REPORT

Protecting the Safety Net in Tough Times

Lessons from the States

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April 2012

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The National Center for Children in Poverty (NCCP) is a leading public policy center dedicated to promoting the economic security, health, and well-being of America's low-income families and children. Using research to inform policy and practice, NCCP seeks to advance family-oriented solutions and the strategic use of public resources at the state and national levels to ensure positive outcomes for the next generation. Founded in 1989 as a division of the Mailman School of Public Health at Columbia University, NCCP is a nonpartisan, public interest research organization.

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Introduction

The Great Recession and its lingering aftermath has damaged state budgets to an extent unseen for decades, severely challenging states' capacity to support critical social safety net programs. Fiscal year 2012 will mark the fourth consecutive year that states have confronted significant shortfall between revenues and expenditures. Over this period, states have confronted – and largely solved – a cumulative \$510.5 billion in budget gaps.[1] While the economy and the fiscal picture appear to be slowly improving, states continue to confront serious challenges.

States have adopted extraordinary measures to deal with their fiscal shortfalls. These different approaches bear significant consequences for the well-being of our nation's low-income children. Some states have targeted damaging cuts to vital social safety net programs, such as Medicaid, state child health insurance programs, subsidized child care, and pre-school programs. *Yet other states with equal or greater fiscal shortfalls have found ways to balance their budgets without jeopardizing the safety net.* Among other initiatives, these states have tapped new sources of revenue and found savings in both safety net and other programs that are less damaging to the well-being of America's poor families.

The fiscal stresses of the Great Recession – the longest and deepest economic downturn in the United States since the Great Depression – are expected to persist for years to come in many states. Even as the recession officially ended in June 2009, low economic growth and persistently high unemployment have kept state revenues below their pre-recession level. Furthermore, vital federal aid delivered to states under the American Recovery and Reinvestment Act of 2009 – notably increased federal support for state Medicaid programs – is expiring.

This policy report offers a summary of the various approaches states are taking or propose taking to balance their budgets. We highlight revenue- and spending-side approaches that are protective of low-income families and endeavor to identify some best practices that other states might adopt. Finally, we seek to draw some lessons in fiscal management that may help states better weather future downturns without putting their most vulnerable populations at risk.

Background of the State Fiscal Crisis

During times of economic recession, when tax revenues fall and demand for social safety net protections rises, the federal government typically runs a budget deficit financed by borrowing to sustain the social safety net and help stimulate the economy. States, however, do not have this option, as almost all of them are mandated by their constitutions to balance their annual or biannual budgets. This mandate means that states typically adjust their spending to their revenue projections. When revenues fall during a recession, states must either cut spending or draw down surpluses accumulated during previous years and held in budget stabilization or "rainy day" funds. In fiscal years 2007 and 2008, general fund revenues for states as a whole closely matched expenditures and state resources as a whole (including budget surpluses accumulated from previous years) provided a substantial cushion for spending.[2]

To some extent, the revenue and spending practices states followed before the recession left them more or less vulnerable to fiscal hardship when the recession struck. Some states relied heavily on income tax revenues, which fell sharply during the recession. Others chronically underfunded their unemployment insurance programs, leaving them unable to meet their obligations when the unemployment rolls rose. By contrast, a number of states followed sound fiscal management practices during the good times, diversifying their revenue streams, effectively funding and efficiently managing key safety net programs, and building sizable rainy day funds to tap when the downturn struck.

The Great Recession sharply reduced state revenues from income, sales, and other taxes while increasing demand for Medicaid and other social safety net programs. State tax collections fell by the highest percentage on record in the course of the year ending in June 2009 and inflation-adjusted general fund revenues fell an extraordinary 17 percent from fiscal years 2008 to 2010.[3] To balance their budgets, states increased their revenue-raising efforts and imposed deep spending cuts. On the revenue side, states enacted a historically large collective tax increase in calendar year 2009, raising personal income tax levies by the largest dollar amount on record. Collectively, states also substantially raised sales and corporate income taxes. However, *not all states raised taxes* – indeed, about the same number *cut* personal and corporate income taxes during that difficult year. Furthermore, the increased revenues primarily accrued to a small number of states with large economies that enacted significant increases, including California, New York and New Jersey (personal income tax) and Massachusetts, California, New York and Pennsylvania (corporate income tax).[4]

Spending cuts were similarly drastic. In dollar terms, the states as a group cut general fund spending (in inflation-adjusted terms) by one percent in fiscal year 2008, 3.4 percent in 2009, and 7.8 percent in 2010 before increasing spending again by 2.4 percent in fiscal year 2011.[5] *No fewer than 42 states plan to spend less in inflation-adjusted dollars in fiscal year 2012 than they did in 2008*. For some states, the revenue shortfalls and corresponding spending cuts have been especially devastating. In California, general fund spending fell a crippling 22 percent in inflation-adjusted terms from fiscal year 2008 to fiscal year 2012 (as appropriated). Alabama, Arizona, Florida, Georgia, Louisiana, Michigan, New Jersey and South Carolina are also spending 17 to 26 percent less in real terms during the current fiscal year than they did before the recession struck.[6]

Responding to the large tax increases enacted in fiscal year 2009 and a fitful return to economic growth, aggregate state sales, personal income, and corporate income tax collections all rose in fiscal year 2011 and are projected to rise modestly in fiscal 2012.[7] Aggregate state general revenue spending also rose modestly in nominal terms during those years. Unfortunately, revenues are still short of their pre-recession peak, and emergency federal assistance is expiring. This aid pumped $135 billion into state coffers during the three previous years, but states have only three billion remaining to draw on during the current fiscal year.[8] While the job market appears to be improving in early 2012, economic growth has been slower than expected in recent quarters, resulting in revenues falling substantially below than those projected for fiscal year 2012 for many states, notably California.[9]

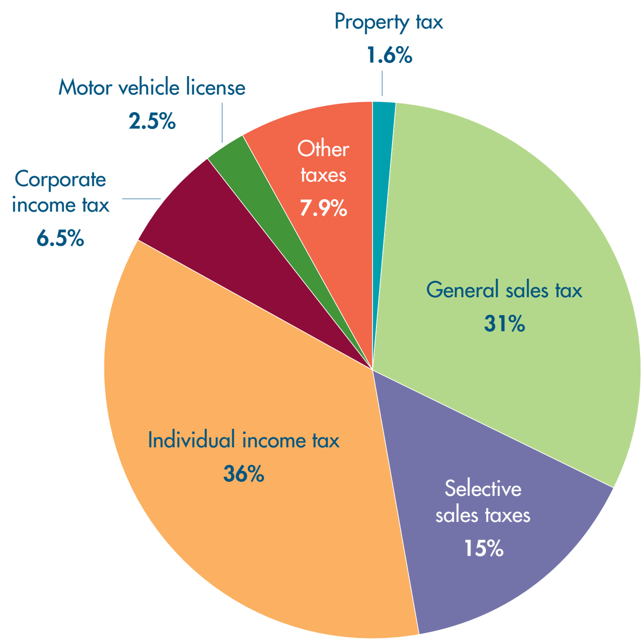
A Primer on State Public Finance

While policymakers often share common goals, states differ greatly in how they obtain and spend their revenues. This variation reflects state diversity across many social, political and economic dimensions, such as industrial structure, the size of per capita personal income, and public perceptions of the appropriate role of government. Different state revenue and expenditure structures can contribute significantly to policymakers' capacity and willingness to fund a strong social safety net during economic hard times.

