced spending on K-12 education, mostly through changes in their school-aid formulas. And according to a December report from the Center on Budget and Policy Priorities, at least eight Midwestern states have cut funding for higher-education operations and/or reduced financial aid for students: Illinois, Iowa, Kansas, Michigan, Minnesota, Nebraska, Ohio and Wisconsin.

The same study also highlights various other programs and services that have been cut or eliminated as a result of state budget cuts. Examples from this region include:

- the elimination in Minnesota of a medical care program providing assistance to low-income adults, ages 21-64, who have no dependent children and who do not qualify for federally funded health care programs;
- Ohio’s decision to remove virtually all state funding for mental health treatment for individuals who are not eligible for Medicaid;
- Illinois’ reduction in funding for child welfare, mental health, youth services and other programs; and
- cuts in aid to local governments in states such as Michigan, Minnesota, Ohio and Wisconsin.

Focus on Medicaid and corrections.

Even before the recession caused state revenues to fall, policymakers were expressing concerns about the increasing cost of Medicaid — the fastest-growing part of state budgets.

According to the Kaiser Family Foundation, cost-containment options enacted over the past few years have included:

- increasing co-payments and premiums for eligible populations, or reducing benefits;
- changing application and renewal policies (such as increasing documentation requirements) to slow caseload growth;
- encouraging home and community-based options in long-term care;
- curbing prescription-drug costs by adopting preferred drug lists, creating rebate programs and entering purchasing pools;
- using managed care, medical homes and disease-management programs to better treat chronic conditions; and
- implementing pay-for-performance programs for providers and encouraging the use of health information technology.
One of the more common cost-saving ideas is to freeze or reduce provider reimbursement rates. The budget cuts announced in November in Indiana, for example, included a 5 percent cut in reimbursements to hospitals that treat Medicaid patients.

Michigan’s FY 2010 budget reduces Medicaid payments to hospitals, physicians, nursing homes and mental health providers by 8 percent compared to the rate at the beginning of FY 2009.

Provider cuts can provide quick relief to Medicaid budgets, but there also can be consequences if the reductions are too deep. Last year, Michigan Medicaid director Steve Fitton expressed concerns about reaching a “tipping point,” when payment rates decline to a level that causes many doctors to drop out of the program — thus decreasing Medicaid patients’ access to physicians.

Second to Medicaid in state spending growth over the past two decades has been the rise in the cost of corrections, according to the Pew Center on the States. As a result, cutting corrections budgets over the short term and reforming criminal justice systems over the long term became top priorities in 2009 in several states.

- Michigan expanded the size of its parole board in order to expedite the review and possible parole of prisoners (up to 12,000 inmates) who have served their minimum sentence.
- Early-release plans for certain prisoners were implemented in states such as Illinois, Ohio and Wisconsin. The Wisconsin plan is for inmates who demonstrate good behavior, complete required programming or treatment, and are not considered at a “high risk of reoffending.” The state is also offering early release to nonviolent offenders within one year of their mandatory release date, some older prisoners and individuals with a terminal illness.
- Ohio’s SB 22 gives inmates the option of participating in a prison-rehabilitation program; in exchange, they could have their sentences cut by five days for every month that they are enrolled in the program. The bill also allows judges to sentence low-level felons to halfway houses rather than jails.

These states and others in the region have also adopted various long-term plans to control corrections costs. Kansas, for example, has received national recognition for its efforts to improve prisoner re-entry programs and reduce recidivism rates. In Wisconsin this year, lawmakers expanded sentencing options for judges, allowing them to order shorter prison terms for nonviolent offenders who complete required treatment or rehabilitative programs.

In Illinois, the newly created Sentencing Policy Advisory Council (SB 1320) will review sentencing policies and practices and examine how they impact costs in the state’s criminal justice system.

**Fiscal crisis highlights importance of government performance, efficiency**

One consequence of the current fiscal crisis is an increased public awareness of and interest in government management and performance. As a 2009 report from the Pew Center on the States notes, “Tough economic times can be a crucible forging better decision making and a heightened vigilance to ensure every precious tax dollar delivers maximum value for the public.”

That same Pew study (“Trade-off Time: How Four States Continue to Deliver”) singles out Indiana as one of four model U.S. states using performance data to improve how government is run and how spending decisions are made. With direction from the governor and legislature, the state’s Office of Management and Budget is using a performance measurement tool known as PROBE (Program Results: An Outcome Based Evaluation) to examine whether various state programs are meeting a set of clearly defined goals and whether services are being delivered in an efficient manner. In other states, meanwhile, governors, legislatures and independent commissions have been examining how to cut costs over the long term and make government run more efficiently.
In Illinois, for example, the governor-appointed Taxpayer Action Board released a study in June 2009 recommending a host of government reforms. Its largest cost-cutting proposals include: policy changes to reduce the number of low-risk inmates in state prisons; the adoption of “private-sector standards” for the state procurement process; the consolidation of K-12 school districts; raising the health care premiums of state employees and retirees; and the implementation of various Medicaid reforms (for example, using medical homes, focusing more on prevention and wellness, and changing the long-term-care system to make it less reliant on institutional care).

Iowa Gov. Chet Culver signed an executive order in December implementing 40 cost-saving recommendations from the Iowa Efficiency Review Report, a 2009 study that included input from legislators, state employees and an outside consulting firm. Actions include consolidating information technology operations, modifying prescription drug and medical equipment purchasing policies in the Medicaid program, and reducing the state’s vehicle fleet. Iowa also will evaluate the cost benefits of moving to a 10-hour, four-day work week. An interim legislative committee also has made cost-saving recommendations of its own that will be considered by the General Assembly in 2010.

In a November 2009 report, the Michigan Legislative Commission on Government Efficiency offers close to 50 recommendations for the state to improve its fiscal situation. The ideas cover every major part of state government. Proposals include changing corrections and sentencing policies to reduce the prison population, restructuring revenue-sharing formulas for local governments and giving local units of government more taxing authority, redesigning the state’s Medicaid system, and giving the state superintendent the authority to consolidate school districts.

For more information on state budgets, please visit the following Web sites:

- Center on Budget and Policy Priorities
- Federation of Tax Administrators
- National Association of State Budget Officers
- Rockefeller Institute of Government
- Tax Foundation
- The Pew Center on the States

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