Brookings Welfare Reform & Beyond Initiative

State Fiscal Crisis:

Implications for Low-Income Families

Falk Auditorium
The Brookings Institution
October 15, 2002

Opening Remarks:

ISABEL V. SAWHILL
Senior Fellow, Economic Studies Program; Co-Director, *Welfare Reform & Beyond*

Moderator:

NEAL R. PEIRCE
Chairman, The Citistates Group

Panelists:

DONALD J. BOYD
Director, Fiscal Studies Program, Rockefeller Institute

SENATOR ANGELA Z. MONSON
Oklahoma State Senate; President, National Conference of State Legislatures

DOUGLAS E. HOWARD
Director, Michigan Family Independence Agency

ALICE M. RIVLIN
Senior Fellow, Economic Studies, The Brookings Institution; Henry J. Cohen Professor, Robert J. Milano Graduate School of Management and Urban Policy, New School University

MS. ISABEL V. SAWHILL: -- Welfare Reform & Beyond project at Brookings, and we have been helped in the effort of organizing and planning this event by many other colleagues at Brookings. The Urban Center in particular, and the new Tax Policy Center that is jointly sponsored by Brookings and the Urban Institute.

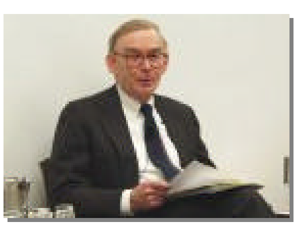
I also want to acknowledge some of the other groups who are doing such important work in this area, some of whom are with us today. In particular the Rockefeller Institute, and Don, we're so glad you could join us today. The Center for Budget and Policy Priorities is doing important work in this area, and Nick Johnson is here from the Center in the front row. They have some new papers that I think you'll find out on the back table along with other interesting materials.

I also want to thank Doug Howard for making the time to be here today from the State of Michigan, and Angela Monson who is the President of the National Conference of State Legislatures and who we're very very pleased to have with us today. I should say that we have worked very closely with NCSL in all of our work and it's been a wonderful partnership.

Let me just make a couple of quick announcements about logistics. This morning's event is being WebCast live on the Internet at *www.brookings.edu*. And for those of you who are watching from your office or from home and would like to submit a question, you can do so by sending an e-mail to *question@brookings.edu*, and we will have plenty of time later in the program for questions and comments from the audience. We suspect there are many people in the audience who have as much to contribute to this discussion as those up here on the panel.

Now I want to finally introduce today's moderator, Neal Peirce. Neal is known to most of us as by far the most serious journalist who has worked over the years in this whole area of state and local issues. He's been writing on these topics for about as long as I can remember, and that's a pretty long time. He's been with the *National Journal*, with *Congressional Quarterly* and has written for many newspapers across the country. He is currently Chairman of the Citistates Group. This is a group of journalists and civic leaders who are interested in creating sustainable and competitive metropolitan regions.

So Neal, with that let me turn this over to you.



MR. NEAL R. PEIRCE: Thanks very much, Belle. Good morning to all of you.

You've gotten a little bit of introduction and we'll introduce everybody else slightly more as we go along, although most of them have fame which walks before them and introductions are sort of superfluous.

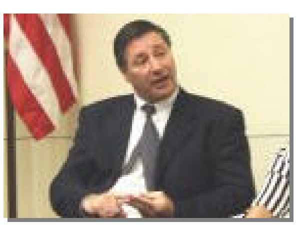
We're on a topic that's a tough one these days, how states maintain their service levels for vital programs for low-income families and children -- child care, after school programs, Medicaid and more -- in the face of a national recession. There's debate about how deep that recession is but not about how deep the hit has been and is on state budgets which is in the multi-billions and over $10 billion in some states during this last year, putting the state governments into a real quandary because they have no choice, they have to balance their budgets underneath their constitutions and they have a deteriorating tax base. The tax base they have is ideal for the manufacturing economy of the '50s and '60s and it's not very appropriate for a high technology, international, service-oriented economy in the 21st Century because it taxes goods but it exempts most services even though it's obvious that services from accounting to real estate to information technology are where the action is of today's economy. So ideally we would have a low tax rate on a broad base, and in fact we have rising rates, or have had, on an artificially limited base.

Corporations have exploited the loopholes in the tax laws so effectively that it's even plausible to suggest we might as well not try taxing them at all and get their income as they come out with their money in their back pockets through income taxes. But income tax yields on the short term have declined precipitously. They were way up in the late '90s with all those wealthy taxpayers and capital gains, and they've gone down very very rapidly. On top of all of that we have a group of political leaders in our states who are really spooked by the idea of instituting any tax increases at this point as they did, which they had done actually in the early '90s in quite significant measures, they raised taxes. But this time they feel very shy about that.

That's sort of an amateur's view. Now you're going to hear a professional's view of exactly what's been happening, what all the factors are, and what some of the possible long-term cures, which aren't easy but may be there, may be.

First we're going to hear from Donald Boyd who does direct the Fiscal Studies Program at the Rockefeller Institute. He's had major budget jobs before including Director of the Economic and Review Staff with the New York State Division of Budget and Director of the Tax Staff for the New York State Assembly Ways and Means Committee where I guess you got to know the real politicians in addition to the economic theories.

Go ahead.



MR. DONALD J. BOYD: Thank you very much.

I'm going to give a quick overview of the current fiscal crisis. I consider it a two-prong crisis in that it has its roots in two related problems. There was a bursting of a bubble, that is there were some of the most unsustainable trends that provided absolutely fabulous benefits to most state governments throughout the late 1990s, and those have been exacerbated by a cyclical downturn which by traditional economic measures at least so far has not been terribly deep, but very severe for state budgets.

Some of the favorable trends in the late 1990s included an economy that was growing consistently faster than private economic forecasters expected and also than state budget forecasters expected due in part to productivity gains that were surprising most analysts.

Financial markets, just astounding. We all know about the growth in the NASDAQ both in the [300 and 4500]. The way it's translated into factors that affect state government finances with 27 percent average annual growth between 1994 and 2000 in capital gains, which is an element of the income taxes in most of the 41 states with income taxes. So it's a quadrupling over that time period.

These gains are disproportionate concentrated among high income taxpayers and state income taxes are generally progressive so they're taxed at the highest rate.

While the sales tax has a lot of long term problems, some of those were masked by fairly strong consumption, very strong consumption relative to income during this time period. Meanwhile Medicaid, the number two spending area in most state budgets after growing rapidly in the early '90s came to a halt in the first part of the second half of the '90s. And lastly, a welfare windfall when the conversion of AFDCs to the block grants TANF. When caseloads fell dramatically the block grants did not bring up a lot of resources for states. All in all, states raised spending, cut taxes and boosted reserve funds.

Those things largely ended and now we have this cyclical problem, the recession. Factors affecting state budgets, the key three factors that affect state budgets typically are income taxes which are 37 percent of taxes on average, and sales taxes, 32 percent. Very sensitive to the economy, and in this particular economy more so than usual, at least in cases of income tax. And Medicaid is large, 21 percent of the [all] funds budget, 12 percent of [OM] funds. It's economically sensitive. What that point is supposed to say is that the Urban Institute estimated that a percentage point increase in the unemployment rate would raise overall Medicaid spending by about $2.7 billion. Spending is generally an entitlement and it's very hard to cut because when you try to achieve state savings you have to cut a lot more than the amount you need [say to the] state in because you're cutting federal revenues too. States vary widely. So that's a snapshot picture of the average. Again, those are the three things that states need to worry about most.