State Revenue Sources

State governments raise revenues primarily from a variety of taxes and charges for services. For the 50 states together in 2008, taxes accounted for 73 percent of general revenues drawn from states' own sources (excluding transfers from the federal and local governments) while charges for state-provided services and miscellaneous general revenues for 27 percent.[10] For the 50 states as a whole, the individual income tax and sales taxes are the most important sources of state tax revenue, as shown in Figure 1.

Figure 1: **Sources of State Tax Revenues, 2008**



Source: U.S. Census Bureau, 2008 Annual Surveys of State and Local Government Finances. Selective sales taxes are those levied on the sale of particular commodities or services not subject to the general sales tax. Other taxes include taxes imposed on the removal of natural resources, such as oil, gas,coal and timber.

Among state governments, there is substantial variation in the proportion of revenue raised from income, corporate, and general sales taxes, as well as other streams such as severance taxes on the extraction of natural resources and selective sales taxes. The heterogeneity among states in their reliance on particular taxes is summarized in Table 1. In 2008, Connecticut, New York and Oregon each relied on the individual income tax for 42 percent of their total revenues from state sources. Massachusetts and California were also highly reliant on this tax. On the other hand, North Dakota, New Hampshire, New Mexico and Tennessee derived less than 15 percent of their revenues from this tax, and seven states impose no tax at all on individual incomes. Similar heterogeneity characterizes states' use of the second principal source of tax revenue overall, the general sales tax. Washington derives fully 47 percent of its revenues from this source, followed by Florida at 45 percent and Nevada and Tennessee, both at 41 percent. Alaska, Delaware, Montana, New Hampshire and Oregon impose no sales tax.

Finally, several states draw a large share of their revenues from selective sales taxes and from other taxes, usually severance taxes imposed on the extraction of natural resources. For example, Nevada draws 25 percent of its revenue from selective sales taxes, most of which are derived from the gaming industry. Alaska earns more than half of its total revenues from the "other taxes" category, primarily from severance taxes. Wyoming, North Dakota, Texas, Montana and New Mexico also earn a large share of their revenues from natural resource extraction. Delaware, meanwhile, garners significant revenues from a franchise tax on businesses.

Table 1: State Tax Revenue Structures at a Glance

State	Individual Income Tax			Corporate Income Tax			General Sales Tax			Selective Sales Taxes			Other Taxes	
	High	Low	None	High	Low	None	High	Low	None	High	Low	None	High	Low
ALABAMA										x				
ALASKA			x	x					x		x		x	
ARIZONA							x							x
ARKANSAS														x
CALIFORNIA	x			x							x			
COLORADO	x													x
CONNECTICUT	x													x
DELAWARE				x					x				x	
FLORIDA			x				x			x				
GEORGIA	x													x
HAWAII					x		x							x
IDAHO	x													
ILLINOIS				x						x				
INDIANA														
IOWA														
KANSAS														
KENTUCKY														
LOUISIANA														
MAINE	x													
MARYLAND	x													
MASSACHUSETTS	x			x							x			x
MICHIGAN														x
MINNESOTA	x													
MISSISSIPPI							x							
MISSOURI	x				x									x
MONTANA									x	x			x	
NEBRASKA	x													x
NEVADA			x			x	x			x				
NEW HAMPSHIRE		x		x					x	x				
NEW JERSEY	x			x										
NEW MEXICO		x											x	
NEW YORK	x			x										
NORTH CAROLINA	x													
NORTH DAKOTA		x											x	
OHIO					x									
OKLAHOMA					x								x	
OREGON	x								x		x			
PENNSYLVANIA														
RHODE ISLAND														x
SOUTH CAROLINA					x									x
SOUTH DAKOTA			x				x			x				
TENNESSEE		x		x			x							
TEXAS			x				x			x			x	
UTAH														x
VERMONT					x			x		x				x
VIRGINIA	x													
WASHINGTON			x			x	x							
WEST VIRGINIA				x						x				
WISCONSIN	x													
WYOMING			x			x					x		x	

Source: U.S. Census Bureau, 2008 Annual Surveys of State and Local Government Finances.
High reliance is defined as percentage of total state revenue from own sources equaling or exceeding the following: individual income tax, 30%; corporate income tax, 6%; general sales tax, 30%; selective sales tax, 15%; other taxes, 10% . Low reliance is defined as percentage of total state revenue from own sources that is less than the following: individual income tax, 15%; corporate sales tax, 3%; general sales tax, 15%; selective sales tax, 7%; other taxes, 3%.

As a general rule, states with a diverse tax revenue structure that includes a progressive individual income tax are better equipped to weather the fiscal problems caused by recessions. Reduced production, employment, consumption and profits typically translate into lower receipts across the spectrum of taxes, but a broad tax base acts to spread the risk among economic actors. A high reliance on selective sales taxes and severance taxes can result in a revenue crash should price and demand for the relevant products fall sharply. High reliance on the general sales tax may also leave states vulnerable to sharp revenue declines when recession induces consumers to cut back on their spending. In general, the progressive individual income tax is a more resilient source of revenue during economic downturns as a comparatively high percentage of higher-income workers often remains employed and tax rates can be readily adjusted to compensate in part for the reduced tax base.

Independent analysts have found that the fiscal crises in Florida and Nevada were exacerbated by the absence of an individual income tax in these states.[11] On the other hand, Oregon's very high reliance on the individual income tax and rejection of a general sales tax also left this state vulnerable to recession-induced employment and earnings losses. Although many states with well-diversified revenue sources – such as California and New York – are also in fiscal distress, diversification has been shown to lower fiscal risk, all else equal.[12]

Because most states are constitutionally required to balance their budgets annually or biannually, states typically cut taxes when times are good and revenue is high and raise taxes when revenues drop during a downturn. Raising taxes, while often necessary and preferable to imposing damaging spending cuts, reduces consumers' disposable income and tends to weaken economic recovery. Prudent budgetary practice would have states defer cutting taxes when the economy is strong until they have built strong rainy days funds to help them weather downturns. *Nevertheless, 18 states are already cutting taxes and fees in fiscal year 2012 despite their fragile finances, reducing net aggregate revenue from these sources by almost $600 million*. For example, Michigan sharply reduced its corporate tax rate in May 2011, costing the state an estimated $1.1 billion in fiscal year 2012, although state revenues still lag far below the pre-recession level.[13]

Rainy Day Funds

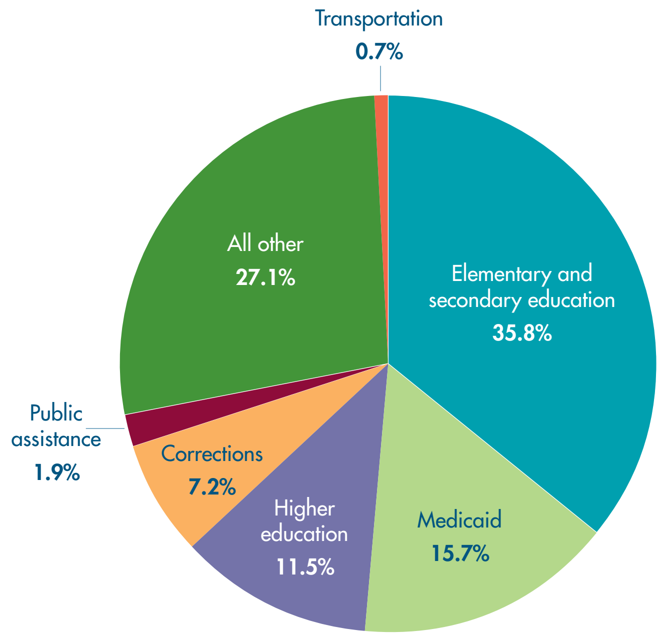
States use budget stabilization or "rainy day" funds to help deal with unforeseen fiscal shocks and to balance budgets at the end of fiscal year. States following prudent budgetary practices build up these funds during good economic times when tax revenues are high and draw them down during recessions or other times of need. While 48 states have rainy day funds, the size of these funds relative to total expenditures varies greatly, as do restrictions imposed on their use. Notably, some three-fifths of states restrict the size of their rainy day funds, ranging from three to 10 percent of appropriations.[14] Since fiscal year 2006, states have spent more than half of their aggregate rainy day balances and 13 states now find themselves in dire straits, with funds below $10 million (11 of these have zero balances).[15]

