Part 4 of 6

# PROBLEMS WITH A STATE-BASED SOCIAL WELFARE SYSTEM

LAUREN DAMME, NEXT SOCIAL CONTRACT INITIATIVE

VALUABLE RESEARCH ASSISTANCE FOR THIS SERIES PROVIDED BY BENJAMIN KOLANSKY

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The Great Recession has exposed numerous flaws in our social contract – weaknesses that existed prior to the economic downturn – highlighting the need for changes in our system. This series of policy briefs explores the stresses on our social contract, and the policy changes that must be made to mend it. The six-part series includes:

- Overview: The Great Recession exposes weaknesses in the American social contract
- Economic security policies are too closely tied to employment
- The safety net for unemployed Americans is inadequate
- Problems with a state-based social welfare system
- The regressive delivery of social welfare benefits in the U.S.
- The ownership society is vulnerable during downturns: Pensions and home ownership

## Introduction

Last week, we showed how the basic American safety net for the unemployed – Unemployment Insurance – excludes the Americans who need it most. This week, we examine the difficulties presented by our state-based delivery system of social safety net programs.

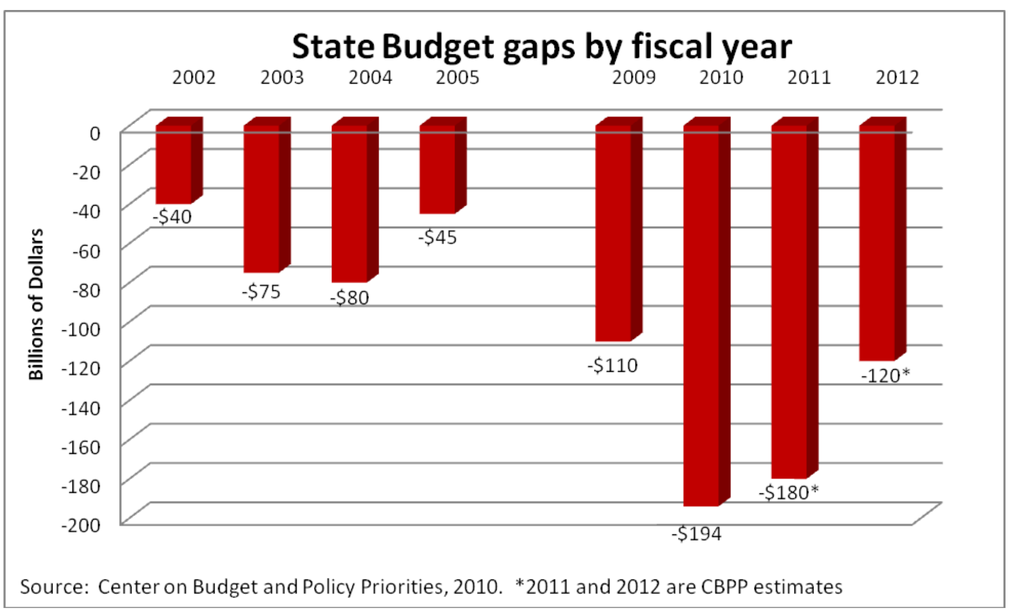
State funding of social support programs presents a budgetary problem for states, for several reasons. First, states are not well-positioned to engage in counter-cyclical spending. Every state but Vermont has constitutionally-mandated balanced budget requirements, and as budgets shrink in times of economic recession – just when demand for services rises – states are unable to borrow to maintain or increase services. Despite this, Congress continues to push welfare spending onto states through unfunded, or incompletely-funded, mandates. Lastly, narrowing the base of funding for welfare programs – from federal to state or state to local levels – diminishes their redistributive power, which is a core function of such programs.