What happened recently, the first column of this table shows you the annual average growth in nominal tax revenue, between '95 and 2000 6.2 percent in total; income taxes, 9.1 percent. During this period states were cutting taxes and this is the growth they had after cutting taxes. It gives you some sense of what the economy was doing to state fiscal systems that they could get this [inaudible] of growth back from the economy while cutting taxes. Lots more could be said about that.

They slowed a bit in fiscal 2001 and they crashed. Last fiscal year which ended, fiscal year 2002 ended in June in most states, absolutely crashed, six percent decline in total taxes, 12 percent decline in the income tax. A very wide spread.

This is the last quarter where overall tax revenue declined 11.8 percent. You can see all regions of the country shared in the pain. This is adjusted for legislation, so it's a slightly better picture. This was the other numbers in the prior graph. But just dramatic declines. The far west, 22 percent decline. That's one of the reasons why California has the enormous budget shortfall that they've been dealing with.

Medicaid cost prices have picked up. I mentioned that they've come to a halt in the mid to late 1990s. Eleven percent growth in 2001. Thirteen percent in 2002. Prescription drugs growing at more than 20 percent. Enrollments increasing fairly substantially. The cost of long term care going up. Some of the spending is also related to things states do to maximize federal reimbursement, but there's a lot of real spending growth in there as well.

Budget problems. Large and widespread. Forty-three states with gaps in 2002; at least 40 tending to problems for 2003 which those budgets are now in place; 14 with gaps of 10 percent or more.

So widespread indeed.

I'm not going to take you through this page in detail, but states have done a lot of different things to close the gap so far. First and foremost, drawing down fund balances and special funds. These are quite naturally, quite logically, they try to do some of these least painful things first. These are among the least painful things.

There was a fair amount of spending cuts -- higher end corrections, Medicaid. The Center on Budget and Priorities has done a number of good reports on Medicaid and child care cuts. There were certainly a fair number of those. Some tax increasing. Forty percent of the tax increasing was cigarette taxes. Again, these days a less painful alternative at least for those imposing them than many other kinds of tax increases. Relatively few broad-based, largescale increases.

One of the important points about what states did is that by taking the easiest actions first -- that's a perfectly logical approach -- many of those solutions effectively rolled the problem into the next year. What that means is that when legislators are dealing with budgets in this coming January through June period, next year's going to be very very difficult.

First of all this year itself is coming undone a little bit. Tax collections are deteriorating further, Medicaid projections are a little bit too optimistic. So there are going to be additional budget gaps to close this year and fiscal 2004, the combination of weakening economy, shortfalls this year, and problems pushed into 2004 means very very difficult time periods for budgets in this upcoming debate.

Over the longer term, likely to be slower growth in the income tax than in the late 1990s. An awful lot of income loss at the highest end. Less income, even if it's growing more quickly, is not going to lead to fast growth in income taxes. And sales tax. There are some well-known reasons why sales taxes are likely to grow more slowly than the economy as a whole. And lastly, accelerating spending pressures in Medicaid likely to grow nine-plus percent, quite a bit faster than typical tax bases. So very difficult choices in the next few years for states.

MR. PEIRCE: We're going to hear next from Alice Rivlin who is sort of my living example that you can both be a very distinguished scholar, write lots of books, know your way around economics, serve in major faculty positions, and at the same time be a star public servant. We know she was a Director of the OMB for two or three years during the Clinton Administration and she's served our city wonderfully as Chair of the District of Columbia Financial Management Assistance Authority in the last few years. She's also very popular. She has a doctorate from lots of universities. She's getting an award from the Harvard Club today sometime. Another recognition.

But Alice, now that we've heard a little bit of what the problem is, what shall we ever do about it?

MS. ALICE M. RIVLIN: I want to shift the focus from what Don has been very ably setting forth—the serious problem facing states right now and certainly into the next year, maybe longer—to the consequences of state fiscal actions for the economy as a whole.

State revenues, as Don has amply illustrated, are very sensitive to the growth of the economy. The personal and the corporate income tax falls sharply when the economy slows or turns down. It's been especially true this time, as Don noted, because of the nature of the '90s boom, the capital gains and the compensation at the high end in bonuses and stock options.

Now all that's true of the federal government too, but we regard that as good because the sensitivity of the federal income tax to the economy actually helps mitigate recessions and a weak economy. But states have to balance budgets so they are forced to take counterproductive or pro-cyclical actions that make a weak economy worse.

They may have reserves. Most states went into this recession with more reserves than they had at the beginning of the 1990-'91 recession and that's good. But as soon as the reserves are exhausted, then they really have two choices -- cut spending or raise taxes, and raising taxes is a very difficult thing to do.

Now you wouldn't want revenues to never go down because some tightening up and being more efficient is undoubtedly a good thing, and falling revenues force all kinds of efforts to tighten up. But to deal with a severe or prolonged drop in revenue, they do have to cut spending and cut services to people or raise revenues. These are actions that make a recession worse and offset whatever stimulus is coming from the federal budget or from the federal reserve. Right now we are having very low interest rates, which help, and we had some stimulus from the federal budget, both in more spending and in the first part of the tax cut which came in the form of a rebate. But all the good that does is at the same time being offset by state and local actions, which make it harder to get out of the recession.

Furthermore, the cuts in state programs tend to fall heavily on low-income people who are losing their jobs and having a tough time as the economy weakens.
A significant part of what states do is services to low-income people in Medicaid, welfare and social services, so those are a natural object of cuts. They're also more cuttable than some of the other things that loom large in state budgets. You can't not service the debt. You can't not pay pensions to state workers. It is very hard to cut the wages of state workers. It's hard to cut long-term contracts. Some programs are funded out of dedicated taxes that can't be used for something else. Our states have formula grants for localities that are hard to cut. And for all of those reasons and for political reasons, because the poor are not a strongly represented constituency, the cuts tend to fall on low-income programs and that's been happening.

There's a particular problem at the moment with what happened after welfare reform. The decline in caseloads in the very good economy of the late '90s allowed the states to spend more in support of low income working families, families that were coming off welfare, or families that were just low income, for training, child care, transportation to work and other kinds of support for low-income families including Medicaid. Now these services are threatened because there's no increase built into the federal grant for TANF, what we used to call welfare, and this means that we're getting big cuts in Medicaid, in child care, in pre-school, and in employment-related programs for low-income people just at the moment when we have more low-income people because the economy is coming down.

So it doesn't make a lot of sense to have important services financed by a system that automatically does the wrong thing in a recession and puts a lot of the burden on people who are already feeling the pain.

But cyclicality is not the only problem of state budgets as both Don and Neal have pointed out. States also have a longer-run structural problem that the cost of their programs, because they're very people-intensive, wage-intensive, tend to rise faster than the GDP does and their revenues don't. That's partly because states compete with each other and they're reluctant to raise taxes for fear of losing people or businesses across the state line, and it's partly because of the structure of state taxes.

The problem of the sales tax has been alluded to already and it's a serious one. The sales taxes loom large in state budgets and the tax is largely good, but their sale of goods is not going up nearly as fast over time as the sale of services, and services are much harder to tax.

There's also the problem of cross-border sales on the internet or in catalogs. In an increasingly mobile and interconnected economy these sales are growing rapidly and they are largely not taxed.