State Spending Categories

The distribution of spending from state "general funds" – the primary category accounting for spending from states' own resources – shows that elementary and secondary education accounts for the largest share of expenditure, followed by Medicaid, as shown in Figure 2.[16] Higher education and corrections also account for substantial shares of spending. The public assistance category is notably small, accounting for just 1.9 percent of state general fund spending. This category is narrowly defined to comprise state spending to support (or supplement federal funding for) cash assistance programs, including Temporary Assistance to Needy Families (TANF), Supplemental Security Income (SSI), General Assistance and emergency assistance. For TANF, only state cash expenditures are counted, and not the value of important non-cash services, such as work activities and child care and transportation supports. The "all other" category includes both safety net program spending (Child Health Insurance Programs, child care subsidies, institutional and community care for the mentally ill and developmentally disabled, and housing assistance) and diverse other activities, including economic development, environmental projects, state police, parks and recreation, and general aid to local governments.

The combined value of state general fund spending on the safety net programs in the Medicaid, "public assistance" and the CHIP component in the "all other" category amounts to about 18 percent of aggregate state general fund spending.[17] While significant (and an understatement of total safety net spending) this comparatively modest share suggests states are likely to find substantial savings to plug budget gaps in larger programs that are less critical to their most vulnerable populations.

Figure 2: **State General Fund Expenditures, 2009**



Source: National Association of State Budget Officers, State Expenditure Report, FY 2009

What Is the State Safety Net?

This report defines the federal/state social safety net to comprise a group of critical, publicly-funded programs designed to help families meet their basic economic needs and support healthy development in early childhood. Defined more broadly, the safety net might include many other important social investments in education, job training, public health, retirement security, and other programs supporting socioeconomic security. The programs discussed in this report (apart from unemployment insurance and universal pre-Kindergarten programs in some states) are directed toward low-income families and most of them include an important state role in setting program rules, funding and/or administration. Most of the programs received critical additional funding during fiscal years 2009 through 2011 under the American Recovery and Reinvestment Act of 2009. Unless otherwise noted, program information is summarized from the U.S. House of Representatives' comprehensive guide known as the Green Book.[18]

Medicaid

- *The program*. Medicaid is a very low-cost public health insurance program. The program primarily serves two distinct populations: low-income families with children and nursing home care for the elderly with low income and assets. The program is an entitlement, meaning that any person meeting eligibility standards is entitled to program benefits. The federal government sets minimum standards for eligibility, which states can expand, resulting in considerable variation in program eligibility across the states. As a result of "maintenance of effort" (MOE) provisions in the American Recovery and Reinvestment Act of 2009 and the Affordable Care Act of 2010, states have generally been required to maintain program eligibility and enrollment policies that were in effect on July 1, 2008 and March 23, 2010, respectively.[19]

- *Funding and administration*. Medicaid is administered by states and jointly funded by the federal and state governments through a formula that bestows a greater share of federal support to poorer states. The federal matching rate increased substantially under the federal American Recovery and Reinvestment Act of 2009, but this increased support expired at the end of June 2011.
- *Trends in enrollment and spending*. Medicaid is a very large program. More than 76 million people (almost one-fourth of the total population) lived in households in which at least one member received Medicaid in 2010.[20] State Medicaid expenditure has grown very fast in recent years, more than doubling in nominal terms from 1995 to 2009.[21] The rapid increase in costs is due to broader program eligibility standards, healthcare inflation and a rapid rise in program enrollment as persistent high unemployment results in rising poverty and a loss of employer-provided health insurance. Enrollment in the program is expected to rise a cumulative 17.7 percent between FY 2010 and FY 2012.[22] States spent an estimated $149 billion of their own funds on Medicaid during FY 2011 and total federal and state spending on the program is projected to grow at an 8.3 percent annual rate for the next decade, in part reflecting program expansions under the Affordable Care Act.[23]

Child Health Insurance Program

- *The program*. Enacted in 1997, CHIP programs provide free or low-cost health insurance for low-income children, and, in some states, their parents. Children with family income that exceeds Medicaid eligibility standards may qualify for CHIP.
- *Funding and administration*. Like Medicaid, CHIP is administered by states and funded by state and matching federal funds. Some states administer CHIP under their Medicaid programs and other states have stand-alone CHIP programs. Unlike Medicaid, CHIP is not an entitlement, and is subject to an annual funding cap. About 7.7 million children were enrolled in CHIP at some point in FY 2010.[24]
- *Trends in enrollment and spending*. Enrollment in CHIP grew very rapidly from 660,351 in 1998, though program growth has slowed in recent years. State and federal program funding rose modestly in recent years to $3.1 billion (states) and $10.6 billion (federal) in FY 2009.[25] Although the CHIP program is capped, the child participation rate (the percentage of eligible children participating in the program) in Medicaid or CHIP is about 85%, although some states, including Nevada, Utah, North Dakota and Texas have substantially lower participation rates.[26]

Supplemental Nutrition Assistance Program

- *The program*. SNAP (formerly food stamps) provides qualifying households with a monthly award of dollars on a special debit card that can be used to purchase a broad range of foods. The award amount is based on the number of qualifying beneficiaries in the household. The program is an entitlement, meaning that it is funded annually at a level sufficient to provide a benefit to all qualifying households seeking this assistance.
- *Funding and administration.* The federal government funds the full benefit cost and half of administrative costs, with states defraying the other half. The federal government sets minimum eligibility standards for the program, but states have options to set more liberal assets and income limits.
- *Trends in enrollment and spending.* More than 44.7 million people participated in the SNAP program in fiscal year 2011 – about 14.5 percent of the U.S. population. Average monthly enrollment has grown by an extraordinary 70 percent since 2007, demonstrating the great importance of SNAP as a safety net program in the course of the Great Recession and its aftermath. Federal and state program spending also more than doubled to $75 billion from fiscal years 2007 to 2011.[27] The program is especially important for low-income families with children: an estimated 92 percent of eligible children participated in the SNAP program in FY 2009 compared to 72 percent of eligible individuals in all households.[28]

Tax Credits for Low-Income Households

- The federal *Child Tax Credit* is an important benefit for low-income families with children. The credit is valued at $1,000 per child and is partly refundable, meaning that households may receive all or a portion of the credit as a cash payment if the credit exceeds their tax liability, subject to certain limitations. The value of the credit declines as gross income rises above a threshold. ARRA expanded the credit by $15 billion, targeting the benefit to low-income families.[29] The credit returned $56 billion to families in tax year 2010.[30]
- The federal *Child and Dependent Care Tax Credit* indirectly supports child care for taxpayers who have earned income. The credit covers up to 35 percent of a limited amount of employment-related child care expenses, with the rate diminishing as income rises. The credit is not refundable, so taxpayers with no tax liability do not get the credit. This credit returned $3.5 billion to families in tax year 2010.[31]
- The federal *Earned Income Tax Credit* is a fully refundable tax credit for low-income, working families. First enacted in 1975, the EITC was made substantially more inclusive and generous in the mid-1990s and has now become the largest cash support program for low-income families with children. The federal EITC returned more than $59 billion to more than 26 million people in low-income families in 2011, providing a top benefit of $5,700.[32] In addition to the federal program, 22 states have their own EITCs.