## Borrowing Is Not an Option

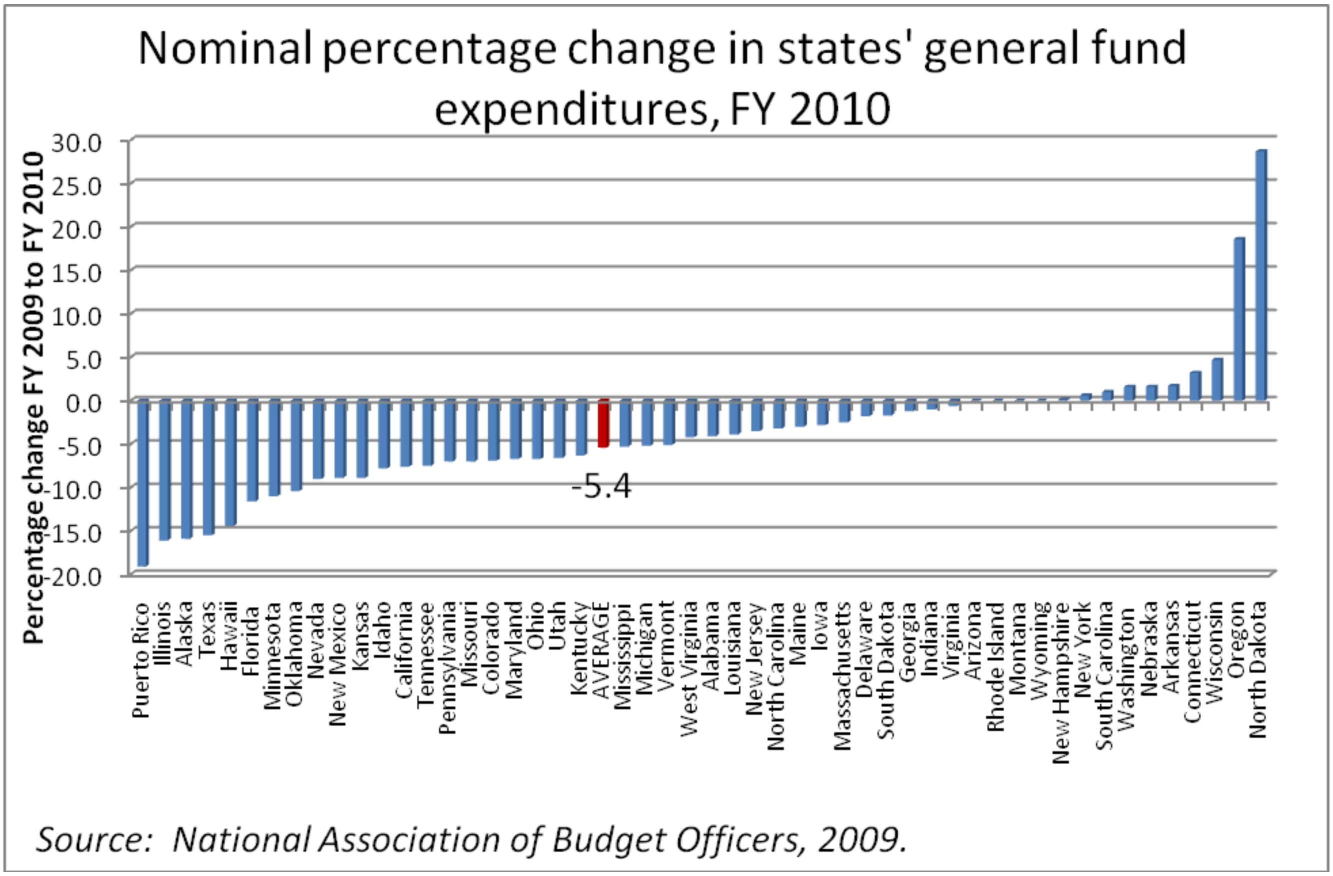
The most serious problem with state-funded social welfare programs has to do with states' ability to borrow. Every state but Vermont has balanced budget requirements in their constitution. This means that when state revenues dry up during economic downturns and demand for programs such as Medicaid, Temporary Assistance for Needy Families, Food Stamps, and other partially or wholly state-funded welfare programs increases, states are not able to borrow to fund these critical services. Our state-funded social welfare system is therefore pro-cyclical: states are able to provide more services when it is least needed - when the economy is booming and states' revenues rise – and fewer services when revenues falter because states cannot borrow to fulfill increasing demand for social support.