To solve the problem of lack of growth in the sales tax, states have tended to shift more of their revenue burden to the income tax over the last few years. That helped because the income tax does grow faster than the economy, but it simply exacerbates the cyclicality problem.

What do we do about it? I think in the short run, there's a very strong case for immediate aid from the federal government to states with fiscal crises who are likely to make the recession worse. Federal aid could come in the form of simple revenue sharing or a check to states on a formula basis, or it could come in the form of increase in the match on Medicaid that would be focused on the particular problem of Medicaid. Since Medicaid looms large in state budgets, the federal government helping more is a form of general relief.

In the longer run, I think we ought to focus heavily on what we can do to make sure this problem doesn't hit us again in the next recession. We could enact something like a counter-cyclical revenue-sharing program in which the federal government automatically gives larger grants to the states when their budgets are under pressure. I don't think we could get ourselves together to pass that right now, but we ought to do it fairly soon before the next recession hits.

So what about the structural problem? One of the problems is the competition between states. I put forward over a decade ago a fairly big idea that the states ought to work together to pass—possibly with the help of the federal government though they could do it on their own- one or more common shares taxes, meaning that they would collect the same tax across all of the states and share the revenues on a formula basis.

One could do that with the sales tax. My favorite one, actually, would be the corporate income tax. As Neal pointed out, the tendency of corporations to game the system and pretend that all of their operations are in the lowest taxed state is very great, and that could be solved by having a common tax, which would be much easier for corporations to deal with, rather than 50 taxes in 50 states, collected centrally and shared among the states.

If that's too big an idea to grasp right now, certainly a practical thing is to push ahead with what states are already doing; work together to simplify the sales tax sufficiently so that they can tax the remote sales by national catalog firms and internet sellers.

The Supreme Court has said that the sales tax is just too complex for those big national companies to try to collect in every jurisdiction. In response, states did a very sensible thing and got together in the Streamlined Sales Tax Project to try to simplify and harmonize their sales taxes to make it less complicated.

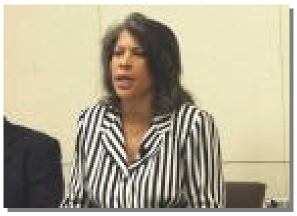
If that doesn't work, another option would be for the federal government to simply enact a tax on those forms of sales and send it back to the states on a formula basis.

The bottom line I think is federalism has a lot of pluses but it does cause problems that require national solutions and we're here today to talk about some of those.

MR. PEIRCE: Thanks very much. Enough ideas for everybody to get their teeth into as we move along here.

The next panelist is Oklahoma State Senator Angela Monson who is President of the NCSL, National Conference of State Legislatures.

Thank you, go ahead.



MS. ANGELA Z. MONSON: Thank you, Neal. Good morning everybody. I'm very happy to be here with you this morning to talk about a problem that all of our states are facing, how do we deal with the needs of individuals, people who we were elected to serve in a time of very very severe budget crises in our states. I've had the pleasure of serving in our state legislature now for 12 years and working with NCSL for longer than that, even as a staff person for our legislature, and understand and truly believe that most legislators are elected to office because they truly want to help meet the needs of individuals. But because of the difficult times, we find ourselves facing some very very difficult decisions.

We work in a political context, and that's not bad. The decisions that we make obviously are influenced by politics. Politics is not a bad word. This nature of democracy that we have in our country, representative democracy is a very good concept and hopefully engages the ideas and thoughts of the best of the best and the end result is good public policies that really make a difference in people's lives.

But when it comes to the requirements that most of us face balancing our state budgets, again those choices are very difficult. It results in competition between programs that service low-income families. Will we finance early childhood development for all three and four year olds, or do we fully fund our Medicaid programs? Do we provide day care assistance? We as legislators have to make those difficult choices within programs and sometimes unfortunately we have advocates in those individual programs that say fund us at the peril of other programs. At the same time we're facing choices among other state responsibilities -- overall education, higher ed, common education funding versus our Medicaid program funding.

Spending for our corrections department -- In my state we incarcerate unfortunately more individuals than virtually any other state and it's a very very costly endeavor on the part of the state. But there are real pressures, political pressures to be tough on crime and to incarcerate and spend dollars where some of us think they could be better spent in other places.

So we're faced with all of these dilemmas and these forces that would [inaudible] even in times of difficult budgets to lower taxes even. There is still a voice out there saying taxes are too high and states have a responsibility to create stimulus in the economy by lowering taxes.

So given all of the voices that we hear, the political context within which we work makes our job very difficult. But I believe that state legislators individually and the institution of representative democracy will stand firm and fast and ultimately do the right thing.

In Oklahoma in particular, we're faced right now with a very very difficult dilemma about our Medicaid program and I want to focus a little on the Medicaid program because it is driving the train in a lot of our states. Our Medicaid agency, our Oklahoma Health Care Authority just recently passed a policy to roll back our eligibility to only the federal mandated levels. It's a very very difficult choice that would have taken some 93,000 Oklahomans -- mind you, our state is only a state of about 3.1 million people. It would have taken 93,000 Oklahomans, mainly children, off of our Medicaid program, without helping things, without any means to secure that health care coverage. There were those of us in the state legislature that thought this was a very difficult decision and we understood why they made it but there were other alternatives that our Medicaid agency should really look at. We worked very hard with the decisionmakers within that agency, with other advocacy organizations. Fortunately last Thursday at the urging of state legislators like myself, we encouraged them to [inaudible] and of course they did, delaying, at least delaying those eligibility reduction given the state legislature an opportunity to come into session next February and hopefully identify new funding sources and at least engage in the debate as to how we make cuts.

Most states are faced with this decision of making cuts. We in Oklahoma, it's very difficult to raise revenue. We have a constitutional amendment that was passed by a [initiative/referendum] process, placed on the ballot through a [initiative/referendum] process, voted upon by the people that requires any income tax increase, any tax increase in our state to be approved by three-fourths vote of both houses in our state legislature. It's quite a difficult task, I think you would agree with me. And if it does not occur, then that decision has to go out to a vote of the people, that tax increase has to go out to the vote of the people at the next general election. So increasing tax revenue is going to be very difficult in my state although we will try.

So that means we are faced with making hard choices about budget cuts. In our Medicaid program the decision was do we cut people from the program or do we reduce services? Do we limit the amount of benefits that people are receiving, giving everybody at least some basic access to coverage, or do we simply take individuals out of the program, providing comprehensive packages of coverage for others?

These are very very difficult decisions that many of our states are facing, not just Oklahoma. But we find that these decisions are being made in other states in a [nature] that those programs that have proven themselves successful may be given some additional funding or support. So it's going to be important that states like my state, many other states, work very hard at accountability and outcome of programs, particularly programs meeting the needs of low-income families.

How do these low-income families fare? Right now at a time of budget crises, not very well unfortunately. Not very well, unfortunately. It is an easier target. They're not necessarily a well-organized group and in my state there are not a lot of advocacy groups that are at the capital saying we must protect the interests of families and children, although there are legislators who are there of course advocating on their behalf.

The activities that states take in response to these budget crises tends to put these families even at greater risk. We talked about that earlier. We do things that reduce their access to health care, their access to day care, their access to services that many of these families need just to make ends meet on a day-to-day basis.

Recently a report was given to me done by a community action agency in Tulsa, Oklahoma, a self-sufficiency report that described the amount of income a family needed in the state of Oklahoma which is relatively a low cost of living state, to be self sufficient. Those numbers are way in excess of the federal poverty guidelines. That's what we match many of our services to.