Child Care Subsidies

- *The programs*. The federal and state governments provide a limited amount of support to subsidize child care expenses for low-income families. Children eligible for the program must be under age 13 and be living with parents who are working or enrolled in school or training (or be in need of protective services); family income may not exceed 85% of state median income, and states may set lower income eligibility. Although child care is not an entitlement, a portion of the federal spending is "mandatory," requiring annual funding of state programs according to state-specific formulas. Another portion is "discretionary" and subject to an annual appropriation.
- *Funding and administration*. The primary source of federal funding of child care assistance is the Child Care and Development Fund (CCDF) distributed to states. Additional federal funding is available, at states' discretion, through the TANF and Social Services Block Grants to states. In addition, the Child and Adult Care Food Program subsidizes meals for children in child care. Some federal monies require state "maintenance of effort" or matching contributions from state funds. States administer child care subsidy programs.
- *Trends in enrollment and spending.* Only an estimated 17 percent of income-eligible children eligible for child care subsidies received them in fiscal year 2010, a proportion that has not increased since 2007.[33] Average monthly enrollment actually declined slightly from 1.7 million children in fiscal year 2007 to 1.6 million in fiscal year 2009, which may in part reflect higher unemployment rates among parents. Total (federal and state) CCDF expenditures, meanwhile, declined by about $1 billion during these two fiscal years to slightly more than $9 billion.[34] However, using ARRA funds, President Obama increased CCDF spending by $2 billion in fiscal years 2009 and 2010.

Early Childhood Programs

- *The programs.* The *Head Start* program provides a wide range of services to low-income, preschool-aged (aged 3 and 4) children and their families, including child cognitive and language development; medical, dental, and mental health services; and nutritional and social services. In 1994, the program was expanded to include *Early Head Start*, providing services to pregnant mothers and children under age 3. State *Pre-Kindergarten* programs provide a year or two of education for 3- and 4-year-olds. Forty states operated pre-K programs in 2010. Twenty-one states operate only means-tested programs but 19 states provide universal pre-K irrespective of family income (although in some cases, low-income children have priority access to limited funding).[35]

- *Funding and administration*. The federally-funded Head Start program is not an entitlement and is subject to an annual appropriation. The federal government makes direct grants to local Head Start program providers and administers the program. State-run pre-K programs are primarily funded by the states, but the federal and local governments also provide some funding.
- *Trends in enrollment and spending*. Head Start program enrollment peaked in FY 2002 at 912,345 children and has since slightly declined. The latest available data show enrollment at 904,153 in FY 2009 and an FY 2010 program appropriation of $7.2 billion (excluding a $2.1 billion ARRA supplement for fiscal years 2009 and 2010).[36] The Head Start program is estimated to serve only about half of eligible low-income children.[37] Almost 1.3 million children were enrolled in state pre-K programs during the 2009-2010 school year. Enrollment of 4-year-olds grew rapidly over the 2002 to 2010 period from 14 to 27 percent of the age group; in addition, about four percent of 3-year-olds are enrolled in pre-K. States spent $5.4 billion on pre-K programs in 2009-2010, including supplementary federal TANF and ARRA funds. Average state spending per child enrolled declined by almost 15 percent from 2002 to 2010.[38]

Temporary Assistance to Needy Families

- *The program.* TANF provides cash assistance to needy families with children. The program is not an entitlement, but is funded annually at a fixed amount through a federal block grant to states. States have significant control over benefit levels, work requirements and time limits for benefit receipt. In many states, working TANF recipients are given priority when allocating subsidized child care, making the program important to families beyond the often-small cash grant. States vary enormously in the scope and generosity of their TANF cash grant programs. In Rhode Island, more than 60 percent of children in poverty lived in families receiving TANF cash assistance, while in Wyoming, only three percent did in 2006. Similarly, the monthly cash benefit amount varies enormously by state – in 2010, a single-parent family of three received $753 in New York City but only $170 in Mississippi.[39]
- *Funding and administration*. States must spend a minimum amount of their own funds on behalf of families meeting state TANF financial eligibility requirements, either by supplementing the TANF program or funding a separate state program. States have broad latitude to determine cash benefit amounts and the distribution of TANF funds among cash benefits and other allowable expenditures, such as job preparation, transportation, marriage promotion and pregnancy prevention, child care subsidies, and other social services.
- *Trends in enrollment and spending*. Following the 1996 welfare reform that set lifetime limits on cash assistance and strengthened parental work requirements, the number of TANF cash recipients fell dramatically from 12.6 million in FY 1996 to 3.8 million in FY 2008.[40] Similarly, the ratio of children in families receiving cash welfare to total children in poverty fell from 61.5 percent in 1995 to 26.7 percent in 2006. In the course of the Great Recession and its aftermath, however, the TANF cash grant caseload rose to 4.4 million by June 2011.[41] The TANF basic block grant (excluding additional funds furnished through ARRA) has been fixed at $16.5 billion annually in nominal terms since 1996 and hence has hence eroded sharply in inflation-adjusted terms.

Unemployment Insurance

- *The program.* State unemployment insurance programs provide a modest, time-limited, weekly cash stipend to qualified workers who have lost their job through no fault of their own. The benefit amount is determined by the amount of the worker's past qualified earnings, up to a maximum benefit. Eligibility, benefit amount, and duration of the benefit vary greatly by state. Many unemployed workers do not qualify for UI benefits, including part-time, temporary and self-employed workers.

- *Funding and administration*. UI is administered by states under federal guidelines. In most states, the first 26 weeks of benefits are funded by an employer-paid payroll tax. Under the temporary Emergency Unemployment Compensation program created in 2008, the federal government funds up to 34 additional weeks of benefits for eligible workers in all states and another 19 additional weeks for workers in states with high unemployment rates. Finally, under the Extended Benefits program, the federal government funds up to 20 additional weeks of UI for workers in states experiencing high unemployment rates who have exhausted their regular UI and EUC benefits. ARRA provided temporary full federal funding for the EB program, which was created in 1970 and is normally funded equally by states and the federal government.[42] The EUC program and full federal funding for EB was extended until March 7, 2012. A number of states are now straining to cover their regular UI commitments due to a combination of high program demand and a pattern of underfunding the trust funds supporting the program over a period of years. By the third quarter of 2011, 14 states had trust fund balances equivalent to less than 0.05 percent of total wages, and states collectively owed the federal government $38 billion in loans to cover their UI obligations.[43]
- *Trends in enrollment and spending*. The UI program, and especially its EUC and EB extensions, has been a very important part of the safety net in the course and aftermath of the Great Recession. Because of historically high unemployment rates and the EUC/EB benefit extensions, the number of UI recipients and program spending has grown very rapidly since 2007. While in 2007, the number of new UI beneficiaries was 7.6 million and $30.5 billion in benefits were paid, these numbers rose to 10.7 million and $107.8 billion in 2010.[44] From July 2008 until October 2011, a cumulative 17.9 million jobseekers received EUC/EB benefits. About 50 million Americans – including 13 million children – either received these benefits or lived in a household with someone who did during this period.[45] According to the U.S. Census Bureau, UI kept 3.2 million people out of poverty in 2010 alone.[46]

Safety Nets *Work*

A compelling body of research demonstrates that publicly-funded safety net programs are effective in protecting the health and economic security of America's families. Two recent studies found that tax credits, SNAP and housing subsidies all had strong poverty-reducing effects, especially for families with children.[47] The child poverty rate in 2010 would have been four percentage points higher without the EITC, for example, and three percentage points higher without SNAP. A recent rigorous study of the Medicaid program found that Medicaid beneficiaries are more likely to receive essential medical care, more likely report their health status as good or excellent, and more likely to maintain financial stability compared to other low-income adults.[48] Extended unemployment insurance benefits have prevented millions of Americans from falling into poverty in the course of the Great Recession and its aftermath.