The Great Recession has clearly highlighted this flaw. Drops in sales tax and personal and corporate income tax revenues, which comprise about 80 percent of state general fund revenue, has hit budgets hard.[1]

States experienced an estimated 11.8 percent drop in tax revenues between FY 2008 and FY 2010, with a forecasted 8.4 percent decline in FY 2011 compared to FY 2008, the last year before revenues were heavily impacted by the recession.[2] States have therefore had to close budget gaps of hundreds of billions of dollars each year since the start of the Great Recession, as shown below.



In order to close these gaps, states' general fund spending decreased in both FY 2009 (June 2008-June 2009) and FY 2010 relative to FY 2008. Fully 40 states decreased expenditures in FY 2010 (total expenditure, $612.9 billion) compared to FY 2009 ($657.9 billion), and in 44 states, FY 2010 general fund spending is lower than that of FY 2008 ($687.3 billion).[3]




Although the National Bureau of Economic Research declared the recession ended in June 2009, in FY 2011, 39 states will still recommend lower spending than in FY 2008, the last year before revenues were heavily impacted by the recession. In fact, the estimated FY 2011 general fund expenditure of $635.3 billion is still $52.0 billion less than that of FY 2008.[4] The National Governors' Association and the National Association of State Budget Officers predict that states will feel the impact of the recession on tax revenues through 2013.

## States are Cutting Crucial Programs

States, in short, have not recovered, despite the $282 billion in federal aid made available through the American Recovery and Reinvestment Act of 2009 (ARRA). Although $154.8 billion of this aid had been paid out as of September 2010, remaining budget gaps have forced states to cut critical social programs.[5]

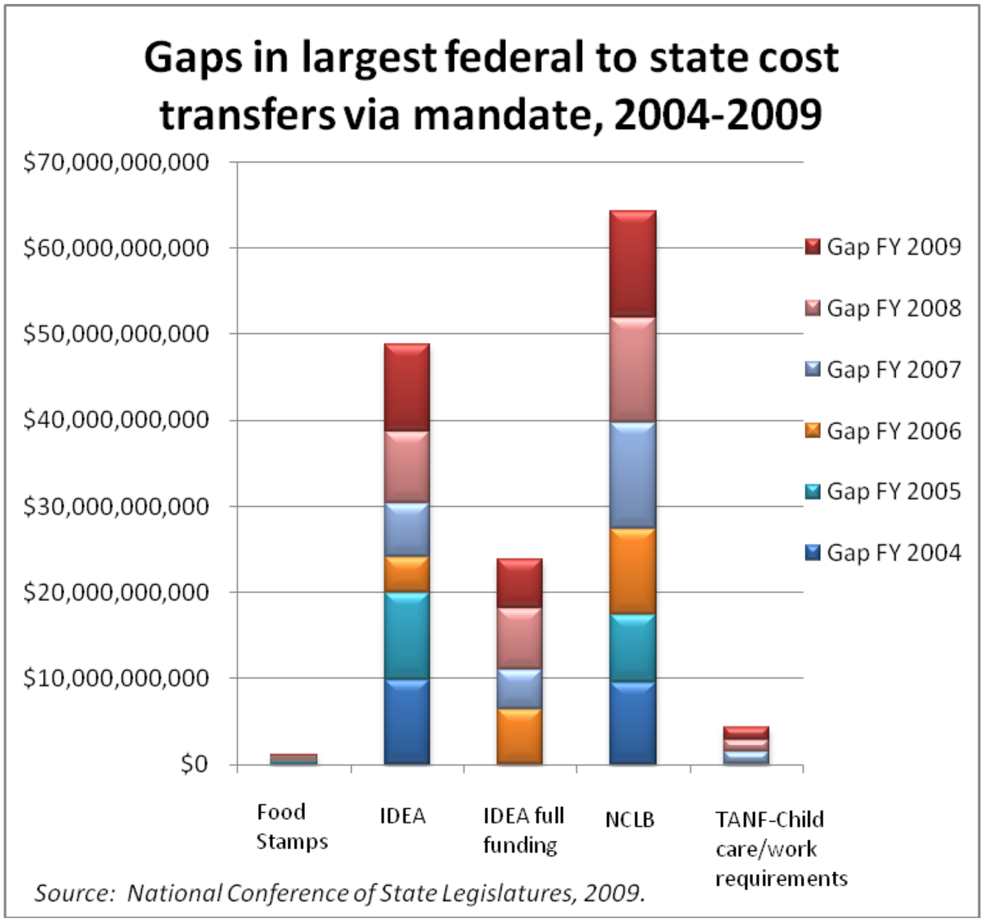
At least 46 states and the District of Columbia have made cuts that hurt vulnerable Americans and contribute to unacceptably high levels of unemployment, including:

- 31 states have cut health care services,
- 29 states have cut services for the elderly and disabled,
- 33 states have cut K-12 funding,
- 43 states have cut higher education funding,
- 43 states have cut employees.[6]

While state cuts are just beginning to take effect, local governments have decreased employment by 234,000 since the beginning of the recession in December 2007, according to the Bureau of Labor Statistics.[7]

## Responsibilities Shift to the States

Despite the known volatility associated with state-funded services, the federal government shifted an estimated $165.24 billion in costs to states from 2004-2009 through underfunded or unfunded mandates, with the largest increases in responsibilities resulting from the Individuals with Disabilities Education Act (IDEA) and No Child Left Behind (NLCB), as shown below.[8]




These shifts represent significant costs to states. The estimated FY 2009 shift of $33.7 billion was five percent of that year's general budget expenditure of $657.9 billion.[9] In short, we have placed increased responsibility on a system unable to maintain stability during downturns, at the cost of reduced benefits and services for Americans when they have the greatest need of a safety net.

## Limited Redistribution, Rising Inequality

Aside from the budgetary shortcomings of a pro-cyclical welfare system, state-level funding of social welfare services limits the redistributive role these services can play in our society. In other words, when service levels are funded by states, wealthier states with higher tax revenues can afford greater levels of service, while poorer states, with poorer tax bases, may not be able to meet demand, leading to the underfunding of programs in the areas that have the greatest need for support. Redistributive programs are meant to contribute to equality and ensure a minimum quality of life. A system that increases inequality will have negative repercussions for all Americans, such as increased crime and social and political strife.

## Conclusion

The dependence of social welfare programs on states' economic prosperity makes America's delivery of social welfare benefits far from being the automatic stabilizer that it must be in order to smooth rough economic transitions for American families. In contrast, federal funding of welfare programs with state- and local-level implementation can provide counter-cyclical social support that increases as Americans' needs increase, while providing a broader, more equitable provision of services than a state-funded system.

Next week, we explore how the regressive delivery of social welfare benefits through the tax code, including those for education, child care, home ownership, and retirement, have led to the creation of a two-tiered welfare state.

[1] National Governors Association and the National Association of State Budget Officers. The Fiscal Survey of States. June 2010.

[2] Ibid.

[3] Ibid.

[4] Ibid.

[5] Government Accountability Office. Recovery Act: Opportunities to improve management and strengthen accountability over states' and localities' uses of funds. GAO-10-999. September 2010.

For further tracking of grants, awards, and loans, see www.recovery.gov.

[6] Johnson, Nicolas, Oliff, Phil & Erica Williams. An updated on state budget cuts. Center on Budget and Policy Priorities. 4 August 2010. Also see: http://www.cbpp.org/slideshows/?fa=stateFiscalCrisis.

[7] From 14,482,000 in Dec. 07 to 14,248,000 in Sept. 2010, seasonally adjusted. Bureau of Labor Statistics. Series ID: CES9093000001. October 2010.

[8] The National Conference of State Legislatures hopes to publish an updated Mandate Monitor in the winter of 2010. National Conference of State Legislatures. Mandate Monitor: Special Edition: Total Cost Shift for FY 2004 through FY 2008 and Projected Cost Shift for FY 2009. Vol. 6, Issue 1. April 2008.

[9] Ibid.

National Governors Association and the National Association of State Budget Officers. The Fiscal Survey of States. June 2010.



MAIN OFFICE
1899 L Street, NW
Suite 400
Washington, DC 20036
Phone 202 986 2700
Fax 202 986 3696

CALIFORNIA OFFICE
921 11th Street
Suite 901
Sacramento, CA 95814
Phone 916 448 5189

NEW AMERICA FOUNDATION
WWW.NEWAMERICA.NET