A family needs a certain amount of income simply to be self sufficient. Those are also the families that are going to be targeted first in the reduction in the loss of services that state governments provide. We're putting many of these families at much greater risk. It's important then that the federal government act on behalf of states.

The reauthorization of the TANF program is so critical at least for three years. States must know that there is some continuity of funding, in program implementation to be able to operationalize and continue to implement some of the activities that really have made families stronger, although we hope for [inaudible] increase in our Medicaid programs, I've asked our Medicaid Director to not put those eggs into that basket because we don't anticipate that occurring. But the federal government must realize that many of their actions that they take, much of their tax relief and changes in their tax schedules have direct implications for state budgets. So we have to do this together and in concert. The federal government cannot continue to evolve some of this responsibility to states without providing some financial resources.

Finally let me mention this sales tax simplification project. I have the benefit of serving on our Implementing State Project Initiative for my state in Oklahoma and it looks like we are very close to finalizing some agreement that will be helpful to states and its ability to collect already legal sales tax across state borders. Hopefully it will increase some revenue for our states, but also set a model that states can use so that we can jointly identify revenue sources and implement ways that we can share those revenue sources. Although it's difficult, we were able to meet the challenge. Hopefully the innovation in these crises that exist will result in great innovation that we can learn from this experience to take us into the next experience because of the cyclical nature of this when it occurs.

MR. PEIRCE: Thank you very much.

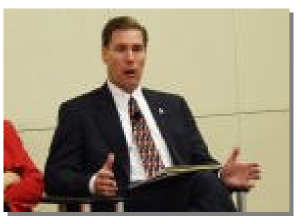
I think we're beginning to hear two major themes. One has to do with the conscience question and the underprivileged or the families that fall into poverty at a time of recession. How well do we take care of the least among us? That's against tax-phobia and anti-governmental conservatives' political moves.

Another issue is the one of simply better administration. The accountability that you mentioned in programs that benefit low-income people; the sales tax simplification; and the whole range of reform ideas that Alice is raising dealing with cyclicalities.

So it seems there are two sides to this. That's just my amateur impression. Now we're going to turn to Doug Howard who is the Director of the Michigan Family Independence Agency. Is that sort of like the welfare agency or just the Family Independence Agency?

MR. DOUGLAS E. HOWARD: We prefer the Family Independence Agency. [Laughter]

MR. PEIRCE: It includes administration of child care, adult protective services, foster care and adoption, family support and preservation, cash assistance, child care, foodstamps. You've got a whole bunch, plus Doug is President of the National Association of States that TANF [inaudible]. [Rob – fill in the correct title from his bio]



MR. HOWARD: Thank you, Neal.

I guess I feel the need to start on a lighter note, partly because I'm an optimist. I think what the tighter economy has done for me personally, it's freed up my schedule. In times of high revenues and bountiful surpluses everyone [is your friend], but when things get tight and agencies get into the [inaudible] mode I think they're afraid to remind me that we might be giving them money. So it's really a different dynamic out there.

The pressure really comes from multiple sources. Today's focus in large part is on state budgets, but our programs in the human services and social services world are really put together through a variety of funding sources -- state monies, federal monies, local government monies, philanthropic contributions, community and private business money. The same pressures we're talking about today are on all of those funding sources and I think it's critical to think about that. We quite often use multiple sources of funding to leverage other things.

I think to recap a little bit of what we've heard, kind of wearing my national association hat, we knew in 2002, and there are a variety of estimates out there, but at one point there were about $50 billion in collective state debt out there. States generally solve that through about a third in cuts in programs, about a third or a little better in rainy day funds, drawdowns and a variety of other mechanisms for the other third.

As we've heard, we're looking at a $57 to $58 billion projection for 2003 and we're talking some pretty significant money.

I want to reiterate, as an administrator I'm not looking to any significant increases in taxes to solve this problem. I think if we look back at the dip at the beginning of the '90s, probably about two-thirds of that was dealt with through tax increases and only about a third through budget cutting, but I just do not as an administrator expect that thing to happen.

So the challenges are there. How do we manage these programs in times of a tight economy? You've heard about the cyclical issues and the structural issues. The cyclical not only drives the revenue but drives the demand. You have both a supply and demand there. Unfortunately when I look at the structural what's really going to drive that is the supply side. What can we offer? What is the scope? How many can we serve? There are some political realities in most states. It's not necessarily the same degree in every state, but health care even with some of the issues, [inaudible], making tough decisions, health care is an area that they will have to address, and education is quite often something held very [safe] politically. So the pressures just increase in other areas of the budget.

Some of the considerations we've thought about in Michigan as we're managing the program, some of the history even. We know we've really been very lucky in that funding for these programs has been fairly stable over the last several years. There's two messages there. One is it was stable so we've been able to plan, we've been able to budget, we've been able to put things in place. The other is we really haven't seen as much growth as some people think. We've seen level funding and to a great degree reduction of resources in a number of these programs.

We know in Michigan in 2004, and this was true in many other states, that some of the federal policies, for example things like Medicaid with upper payment levels will put increased pressures on state budgets. We're looking potentially at hundreds of millions of dollars of lost drawdown because of some of those policies.

We know that some of the decisions we're now making really do directly impact our service delivery capacity. One of the things we've done in Michigan to address some of the budget pressures has been through an incentivized early retirement program. Last spring I had about 13,000 employees in my agency. When this early retirement cycle ends actually at the end of this month, I will be going into November with a workforce slightly less than 11,000, losing about 2700 employees and replacing only about 1,000. I think we can make it work, we don't have any option, but I do think we can't go with status quo. We know there's a lot of knowledge walking out the door and that really changes the ability of agencies in states and the area's capacity, but you have to think about how you do things differently.

Then of course there's a lot of uncertainty around federal budget issues. Many states operate in these one-year budget cycles or two-year budget cycles. I think as a prime example is what Angela's already offered as TANF reauthorization. It makes it very difficult to plan for the future when you look at three months or even one year reauthorization of TANF, so we are out there as well encouraging longer-term commitments in the federal partnership with the states.

Some of the specific things we've had to do within the context of my agency, I've talked about the early retirement. The knowledge walking out the door is tough, but I would tell you it's a lot better than some of the other options in reducing operating costs, layoffs are bad. People don't leave under their own terms. You aren't able to give people opportunities to move up. But again, the capacity issues abound.

We've had to do a lot of the traditional things you hear about in business as well as in government. Some heavy compacting of management supervisory loads. We're looking at eliminating and combining some functions of staff. Again, changing the capacity. Looking at program limitations. That may be eligibility, it may be scope of services.

One of the big things that often gets overlooked is the inability to address provider rate increases. Whether that's providers of child care, providers of services to help the welfare-to-work population, employment services, foster care, those are pressures that will start to directly affect years down the road the quality of those services if we can't turn this thing around in the coming years.

And of course we've looked at limiting expansions of any initiatives that are going on currently. Nationwide states are looking at a variety of options. If you can think of it there's probably one or two states that have tried it in the last year or two or will be trying it in the coming year, ranging from changes in their child care programs, cutbacks in before and after school programs, the rescoping of health initiatives, layoffs, furloughs, hiring freezes, early retirements, closings or consolidations of facilities, across the board cuts, reduction in technology and training investments, imposition of client fees or co-pays, drawdowns of reserve funds, we've heard about tax strategies, deferrals on capital projects of equipment purchases, eliminating or reducing or delaying the startup of new programs, reducing outreach. We of course want people to access the services that are needed, but we're faced with the very real problem of if they come can we provide it, reducing allocations paid to other entities whether they're local government entities or contractor groups, changing program eligibility I mentioned. We have a number of one-year programs out there that were pilots. They are at great risk. No new initiatives.