Rigorous research also shows that investing in high-quality early childhood education and development programs is protective of disadvantaged children and improves their socioeconomic prospects as adults.[49] Supporting child health and cognitive development during the critical years from birth to age five is linked to better health, educational, and economic outcomes throughout the life course. Both the individual and society gain.

State Safety Nets: Where You Live Makes a Big Difference

States differ greatly in both their capacity to fund social safety nets and their commitment to funding them. States with comparatively low per capita incomes generate lower per capita tax revenues, all else equal. Hence, poorer states – where the need for a social safety net is greatest – are often the least able to finance their safety net programs. The federal government considers comparative state need – as measured by average personal income, poverty rates, unemployment rates and other indicators – in the formulas it uses to distribute federal aid in many important safety net programs. However, these formulas are only modestly redistributive to higher-need states. A particularly striking case is the TANF program. The federal allocation to states is based on state spending levels during the mid-1990s under the predecessor Aid to Families with Dependent Children program. Since poorer states typically granted a smaller AFDC benefit and enrolled fewer of their poor populations in the program, they now receive a lower federal TANF match than do richer and more generous states. A supplemental federal TANF grant provides modest additional support to 17 of these low-spending states, but still leaves large inter-state disparities in federal funding.

Moreover, the block granting of federal aid supporting crucial programs – including child care subsidies and TANF – gives states great leeway with respect to how they spend these monies, and some poorer states with great need have chosen to spend comparatively few of their own or federal resources on important safety net programs, such as TANF cash benefits.

One way to roughly evaluate states' commitment to their social safety nets is to compare what they spend on these programs to the average share of safety net spending among all states, adjusted for state poverty rates. Table 2 identifies two groups of states: those that spent a substantially higher share and those that spent a substantially lower share of their direct general expenditures on safety net programs than what would be predicted by their poverty rates. The frame of reference is the share of safety net spending for the aggregate of all 50 states. For the whole group of 50 states, the ratio of the safety net share of spending to the poverty rate is 2.69 to one. In other words, for each increase in the state poverty rate of one percentage point, the share of safety net spending is expected to increase by 2.69 percentage points. Although this spending includes both state and *federal* spending (unlike the state-only general fund spending discussed above), the ranking still provides a sense of how states prioritize their safety nets.

The data for all 50 states show a weak positive association between state poverty rates and the share of spending spent on safety net programs. Strikingly, however, all of the states listed in the lowest safety net expenditure group have high poverty rates with the exception of Hawaii. While state spending per capita is expected to be low among these poorer states, the data in Table 2 show many of these poorer states also give comparatively low priority to safety net spending in their direct general expenditures. On average, the 10 lowest-expenditure states listed in Table 2 devoted higher shares of their direct general expenditures to education, hospitals, and highways compared to the 10 highest-expenditure states in the table.

Table 2: States with Strong and Weak Safety Net Commitments, 2008

State	Actual Safety Net Spending (%)	Expected Safety Net Spending (%)	Actual-Expected (percentage points)	State Poverty Rate (%)
ALL STATES	**34.6**	**34.6**	–	–
Ten Highest Expenditure States				
MINNESOTA	44.0	25.3	18.7	9.4
NEW HAMPSHIRE	34.0	20.4	13.6	7.6
MASSACHUSETTS	39.5	26.1	13.4	9.7
MARYLAND	32.6	21.3	11.3	7.9
RHODE ISLAND	41.4	31.2	10.2	11.6
VERMONT	37.2	27.2	10.0	10.1
NEW JERSEY	32.2	22.9	9.3	8.5
NEW YORK	44.3	35.8	8.5	13.3
CONNECTICUT	32.1	23.7	8.4	8.8
MAINE	40.6	32.8	7.8	12.2
Ten Lowest Expenditure States				
LOUISIANA	23.9	45.7	-21.8	17.0
MISSISSIPPI	36.2	54.1	-17.9	20.1
MONTANA	20.9	36.9	-16.0	13.7
ALABAMA	29.3	41.4	-12.1	15.4
WEST VIRGINIA	33.7	45.7	-12.0	17.0
KENTUCKY	34.3	44.9	-10.6	16.7
NEW MEXICO	35.4	44.7	-9.3	16.6
SOUTH CAROLINA	31.4	40.6	-9.2	15.1
HAWAII	16.6	24.5	-7.9	9.1
ARKANSAS	37.9	44.9	-7.0	16.7
Other States				
ALASKA	18.4	24.2	-5.8	9.0
ARIZONA	40.2	38.7	1.5	14.4
CALIFORNIA	30.5	35.2	-4.7	13.1
COLORADO	26.1	29.6	-3.5	11.0
DELAWARE	26.8	26.9	-0.1	10.0
FLORIDA	36.5	34.7	1.8	12.9
GEORGIA	35.5	38.5	-3.0	14.3
IDAHO	33.9	32.8	1.1	12.2
ILLINOIS	39.6	32.0	7.6	11.9
INDIANA	38.4	33.6	4.8	12.5
IOWA	35.5	29.9	5.6	11.1
KANSAS	33.6	29.6	4.0	11.0
MICHIGAN	34.8	37.7	-2.9	14.0
MISSOURI	34.3	35.0	-0.7	13.0
NEBRASKA	34.2	28.2	6.0	10.5
NEVADA	27.3	29.6	-2.3	11.0
NORTH CAROLINA	31.2	37.9	-6.7	14.1
NORTH DAKOTA	25.4	29.6	-4.2	11.0
OHIO	37.7	34.7	3.0	12.9
OKLAHOMA	37.2	40.9	-3.7	15.2
OREGON	30.8	35.8	-5.0	13.3
PENNSYLVANIA	38.6	31.2	7.4	11.6
SOUTH DAKOTA	29.6	32.8	-3.2	12.2
TENNESSEE	44.9	40.3	4.6	15.0
TEXAS	35.3	41.4	-6.1	15.4
UTAH	22.0	25.8	-3.8	9.6
VIRGINIA	26.4	26.4	0.0	9.8
WASHINGTON	30.5	29.9	0.6	11.1
WISCONSIN	32.7	27.4	5.3	10.2
WYOMING	23.5	25.0	-1.5	9.3

Sources: U.S. Census Bureau, 2008 Annual Surveys of State and Local Government Finances; U.S. Census Bureau, Small Area Income and Poverty Estimates, 2008. Actual Safety Net Spending is the ratio of public welfare spending to total direct state general expenditure. Public welfare spending includes that associated with major means-tested programs (SSI, TANF, Medicaid) and other publicly-funded programs, including general relief, foster care, day care, and homeless services.

How Are States Balancing Budgets?

Given the dire condition of state finances, there is no question that states must make some difficult and unpopular decisions about cutting spending and raising taxes. Nevertheless, state policymakers have a wide range of revenue and spending options to craft lean and balanced budgets. Apart from Medicaid, the major social safety net programs account for a small share of state spending. *Yet some states have imposed damaging cuts on these programs, while others have found ways to protect many of their programs, and in some cases, even expand them.* A number of governors and state legislatures have resisted taking any significant new revenue measures to complement spending cuts, while others have raised taxes and fees substantially, allowing them to maintain funding of important programs. This section of the report compares some of these different state approaches to budget balancing, emphasizing progressive measures that are protective of the safety net.

Damaging Social Safety Net Cuts

As would be expected, states have generally concentrated their general fund budget cuts in the largest expenditure categories: K-12 education, higher education, and Medicaid. In FY 2012, for example, 28 states cut nominal (not adjusted for inflation) higher education spending in their enacted budgets relative to FY 2011and 12 cut nominal K-12 spending. Thirteen states cut nominal Medicaid spending or kept it at the FY 2011 level.[50]

In some states, governors and legislators have made additional deep cuts in safety net programs that risk jeopardizing the health and well-being of their low-income constituents. Public spending cuts that reduce services (such as those provided by Medicaid) and disposable income (such as cuts to state tax credits for low-income households) also slow economic recovery by reducing consumer spending and economic activity. Furthermore, they may also end up costing states and localities as much or more than the supposed savings if the cost is simply shifted. For example, children who are dropped from state child health programs may forego regular doctors' visits for preventive care and end up receiving more expensive care in public hospitals. *To get an accurate estimate of the true savings from spending cuts, it is critical to adjust gross savings by the expected effect of the cuts on state economic output, consumer spending, tax revenues, and use of other safety net programs.* State governors and legislators rarely consider net savings when preparing their budget-cutting exercises, however. Some of the more damaging cuts to safety net programs enacted in fiscal year 2012 are summarized as follows.[51]

Medicaid and CHIP

Federal "maintenance of effort" requirements have generally kept states from imposing new restrictions on Medicaid eligibility and enrollment in an effort to save costs. Indeed, almost all states maintained their eligibility and enrollment standards or actually liberalized these rules, according to the most recent survey, for 2010, from the Kaiser Commission on Medicaid and the Uninsured.[52] Because of the federal match, states must cut at least two dollars in qualified program spending, such as provider payments, to save one dollar in state spending. Given the program's costliness to state budgets, all states have sought to control rapidly growing Medicaid expenses. Some of these cost-cutting measures are harmful to those who depend on this important safety net program.

- **Arizona** received a federal waiver to cut 120,000 childless adults from the state Medicaid program.
- **Arizona** capped enrollment in its CHIP program in 2010, and the cap is still in effect.[53]
- **New Jersey** stopped enrolling parents in its CHIP program in 2010.

- **California** enacted legislation cutting $1.7 billion in the state's Medicaid program that included a deep cut in provider reimbursement, new co-payments for beneficiaries and a cap on physician office visits. (A federal court subsequently struck down the payment cut to providers.)
- **Rhode Island** reduced the Medicaid income eligibility limit for parents from 175 percent of the federal poverty line to 133 percent of the line.
- While most states increased their Medicaid spending in FY 2012, eight states kept spending flat in their enacted budgets and **Illinois, Mississippi, South Carolina, Massachusetts** and **Vermont** actually cut Medicaid spending.[54]
- **39 states** cut rates paid to Medicaid providers in FY 2011 and **46 states** plan to do so in FY 2012. Continued cuts in reimbursement rates that are already low act to reduce the quality of care and limit the number of health care providers willing to accept Medicaid payment, in effect reducing Medicaid beneficiaries' access to care.[55]
- **18 states** in both FY 2011 and 2012 eliminated, reduced or restricted services to beneficiaries, including dental, therapeutic, and personal care services.[56]
- **Five states** in FY 2011 and **14 states** in FY 2012 increased co-payments or imposed new co-payments for services on beneficiaries.
- **Maine** cut Medicaid benefits to legal noncitizens not residing in the U.S. for at least five years.

Tax Credits

- **New Jersey, Michigan** and **Wisconsin** reduced the generosity of their Earned Income Tax Credit programs.

Child Care Subsidies

- **California** cut its childcare subsidy budget by 11 percent in FY 2012, excepting only the mandated funding in its TANF program.[57] The state also eliminated subsidized child care for 11 and 12 year olds.
- **Florida, Georgia, Hawaii, Minnesota, Nevada, Ohio, Oklahoma** and **Wisconsin** also cut their state child care funding in 2011.
- Since 2010, a number of states have lowered family income eligibility for child care, raised co-payments, cut reimbursement rates to providers, reduced child care assistance granted to parents searching for a job, and increased the length of their waiting lists for families seeking child care.[58]

Early Childhood

- **19 states** reduced inflation-adjusted, per-child pre-K spending in 2010.[59]
- **Georgia, Iowa** and **Texas** substantially cut preschool spending in FY 2012.[60]

TANF

- In FY 2012, 46 states maintained the same cash assistance benefit level of 2011, one state (Florida) increased the benefit, and three states, **California, Wisconsin,** and **Nevada**, cut the TANF cash benefit level by 8 percent, 2.9 percent and 1.8 percent, respectively. **Arizona** reduced the lifetime time limit for cash benefit receipt from 36 to 24 months and **California** reduced the lifetime limit from five to four years.[61] **California** also cut funding for employment services and child care and lowered the earning limit for working families to receive a cash grant.
- **Nineteen states** cut general fund spending for public assistance and twenty-three kept the same nominal level of spending as fiscal year 2011.
- In **Maine,** legal noncitizens not residing in the U.S. for at least five years are no longer eligible for TANF cash assistance.

Unemployment Insurance

- In 2011, for the first time in more than 50 years, six states – **Arkansas, Florida, Illinois, Michigan, Missouri and South Carolina** – cut the maximum period workers can receive benefit below 26 weeks.[62]
- **Arkansas, Indiana** and **Rhode Island** reduced UI benefit amounts for recipients.

Best Practices: What States Can Do to Protect their Safety Nets During Hard Fiscal Times

Promising Revenue Strategies

Because of state balanced-budget requirements, policymakers are generally compelled to cut spending, seek new sources of revenue, or undertake both actions when revenues fall below projections. In a deep recession, past-year surpluses and rainy day funds may be quickly exhausted. Raising taxes and fees on individuals and businesses during an economic downturn may dampen consumer and business spending and prolong the downturn. Nevertheless, from the economic security perspective of low-income Americans, it is far preferable to cutting social safety net spending.

As noted above, states collectively enacted large tax increases in FY 2010. In subsequent years, states have both raised and cut their principal personal income, corporate income, and sales taxes. In FY 2011, for example, eight states raised personal income taxes and four states cut this tax. In FY 2012, three states raised this tax and 12 states cut it.[63] *To protect vital social spending (including both the safety net and education), it is indispensable to raise new revenues.* But governors and legislatures in a number of states have demonstrated an unyielding resistance to raising taxes and have sought to cover budget gaps almost exclusively with spending cuts.[64]

When enacting tax increases, best practice mandates that they be designed progressively, so that lower-income individuals are taxed at a lower rate than are higher-income persons. A surprising number of states – 15 – collected income taxes from families with incomes below the poverty line in tax year 2010. In recent years, however, more states have moved to relieve their poor families of income tax liability.[65]

A number of states have taken bold and creative revenue initiatives that have helped them protect critical safety net spending. Unless otherwise noted, the measures listed below are those successfully enacted by states in fiscal year 2012.[66] As noted above, many states increased revenues in earlier years.