What can the federal government do? A lot of things. We'll probably get into this in more detail. But I think we need the stability in some of these policy and funding programs, multiyear commitments. Medicaid is clearly if not the number one close to the number one pressure in every state. We have issues ranging from long term care to the whole eligible debate, disabled individuals, pharmaceutical costs that are simply driving a bigger and bigger share of state government. I believe the gross last year nationally in Medicaid was around 13 percent. And we need that fiscal relief package.

I have to believe that there's a sentiment among both Chambers of Congress and the Administration that the need is real, that something should be done. From a state level, I'll tell you, we're quite scared that the politics will work in such a way that it won't happen and that fiscal relief is just absolutely critical to keep these things going.

What do I do in the mean time as an administrator of an agency? We have to prioritize, make sure we're getting the outcomes that are measurable and memorable. In a high revenue period we tend to use the dataset as a definition of two or more anecdotes that make our case. We're now in a period where we have to be clear that we're making a difference. We have to have real data, we have to have real results. We have to rethink ways to do business and that means redirecting money. We do have to make structural changes and that means redirecting money.

We have to really understand and appreciate our true core missions in each and every agency and government level and redirect money to do that. It's been very easy over the years to kind of grow the scope of what you provide. I'm not saying they're necessarily bad ideas, and quite frankly, most of them are probably good ideas, but get back to your core.

You need clear vision and communication. During a tough budget that's one of the things that breaks down quite often, communicating where you're going and why you're going there.

We have to put faces to these initiatives. Remember there are people being affected. We have to make sure we have stakeholder buy-in and create ownership for some of the tough decisions we make. We have to continue to look at public/private partnerships. We have to get a public message out there about what we're doing. We have to worry about unintended consequences. Quite often a decision you make can start affecting multiple programs or multiple outcomes. We also need to think about secondary benefits. If you do this will we start to see benefits in other areas? We need to really leverage multiple programs, multiple partners.

I like to use the phrase we need to find uncommon problems and drive them with common solutions. One of the things that comes up across low-income programs a lot is housing. It's a tough one to crack, but to the extent you solve housing you're solving problems in multiple areas.

We really need to think about the duration of a project and sustainability. The sustainability question is probably one of the toughest ones I'm faced with in a tight budget time. If I start something can I sustain it? If I keep it going can I sustain it? Am I just postponing a hard decision or do we need to address it now?

I want to think about replicability and adaptability. Are these programs or initiatives that can be adapted and replicated in a tight budget time? And I need to think about opportunity costs. There's not a lack of good ideas out there, and opportunity cost is not just a matter of for every dollar you invest you get $1.50 back or $2 back or $5 back over one, five or ten years. It's a matter of comparing it to the next option and saying the opportunity costs are even higher.

Just in summary, times are tight. I think we can get through it. There will be a lot of tough decisions that have to be made, that will be made, that won't be popular, but even though it's easier to manage when there's literally money falling from the sky saying here, spend me, I always like to remind myself that good managers and good leaders manage and lead in both bad times as well as good times, and even when decisions aren't popular there are some decisions you have to make.

I will stop at that and turn it back to you, Neal.

MR. PEIRCE: Doug, you sort of framed an interesting question at the end. Given all the multiple choices, given the multiplicity of programs, given all these funding streams, is there ever a chance to look at the whole system and see how it works? Are you able to do that while administering it day by day?

MR. HOWARD: It's very difficult to be quite honest, Neal. If you think about the way these are structured and were driven in many ways by the multiple funding streams and multiple interests, there's a diagram I plagiarized from some other source that I have in my mind where you start with Congress as a single dot, and it attaches budget bills that go down the multiple agencies and those agencies send multiple lines down to state governments and we send multiple lines down to local governments and community groups, and you literally get hundreds of thousands of lines representing funding streams which represent programs. If you think about what you're trying to do in the end, you're really trying to funnel them right back to an individual person or a family to make a difference.

What we really want to do in looking at the big picture I think is reduce the numbers of those lines so that we can take more comprehensive approaches.

MR. PEIRCE: You sort of start at zero base --

MR. HOWARD: That would be the approach you'd like to take but there are a lot of political pressures. Everyone has favorite projects. You have a lot of stakeholder groups. But I think if we don't do what you're suggesting we're simply going to exacerbate our decisions we have to make in the coming years.

MS. MONSON: I think it's important to always keep in mind that our target audience is the family. Regardless of what programs or funding stream we're talking about, [inaudible] as a result of funding from a foundation to work with state legislators, even some of these stakeholder groups to determine what the best approach is of meeting the needs of families and children. Across the turf boundaries, across the agency boundaries, see how we can put in place a thruster that would identify the family and its needs and create coordination systems. It's a little different from the old case management system, but rather unique and innovative. So state legislators at the legislative level are at least aware of the difficulty administrators have delivering services when you have a multiplicity of funding streams, to try to give any kind of support that we can to make sure that it's a simple, easy to access process.

MR. PEIRCE: But if you really looked at families, wouldn't you have to look at corrections policies? How many people are incarcerated for a pretty minor, just drug possession or very minor drug trading charges, and kept in during the years that their families are growing so you're disbursing families, killing family life through incarceration as a state policy.

MS. MONSON: You're absolutely correct. In fact in Oklahoma as this discussion takes place at the table are representatives of our correction system and our juvenile justice system as well. I know that, you know that, probably everybody in this audience is aware of that. The difficulty is convincing others that there is a draw, there is a pull away from families when we incarcerate people.

We just changed our state law and you can be incarcerated for felony convictions for stealing $50 worth of items, worth of goods in the State of Oklahoma. Just last year we changed the law.

So you're absolutely right. It's just a matter of convincing enough individuals that it's not good public policy to separate families when the need is for treatment in the case of substance abuse, with some other kind of activity or penalty rather than incarceration. It's very ineffective.

MR. PEIRCE: Donald Boyd, how much is corrections in the state budgets these days? They grew like Topsy over the last 20 years. How big do they look in terms of the overall state budget?

MR. BOYD: In terms of state budgets, they [inaudible]. [inaudible]

MR. PEIRCE: But we're up there still with all these other repercussions.

MS. RIVLIN: I think your point is a very important one, but in terms of dollars, that's not really where the money is. In the aggregate, total state general expenditures, police protection and corrections were about five percent. So if you're going to save a lot of money it's a good idea but it's not going to bring in the big bucks.

MR. PEIRCE: You actually might save more money through better family policies if you think about it carefully.

MS. RIVLIN: Oh, yes.

Can I bring us back to the current situation and ask Doug and Angela a question.

It does seem to me, as I said, that it's very important for the federal government to help the states so that the states aren't doing these counterproductive things that weaken the economy further, and yet both of you have sounded a little bit like you're giving up. You're being super-realistic and saying to your Medicaid Director you're not going to get the [inaudible] increase. Doug is talking about all the great things he's going to do to manage better which I'm fully in favor of, but my question is, are the states and the state politicians really getting across to the Congress how serious this situation already is and is going to be in the next legislative session? It's going to get worse. And you know it's going to get worse. But are you getting across to the Congress how bad it is and how much you need help?

MR. PEIRCE: When you say how bad it is are you talking about the potential conditions for families, or how bad the overall budget crisis for the states is?

MS. RIVLIN: I am talking about both, but it is the overall crisis. The fact that you're going to have to cut, and that a lot of those cuts are going to come on low-income families. If you agree with that analysis, are you really getting that across?

MS. MONSON: I agree with that analysis. We're making every attempt to get that across. We hope that the TANF reauthorization for at least three years will prove successful and they heard it and Congress acts. We're still waiting for them to take the necessary action.

As it relates to the Medicaid programs, I'm not sure in this overall kind of fiscal crisis we find ourselves in, I'm not sure we're getting that message across for several reasons.

Number one, I think we're working again in the political context. Congress wants to say we balanced the budget again and that we've been fiscally conservative again. Believe it or not, if they have to do that on the back of states I think there are some congressional representatives that would be willing to do that. So they're not so sensitive to our plight in the states. It's our responsibility.

I also think they don't understand that many of their fiscal policies [inaudible], when Congress has a very large tax rededuction with this President it will have major implications for state budgets. Most of our income tax provisions are tied directly to the federal income tax provisions, so when you have a reduction at that level it can't help but have a reduction at the state level. Therein lies some of the income tax reduction that you see at the state level to some extent.

So every time Congress makes some tax policy there are implications for the states. Which is fine.

I have not given up. I believe our voices will be heard loud and clear, but I also understand that the answer is not going to be an immediate answer.

MR. PEIRCE: You seem rather left or right. Washington rarely really has a full dialogue with the states. We elected a conservative, consumer states oriented administration and yet the tax cut is far more important than what's happening with the states. The same thing happens in other forms in a Democratic administration.

Do you have a response on this?

MR. HOWARD: It's hard for me to see the federal government doing something now. I would be surprised. The point Alice Rivlin made is that once you get past this you can certainly consider some sort of longer term countercyclical aid to the states program. That seems at least to me feasible in part because you don't have to budget for it because you're not going to forecast a recession.

MR. PEIRCE: I do want to ask all of you about willingness to make state tax increases. I understand Alice's point they're countercyclical. On the other hand they are a way to meet a budget deficit.

You explained the constitutional problem in your state. Other states had many of those votes but some haven't. It's a mixed bag.

The spooking of the state politicos on the [inaudible] tax increases. After all they raised taxes early in the '90s, they lowered them later in the '90s. Why can't they raise some at least again in critical places in order to make up for these deficits?

MR. HOWARD: I certainly agree that there is a greater anti-tax fervor -- that may not be quite the right word. A greater anti-tax feeling right now than perhaps a decade ago, but I don't have any really good measures of it.

If you look at what happened in the last two recessions what you do see is that the pattern was at least a fair bit like the current pattern. States drastically draw down reserve funds and take money from every fund they can find in the beginning, and that's perfectly logical given the environment in which they work. And as tax increases come later, often as the economy is recovering and drive a boom in state finances afterwards. So I think that it's early to conclude that there won't be a lot more tax increases.

MS. RIVLIN: One thing that has already happened is postponement of tax cuts that were on the books. We’ve done that in the District of Columbia and it's happening in other states.

MS. MONSON: One other thing, just look at the calendar. This upcoming fiscal year is in most states an off-election year. So in reality you may see more proposals [inaudible], but fortunately not a lot of states are constrained like we are in Oklahoma. We still shot out some tax proposals that will result in hopefully increased revenues for our state, but I think in 2003, the actual calendar year 2003, to be implemented fiscal year '04, you may see more of these proposals at least being presented. I would suspect a higher [inaudible] taxes.

MR. PEIRCE: I was interested in Alice's point on states competing with their neighbors for economies, trying to show they have lower tax bases and so on. We get the same thing in metropolitan regions where one locale is trying to get the jump over the other or stealing their industries and subsidies or things like that. It seems to me it's one of the least [inaudible] parts of the American system. You can argue to some point a little competition is good, but when you push it so far then you get also states forced into, or at least the dialogue gets into lotteries and all sorts of other sort of [inaudible] methods of covering the problem. So Alice has come back with a number of ideas of a federal/state cooperative plan. I think those are interesting but I'd like to get others' opinion on the panel about how, when, under what circumstances could we really get a serious consideration on those kinds of ideas.

MR. HOWARD: My opinion I guess is that in the case of the sales tax you have a very specific problem that is very large in nature. We talked about sales tax as being a third of state tax revenue and having all sorts of pressures creating long-term erosion in the sales tax base. That to me seems like a good case for some sort of either agreement among states to create tax bases that are sufficiently conforming, that businesses can administer the taxes on these cross-border sales, the internet and the mail order sales. So I think there's at least some hope that that's realistic. The idea that tax levels in any way could somehow be conformed across states, that low tax New Hampshire ought to have to have taxes like Massachusetts, I'd be hard-pressed to see any support for anything like that.

MR. PEIRCE: New Hampshire would be against it unless they made them do it. The old [inaudible] politics -- I'm against it I won't raise it myself, but if they force it down my throat --

MR. HOWARD: They have a motto about that --

MR. PEIRCE: They could sure use the money in New Hampshire to balance their budget right now.

MR. BOYD: The competitive nature between states I think is really inherent in everything we do. It's not just tax problems, it's economic development, quality of life, roads and highways, and the list goes on and on. I do think it would be difficult given states rights and federalism issues to drive too much change that way.

I do think there are some things. I think the internet tax is probably one that jumps out at me as having the most attraction because there's a lot of interest among states around creating more of a level playing field. It has nothing to do with the rates, it's simply a level playing field in commerce. I think there may be some other policies where it's not so much making them consistent, but states take the action and there may be more of a kind of follow-the-leader mentality like cigarette tax increases, some of the things that are a little bit more on the periphery than the income tax, sales tax.

I just see a lot of challenges in terms of too much interest in state policy out there.

MR. PEIRCE: There's a lot of bad results. I mean the cigarette tax alone, some states are trying to buy bonds with it so they can get their income up front, so they get only a fraction as much as they would otherwise. It makes you wonder.

MS. MONSON: Competition is great, but if we could just give part of the competition to the excellence of services. Come to our state because we have better schools rather than because we have lower taxes.

The poll evidence on why people, particularly why businesses locate, would support that argument.

I would certainly give in there and give Alice the last word since it's kind of her idea. It is difficult to do, but it may make sense with a little education, the streamlined sales tax initiative [inaudible] has been a great example of how states can come together, some 35-plus states, and agree on just [inaudible] for taxation. But the [inaudible] has been how much sales tax revenue will I lose, more than how much sales tax revenue will I gain from creating some uniformity.

Of course we have not dictated to states and would not through this process how much their sales tax rate must be. But to streamline and simplify the process and entice the private sector to voluntarily collect taxes from e-commerce or other kinds of sales.

The same argument I think would hold true for this corporate taxation. You're right. States have gone out there and whoever is the lowest bidder, who can give away the store in reality to attract business. In Oklahoma we offer a package, but it's the same for every industry and it balances with anticipated revenues that the state might receive. But in many cases corporations will shop. Business people will go and shop around and see who can give the best deal, and the best deal many times being the lower tax rate.

When we look at the actual corporate taxation that states are receiving, it's not a huge amount. There are many [inaudible] to states getting together and agreeing upon some uniformity in structure, at least, if not a single tax rate which may be much more difficult to achieve. Attempts to make it less complex to corporations and certainly levels the playing field to the challenges of the competition [inaudible] those things that really do make a difference like quality of life issues.