Raise personal income tax rates progressively

- **Connecticut** raised marginal personal income tax rates. The state expects to collect almost $2 billion more in personal income tax receipts in fiscal year 2012 compared to 2010.[67]
- In FY 2011, **Illinois** enacted a temporary, four-year increase in the marginal personal income tax rate from three to five percent.[68]
- In **California**, Governor Brown proposes a two percent surtax on the top one percent of wage earners for five years, netting (along with a temporary sales tax increase), $7 billion to be spent exclusively on education and public safety. This proposal is expected to be a ballot initiative for voters in November 2012.[69]
- In 2009, **New York** enacted a three-year income tax surcharge on individuals earning more than $200,000. This tax was allowed to expire in 2011, but a surcharge was extended for individuals earning more than $2 million that is expected to raise about $2 billion in revenues.

Eliminate or cap itemized deductions from state personal income taxes

Itemized deductions preferentially benefit households with high incomes, resulting in tax regressivity. Ten states do not allow any itemized deductions, and an additional six states limit these deductions.[70]

- **Hawaii** capped itemized deductions on higher-income taxpayers.

Raise income and other taxes on corporations

- **Illinois** raised the corporate income tax rate from 4.8 percent to 7 percent, for a four-year period. As a result of this hike and the increase in the personal income tax rate discussed above, the state projects revenues to rise by an extraordinary three quarters or $7 billion in fiscal year 2012 compared to FY 2011.
- **Connecticut** raised a corporate tax surcharge (levied on companies with at least $100 million in gross annual revenue) from 10 percent to 20 percent for tax years 2012 and 2013.

Raise more general sales tax revenues by raising rates and extending the tax to selected uncovered goods and services

Although sales taxes are regressive in that a uniform tax rate takes a bigger bite out of the budget of a low-income household compared to a high-income household, raising new revenues by increasing sales tax rates or extending tax coverage to a broader range of goods and services is often preferable to an alternative of damaging spending cuts. Furthermore, sales tax initiatives can be structured so as to include progressive features, such as relatively higher tax rates on luxury goods and services purchased more often by higher-income households.

- An initiative in **California** for the November 2012 ballot would expand the sales tax to professional services and other services.
- **California** increased enforcement of sales and use tax collections on online and out-of-state retailers.
- **Connecticut** raised the general sales tax rate from six to 6.35 percent across the board and raised the rate to 7 percent for certain luxury items.
- **Connecticut** created a new Internet sales or "Amazon tax," and extended the tax to certain previously exempted services.
- **Illinois** enacted a measure to collect sales taxes by online retailers with a physical presence in the state, including affiliates.

Raise more selective taxes and fees

- **Connecticut, Maryland, New York and Vermont** enacted tax increases on alcohol and/or tobacco products.
- **Connecticut** raised $521.8 million in "other taxes" in FY 2012, including changes to the inheritance and estate taxes, and taxes on insurance companies, utilities, and health providers.[71]
- **California, Connecticut, Hawaii** and **Maryland** enacted motor fuel and/or vehicle taxes or fee increases.
- A number of states have raised taxes on health care providers, which generates additional federal matching Medicaid funds. **Idaho, Kansas, Tennessee** and **Wisconsin** imposed such taxes in FY 2011. These tax increases can be offset in part by granting Medicaid rate increases to providers. From a safety net perspective, such taxes are preferable to cuts in services to Medicaid beneficiaries or cuts in provider reimbursement rates.

Grant amnesties to delinquent payers and strengthen tax collection efforts

By waiving or reducing penalties and interest for delinquent taxpayers who file their late return within a stipulated period, states can improve collections. Revenues collected through these programs are often modest, however.

- **Colorado**, **Florida, Nevada and New Mexico** enacted temporary tax amnesties in fiscal years 2011 and 2012.

Progressive Saving and Spending Strategies

When budgets are tight, it is important that state fiscal managers be smart about prioritizing programs that provide a strong social return and look for savings in less important programs. Uniform, across-the-board cuts in state agencies are generally less than optimal because they treat all state spending equally. Nevertheless, the comparative simplicity and perceived equity of such cuts appeals to policymakers, and Hawaii, New Hampshire, and New York enacted such across-the-board cuts in fiscal year 2012.

Although it is certainly important to staff government efficiently, cutting the state workforce can undermine both the quality of government services and state economic and revenue growth. Unemployed workers typically reduce their consumption, and weaker demand for goods and services slows the economy. For these and other reasons, state governors and legislators have often been reluctant to enact deep workforce reductions in a weak economy. Nevertheless, 14 states have enacted fiscal year 2012 budgets that reduce state employee full-time-equivalent staffing by two percent or more relative to 2011.[72]

Many state policymakers recognize the need to improve setting policy priorities and assessing how well programs achieve these priorities. "Program-based" or "performance-based" budgeting attempts to prioritize goals, apply cost-benefit analysis to state expenditures by program, and evaluate program effectiveness in meeting objectives. However, effectively implementing such budgetary systems is difficult and usually requires substantial investment in personnel and data systems. Some 22 states included elements of program or performance-based budgeting in 2008, but often the practical scope of such efforts was limited.[73] Both Illinois and Nevada have recently moved toward adopting these budget practices.[74]

On the savings side, a number of states are exploring program efficiencies in safety net programs that do not compromise the well-being of beneficiaries. Given its comparative importance in state budgets, Medicaid is a prime target. In particular, states are moving rapidly to enroll Medicaid beneficiaries in managed care plans. All states except Alaska, New Hampshire and Wyoming operated Medicaid managed care programs in 2011, and 66% of all beneficiaries were enrolled in the two principal forms of managed care.[75]

Managed care plans that are well administered and carefully supervised by state authorities can increase provider accountability and provide better-quality care more efficiently than fee-for-service Medicaid. "Primary Care Case Management" systems provide each enrolled beneficiary with a primary care provider who serves as the patient's "medical home," providing primary and preventive care and coordinating specialty care. Under capitated programs, the state contracts with managed care organizations (MCOs) to provide Medicaid services for a fixed payment per enrollee. Although subject to strict federal and state regulations intended to assure adequate quality of care, for-profit managed care companies may have an incentive to ration care under capitated programs. It has also proven difficult for MCOs in some states to recruit adequate numbers of providers into their networks. A 2010 survey by the Kaiser Commission on Medicaid and the Uninsured found two-thirds of responding states with MCOs reported enrollee access problems to some specialty services.[76] However, provider access has also been a longstanding problem in traditional, fee-for-service Medicaid, in large part because of low program fees to providers.

Specific examples of progressive spending and saving strategies pursued by states in recent years include the following.

Maintain or expand coverage and benefit levels for key safety net programs

Despite the very difficult budget climate, some states have found ways to not only maintain but to actually *expand* key social safety net programs. Strikingly, 41 states made positive eligibility and enrollment changes in their Medicaid programs in fiscal year 2010, followed by 31 states in FY 2011 and 22 states in FY 2012.[77] Federal incentives under the Affordable Care Act encouraged some of the state Medicaid program expansions. Although many of these changes had modest effects, some significant reforms are noted below.