MS. RIVLIN: The multi-state tax [inaudible] working.

MR. PEIRCE: And of course you can argue that the nature of business incentives ought to be changing. You were trying in the last century to draw in big factories, and in this century you're really trying to have a trained workforce.

With a trained workforce you're economically competitive. Now it's easy to say that and hard to translate that message into politics, but it is a different type of competition than existed before for really competing.

I want to ask another question of the panel before we go to the audience for questions. Your thought on -- Alice brought up long-term countercyclical revenue-sharing programs. That's a different idea than taxes, per se. Is there any chance in your mind that there would be consensus on that in the states and the congressional positive thinking?

My cynical reporter's mind is politicians think short term. That's for the future. If they could enact it so that it's so far out they don't have to [inaudible] at the moment, it would be okay, but -- I lost my thought.

MS. RIVLIN: I think short-term on spending, but I think long-term on taxes.

MR. PEIRCE: That's true. [Laughter]

MS. MONSON: -- agreement among state legislators was [inaudible] to do something like this without [inaudible] short term, long term, it doesn't matter. I kind of dated myself because I can remember the revenue-sharing days and I was an adult then, so golly gee.

Whether or not Congress would want to share their revenue with ease, without a whole lot of strings attached with state governments or local governments, I'm not really sure. I think it's an idea like any of these ideas now that merits additional discussion and some advocacy work on the [inaudible] in that regard. I would like to be optimistic, but let's just float it out there and keep floating it until we see what response you get. Certainly there is support from the states on such an idea.

MR. PEIRCE: It's a hard idea to get much debate about when times are good, but that would be the easiest time to pass it.

MS. MONSON: That's absolutely right. Now's the time to start the discussion though.

MR. PEIRCE: We're ready for questions that you all may have. There are some mikes ready to travel around.

QUESTION: I'm Rachelle Freedman with McCauley Institute. I have a question specifically for Ms. Rivlin and then for the state people.

You talk about federal government sharing its resources with states and as we know, the federal picture has turned significantly as well. In 2001 there was projected a $5 to $6 trillion ten-year budget surplus. In one year since, at the end of '02, in '02 there was a $160 billion deficit.

Now the Congressional Budget Office has said that it's not mainly the fight against terrorism nor the economic downturn, but the greatest contributor to that swing has been the tax cut. The federal tax cut.

So I'm wondering, Ms. Rivlin, if you would support the federal Congress reversing some of the elements of the 2001 major big tax cut and if so, which elements?

In terms of the state taxes, my concern is often states look to increases in sales tax, and locals do as well. Sales tax is one of the most regressive taxes there is. So the very people that are harmed by downturns in the economy, i.e. low-income people, it's compounded because they pay a greater percentage of their income, they have to spend it. So sales taxes fall upon them. So it's almost like a double whammy.

MS. RIVLIN: I didn't plant that question but I'm delighted to have it. [Laughter]

I agree strongly with the implication of the question. I believe that the big tax cut was a mistake and the part that has not yet gone into effect, the rate cuts which benefit only people at the top of the income distribution, should be rescinded as well as the zeroing out of the state tax.

I believe that the tax cut was a mistake even at the time it was passed because those big surpluses weren't as real as they appeared. They depended in assumptions that spending would grow at unrealistic low rates even without the homeland security, etc. They depended on under-estimates of the cost of the tax cuts. So I thought it was a mistake at the time and I think it's an even bigger mistake now that the economy is not doing as well.

Now that does not mean that I think the current deficit in the federal budget right now is a mistake. This is when we need a deficit for fiscal policy reasons. But we hope we're not going to need it in 2005 or 2007.

In reality, and I said it earlier, the fiscal policy of the federal government, the tax rates that the President proposed, Congress passed, had a direct negative implication for states and the [inaudible] estate tax really hits us hard too in areas that are very very important for us. That's [inaudible].

MS. MONSON: We advocated it, we being state legislators, the other way, but of course we were not successful on that point.

You're right about the regressivity of sales tax. We understand that it's an easy tax to apply, unfortunately. In most cases it puts state government in competition with country or local governments who also can apply their sales tax. In our state when we do it, we give a rebate back, but it's been sort of after the fact, to people who meet certain income guidelines. Income tax increases really make more sense but politically they're more difficult to do.

MR. PEIRCE: Wouldn't a sales tax broadened into services be much less regressive?

MS. MONSON: I spent last year, every Thursday for four hours with about 30 other people around the table talking about ways to apply sales taxes on services. I told my presiding officer, I have not been bad. Why am I being punished like this? [Laughter] We could not come to any agreement on the application of sales tax for services because they apply to very very strong lobby groups, obviously. Special interest groups. It's going to be very difficult to sell. It's even harder to administer in a state where there's been no application of sales tax on services.

Can you imagine going to your local barbershop and having a $7 or $10 haircut and being asked to pay an eight percent sales tax, and the barber who's never collected sales tax being forced to collect and remit it to the state. Quite difficult.

MR. PEIRCE: You mean asking him to do it or his capacity to figure out eight percent of $8? [Laughter]

MS. MONSON: I'm not going to say. It's a very difficult system to administer.

And unfortunately in our state, like many others, we know that the ability to collect the actual correct sales tax -- to have the correct amount remitted to the state I should say, there's some place for error and miscalculation as well. There's a fairly high error rate in the actual amount remitted to the states ion terms of sales tax. It's not a good tax but it's the easy tax.

QUESTION: I'm Jim Ketzen from the American Bankers Association.

It seems to me there's an element that's missing here, particularly for the long term structural changes. There's no question there's a huge deficit that states face today but a good portion of that, not all of it certainly, is a result of actions that states took because they had a windfall in revenue. I think in Colorado, I don't know the program specifically, but I think they have a combination where spending is limited to inflation and population growth. As I understand it, Colorado is one of the few states that doesn't have the crisis that a lot of other states do.

Shouldn't we be looking for that type of reform that constrains behavior in good times in expenditures so that we don't end up with this problem?

MS. MONSON: I want to make sure that no one leaves this place thinking that the problems that states face are problems that we brought upon ourselves. I truly support the notion of constrained spending and most states do have some constraints, at least [inaudible] 95 percent of projected revenue. But remember, it's projections. States base budgets in a historical context based on what we anticipate. No one anticipated to this extent the shortfall in revenue. So although constrained and although reasonable, the actions of states have been -- The dynamics and the things that have happened in the budget I think are things no one had ever anticipated.

So I totally support the responsibility of states and responsible budgets and responsible appropriations, but I think the reason we're at this point this day has to do with changes in the larger economy. Changes in corporate America. Changes in the stock market that none of us had ever anticipated. Not just because states overspent when times were good.

MR. PEIRCE: How many of you feel that states actually didn't spend enough when times were good on basic infrastructure? Basic physical infrastructure and basic human infrastructure, in order to be more profitable and less welfare afflicted, deprivation afflicted in the future? That's one of the arguments for these children’s programs. If they're good enough and broadly enough interested like France and other countries reportedly have, we wouldn't have in the long term as many of the debts and the spending obligations.

MR. BOYD:?? Tying the two together, I do think most states probably have either some kind of constitutional or self-imposed legislative restriction on their spending X percent of projected revenues based on revenue estimating or based on actual growth or simply a requirement to balance their budget.

I believe the growth in state budgets during the boom time averaged somewhere around 6.5

percent which isn't inconsistent with the growth. The dynamic we have is we had such a sudden and great turn-around in the revenues that it was really hard to project. The investment issue I think during boom times, I think there are a lot of examples out there among states and it's not a partisan issue. States, Republican and Democrat, came up with a lot of really good prevention programs that were really trying to show a return on investment. But we're now into the time of you have less revenues, you have to balance the budget or you're limited to X percent of your revenue projections. Many of those programs are new, they're early, they're not statewide, they're the very programs that are at risk.

MS. RIVLIN: I think one of the things that one could urge states to spend more on in good times is building up reserves. Because that does help when the economy comes down and it is one thing that states can do themselves, is be more strict in their rules that they impose on themselves about building up reserves.

But on the specific question raised, whether or not it is sensible to constrain state spending in some way depends a lot on what the federal government is doing. If the federal government is opting out of a lot of programs and putting mandates on the state and saying you have to raise education standards, and you have to be [inaudible], and you have to do various other things, then it doesn't make sense for the states to be imposing restraints on themselves at the same time.

MR. BOYD: A lot of that comes down to how well you think representative democracy works in terms of reflecting voters' desires, and I think to support tax and expenditure limits you have to believe, well, a lot of those who do support these limits believe that in fact the representative process is not reflecting voters' desires. I don't know.

If you were to look at state government spending over the last five decades you'd find that in every one of those decades real per capita spending grew substantially, which means that there has certainly been some long-term support for state governments doing more than they had been doing.

Colorado is highly unusual in that it has an extraordinarily broadly drawn limit. In most cases what they do is divert the spending activity to funds outside of what's limited or to entities outside of the particular [inaudible] it's limited in. So I think that's a highly unusual case.

QUESTION: I'm Rachel Reed from the British Embassy.

I was interested in [inaudible] about public/private partnerships. They've been very popular in the UK mainly as a way of raising finance to provide [inaudible] money, but it also has been [inaudible] for the future that would be [inaudible]. Do you have examples of where that's been used and [inaudible] and perhaps more broadly?

MR. HOWARD: I'll throw some out at random. These may or may not be the best ones, but they're the ones that pop into my head I think in the area of welfare reform and workforce development.

We've seen a growth in Michigan in trying to leverage the brains and intelligence and experience of the private sector in thinking through training programs and in some cases actually developing the training programs in conjunction between our local workforce agencies funded by government and the employers themselves so that we're driving people towards skill development that the employers want for the jobs that are in the area.

We have a couple of public/private partnerships in welfare reform where we actually have the equivalent of our social worker on-site at the employer serving as an equivalent of an employee assistance program. As we're placing individuals moving off of welfare into these words we find that very early on in the first one to three months if they have barriers to keeping that job they're going to surface quickly, and with that on-site support we can help them through the question of what do you do when your child's sick, housing issues, domestic violence issues. We've seen some dramatic turn-arounds in job retention.

We have public/private partnerships on the child welfare side. In Michigan we heavily use some of the private non-profit agencies to help us with foster care and adoption. One of the partnerships we've done for an economy of scale there is developed jointly a training program, government employees and private employees both go through the same training institute for foster care and child protection so that we aren't having multiple programs.

Those are just a few examples.

QUESTION: Nick Johnson.

I want to come back to a point that we sort of touched on earlier which is the possible role of tax increases in the coming legislative session. I think the picture is more pro-tax increases perhaps than some of you have suggested for a couple of reasons. One is the tax increases of the early '90s as a possible model. As Don mentioned they tend to kick in later in the process after all the easy choices have been expended.

But at the same time it also strikes me that it's very hard for state legislators themselves who have just come through eight years of cutting taxes to suddenly kind of change their whole frame, perhaps change the platforms on which they were elected to acknowledge that at times we now have a revenue problem that demands a revenue solution.

So I guess my question is do you see after we get through this election, the mindset of state legislators changing, and I guess particularly how is it influenced by term limits? Do term limits help in that we'll have a new crop of legislators that may be able to take a fresh look at the problem, or do they hurt in that most of the state legislators who are in office now, like yourself, have no idea of what happened in the early '90s and how those problems were dealt with?

MS. MONSON: I'm hopeful that they will take a different look at tax increases. And if there are tax increases the application would be as fair and equitable as possible for the poor. And we try to implement progressive taxation. That's why the income tax method is really a more prudent method of increasing and probably the most stable method of increasing revenues for states.

I'm from a term limited state. Our term limits will go into effect in 2004 the first time. It could work either way. State legislators who came into office in a no-tax platform could say I'm going to stay true to that platform throughout my career because I'm going to be gone in two years and it will be somebody else's problem. Or they could say I understand the problem and the crisis that we face and the only solution is new tax revenues and I'm going to be gone in two years. So --

MR. PEIRCE: If you don't have to face reelection it's easy to vote for it, isn't it?

MS. MONSON: You're right. California probably is a better example because they have the shorter term limit that's been in effect a lot longer than of course the [inaudible] in Oklahoma. So I don't know if that's a good sign or a bad sign in reality.

I hope that you're right, that states will [inaudible]. There are probably other answers to a revenue increase. What is really, from my social change days, [inaudible] social change days, what it really will take I think is not only a different view from the legislature prospective but a very vocal and active advocacy [inaudible] from the grassroots and a reasonable voice from corporate America that understands that the policies we make at the state level have some implications for them as well.

MR. PEIRCE: One last question. Belle Sawhill.

QUESTION: This gives me the excuse to thank all of you very much for being here. It's been a great discussion, and also make a little advertisement for the policy brief that Alice Rivlin has written and it's in draft still but we will be putting it out in final after she makes whatever revisions she wants after this meeting.

My question or comment is that none of you have talked about homeland security. Several of you mentioned that if there was an increase in the federal contribution to the Medicaid program that that would have the indirect effect of releasing some of these central pressures.

I would have thought that a good strategy for states to use right now would be to say we need help from the federal government with all of our first responder responsibilities and that those monies could hopefully be more than enough to cover the marginal cost, if you will, of homeland security, and similarly relieve some of this pressure, but that it would be a politically easier sell than the other ones you've been talking about.

MS. MONSON: Money has been appropriated to states from the Department of Health and Human Services and one other federal agency, law enforcement. Who gets that? You have states and county governments or local governments deal with this issue of homeland security, whether it be increased laboratory activities on the part of county or state health departments, or increased law enforcement activities on the part of local governments and state governments. So money is there and available. But I think if my memory serves me correctly, that much of that, all of those dollars, came to states with some strings attached and with a requirement that we not use it to supplant current state money.

So it didn't work in the way we would like to have seen it work. It worked in the way that it did take some of the financial pressure that we were facing off in terms of this new responsibility of homeland security.

MR. PEIRCE: Isn't it also safe to say though that most, the overwhelming burden really falls on local governments, so the states are not a major actor financially on the homeland security front, compared to what the increased bills are for local governments.

MS. MONSON: Any act of terror -- from Oklahoma City. We've seen it happen. It's a multi-action. You're right, the first responders are your local fire department and police department. The state has the responsibility to coordinate and make sure that other services are available. Therefore, the federal [inaudible] many of these [inaudible] local governments [inaudible].

MR. PEIRCE: And if you've spoken to local governments these days --

MS. MONSON: It's not enough.

MR. PEIRCE: You're hearing a lot of cries of agony about lack of any kind of help on the new homeland security cause.

I guess that does it -- Belle had the last question. Thank you all very much for being with us.

# # # #