- **California, Minnesota, New Jersey, Washington, and Colorado** introduced new initiatives to cover childless adults under Medicaid in FY 2011 and FY 2012.[78]
- **Delaware, Illinois, Nebraska, North Carolina, Texas and Vermont** opted to include legal permanent resident children and/or pregnant women with less than five years residence in the U.S. under their state Medicaid/CHIP programs, joining 20 other states with this coverage.[79]
- **Colorado, Kansas, and Oregon** extended Medicaid/CHIP coverage to additional low-income children by raising income eligibility thresholds in 2010.[80]
- **Rhode Island** and **Alaska** launched new state-funded pre-Kindergarten programs in 2010.[81]
- **Connecticut** substantially increased its pre-Kindergarten spending per child in 2010.[82]
- **Florida** increased its TANF cash assistance benefit level by 4.1 percent in FY 2012, the only state to do so. At $303 per month for a family of three, the Florida benefit had not changed in value since 1996 before this modest increase and still remains one of the lowest in the country.[83]

- **Connecticut** introduced its first Earned Income Tax Credit providing a maximum of $1,700 for low-income families.[84]
- **Virginia** strengthened the state's EITC. The **Iowa** state legislature also passed a modest expansion of the state EITC in 2011, but the measure was vetoed by the state's governor.
- **Illinois** signed legislation doubling the state's Earned Income Tax Credit from five to 10 percent of the federal EITC over a two year period.[85]

Use rainy day funds effectively

- **Massachusetts** draws down $185 million in rainy day funds in its enacted FY 2012 budget.
- **Maine, Michigan, Nebraska** and **Oregon** plan to use their rainy day funds to close anticipated budget gaps in FY 2012.
- The **Texas** governor and legislature agreed to draw down $3 billion from the state rainy day fund to help cover the 2010-2011 state budget shortfall and prevent further cuts. However, state lawmakers have ruled out using the rainy day fund in the 2012-2013 budget, despite a rainy day fund balance of more than $5 billion.

Find Medicaid program savings in administrative efficiencies and improved services

- The **Wisconsin** Medicaid Rate Reform Project, composed of stakeholders including providers, patient advocates, insurance companies, and academics, has identified hundreds of millions of dollars in potential savings resulting from administrative efficiencies and negotiating better terms with Medicaid Home Maintenance Organizations.
- **New York** followed the Wisconsin model by convening a Medicaid Redesign Team including representatives from government, the health industry, businesses and consumers to make recommendations on improving program quality and reducing costs. Although a wide range of recommendations were made and adopted, the most significant reforms enacted were conventional: capping overall Medicaid spending and moving more enrollees from fee-for-service to managed care. The state is also increasing enrollment of beneficiaries into medical homes and health homes to coordinate care for the chronically ill.
- **Ohio**'s enacted biannual budget anticipates substantially reducing Medicaid spending growth by improving care delivery systems and promoting primary care.

Find savings in state agency consolidations and improved management

- **Colorado, Connecticut, Kansas, Oklahoma** and **Washington** all enacted measures in fiscal year 2012 to consolidate state agencies with the goal of gaining efficiencies and reducing costs.

Reform prison sentencing and parole procedures

A modest silver lining to the fiscal crisis of the states is a long overdue re-examination in a number of states of costly incarceration and parole policies that many criminal justice experts judge both unduly punitive and ineffective in reducing crime and increasing public security.[86]

- **Connecticut** enacted a measure reducing prison sentences for certain inmates who earn credits by pursuing educational programs and for good behavior.
- **Ohio** will make greater use of community-based corrections programs and allow certain inmates to reduce their sentences by pursuing education, job training, and drug treatment.
- In FY 2011, **South Carolina** approved a bill to reduce the population incarcerated for minor offenses and increase the use of parole.
- **Arizona, Colorado, New York, Washington, and Wisconsin** have also enacted reforms in their incarceration and parole policies in recent years.[87]

Conclusion and Policy Recommendations

State policymakers have demonstrated that they can protect their social safety net programs even during the course of a severe economic recession provided they have the political will and imagination to raise taxes and seek savings in programs less critical to their most vulnerable populations. The governors of Connecticut and Illinois stand out for their imaginative and robust approach to raising new revenues even as they strengthened key elements of the safety net, notably their state Earned Income Tax Credit.

Other states have also adopted progressive revenue and spending measures during difficult times. Numerous states enacted substantial increases in state personal income, corporate, and sales taxes that helped buffer crucial safety net programs even as other states *cut* taxes and their social safety nets. On the spending side, at least 13 states significantly liberalized Medicaid/CHIP program eligibility and enrollment criteria in recent years and many other states made modest improvements, in part encouraged by incentives in the federal Affordable Care Act. Some states have also found both savings and program quality gains in improved managerial practices. Drawing down rainy day funds also helped many states avoid damaging spending cuts early in the recession.

The federal government played a crucial role in helping states weather their fiscal crisis by providing substantial assistance through the American Recovery and Reinvestment Act of 2009. ARRA gave states emergency aid to use at their discretion and significantly increased funding for key safety net programs, including Medicaid, TANF, SNAP, Head Start, child care subsidies, the child tax credit, and Unemployment Insurance. Even as the economy slowly recovers and state revenues grow, continued high unemployment, the winding down of ARRA assistance and the depletion of state rainy day funds and Unemployment Insurance trust funds will continue to challenge states' finances in the years ahead.

State practice over the course of the Great Recession and its aftermath offers some simple but important lessons to help cope with immediate budgetary stresses and develop sound fiscal practices for the longer term:

- **Raise taxes when needed to protect the safety net.** Although raising taxes in a weak economy should be avoided when possible, it is far better to raise new revenue than to cut safety net programs that are vitally important to low-income families. The burden of new taxes can be designed to be progressive, whereas safety net spending cuts are disproportionately borne by the most vulnerable groups in the population.
- **Find savings in administrative efficiencies**. Although the potential savings can be overstated and care must be taken to avoid damaging service quality in the quest for efficiency, well-regulated Medicaid managed care programs can increase the quality of care and yield significant savings in states' fastest-growing and most expensive safety net program.
- **Build a strong rainy day fund and use it when it's raining**. When the economy strengthens, state policymakers should resist cutting taxes until state-funded programs are on a sound fiscal footing and the state has built up a strong rainy day fund to protect vital spending during future downturns. Governors should be permitted to draw down the rainy day fund when revenues fall without undue legislative restrictions.
- **Diversify and strengthen revenues**. States can hedge their revenue risk during an economic downturn if they maintain a diversified and productive tax and fee revenue base. Relying heavily on a single tax can expose a state to an abrupt collapse in revenues. A progressive income tax is comparatively resilient source of revenue in a slow economy.
- **Adopt program-based budgeting and assess net impacts of spending.** State policymakers can do much more to identify and rank program priorities and evaluate program success in meeting these priorities. Policymakers should

also make an effort to assess the net effects of proposed program cuts, particularly those to safety net programs. Savings can be chimerical if cutting a comparatively efficient program shifts service demand to less-efficient programs. A porous safety net can be costly for states in the short-term and long-term. Because improving program planning, prioritization, and evaluation typically has significant start-up costs in personnel and information technology, states may need to defer these investments until their immediate fiscal conditions improve.

- **Shore up state Unemployment Insurance systems.** Many states have chronically underfunded their UI systems, forcing them to borrow heavily from the federal government to meet their obligations to unemployed workers. In a few instances, states have cited these shortfalls to justify cutting the number of weeks they fund this critical support for jobless workers and their families. States need to ensure that the employer payroll tax supporting the program is sufficiently broad-based enough and the rate sufficiently high to build an adequate funding pool in good times.

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