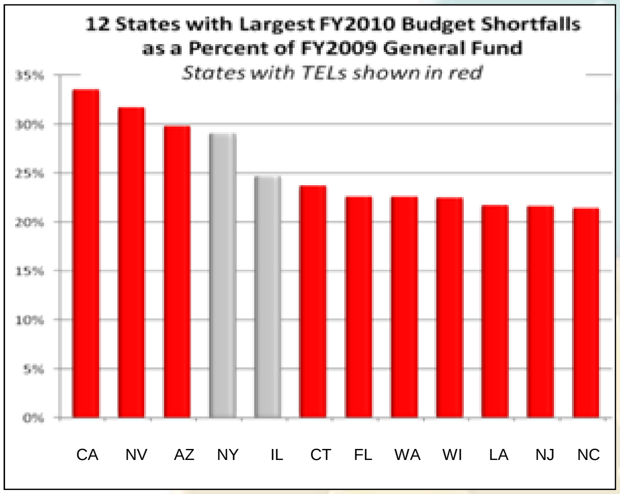
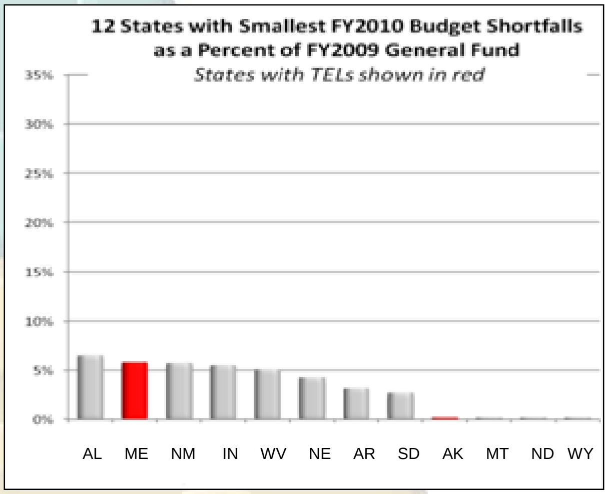
TELs, the Recession, and Budget Gaps

What role have tax or spending limitations played in states during the current recession? According to the National Council of State Legislatures, 26 states have either a statutory or constitutional formula-driven limit on state expenditures or revenues, known as tax expenditure limits or TELs. (Three states have provisions requiring that appropriations not exceed a set percentage of the revenue forecast; these are not considered formula-driven TELs in this analysis. Montana enacted a TEL, but the courts placed it on hold.) During the recession, these limitations appear to be strongly associated with widening budget gaps and massive cuts to public services.

The three states with the largest funding gaps were all subject to TELs: California (with a 33.5% gap in FY 2010 general funds compared to FY 2009), Nevada (a 31.7% gap), and Arizona (29.8%). Of the 12 states with the largest gaps, 10 have budgets subject to TEL limitations (see chart, below left). Alternatively, of the 12 states with the smallest gaps (including the four states with none) only two were restricted by TELs (see chart, below right).

States with the Highest (left) and Lowest (right) Budget Shortfalls





The TEL-constrained states comprise 60% of all states' general fund revenues, but they account for 91% of the states' total FY 2010 budget shortfalls. The average budget shortfall for the 26 states with TELs was 16.2% while the average for the non-TEL states was 11.1%. These numbers indicate that, on average, TEL-limited states experienced funding gaps that were 5% greater than the gaps of non-TEL states. That means that for each billion dollars of a state's total general fund budget, the average TEL state experienced a shortfall of $162 million while the average non-TEL state saw a shortfall of only $111 million.

From a broader economic perspective, state and local governments are vital to local economies and, in addition, tend to be very labor intensive. One of the characteristics of government jobs is that they tend to provide stability. Formula-driven measures that squeeze budgets even further during economic slowdowns are pro-cyclical, making the situation worse and exacerbating downward pressure on jobs and income.

Still, some might ask whether TELs lead a state to better economic growth during more normal times. According to the evidence, the answer is "No." Over the previous five years (2003 to 2008), states with TELs have generally underperformed non-TEL states in terms of growth in their residents' per capita personal income – 4.7% average annual growth for the TEL states versus 5.1% for the non-TEL states (see chart, over left).

A simple correlation such as this doesn't prove or disprove a connection between TELs and states' economic performance. It does, however, strongly suggest that arguments claiming that TELs are good for the economy should be looked at very skeptically. Historically, TELs have not been a panacea for states wanting to accelerate economic growth (see chart, over right; blue bars are TELs states). As shown, states enacting various TELs have seen per capita income grow at a slower pace, on average, than states without TELs. In fact, a look at *all* states (the two right hand columns) shows that those with TELs have grown at only half the pace (0.7% p/y) in the first 5 years as have non-TELs states (1.4% p/y) in comparable years.

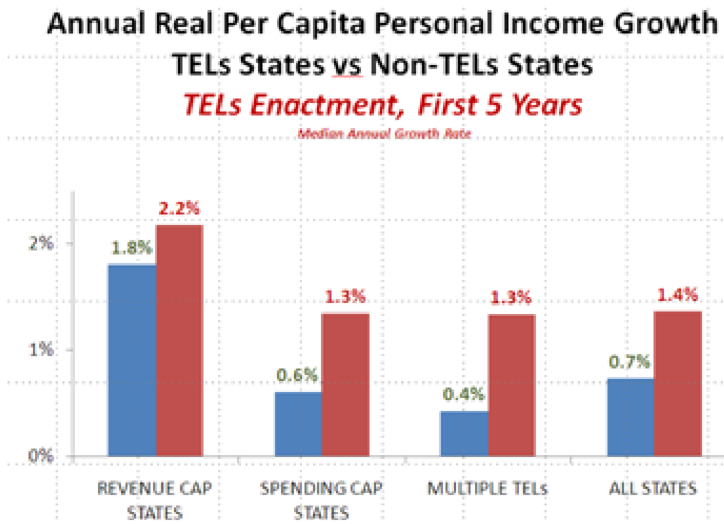
Over

TELs, the Recession, and Budget Gaps (*cont.*)

Average Annual Growth in Per Capita Personal Income, TEL States and Non-TEL States, 2003-08

STATE	TEL State	Non-TEL
Alabama		5.0%
Alaska	5.9%	
Arizona	4.1%	
Arkansas		5.0%
California	4.9%	
Colorado	4.5%	
Connecticut	5.6%	
Delaware		4.0%
District of Columbia		6.9%
Florida	5.2%	
Georgia		3.4%
Hawaii	5.8%	
Idaho	4.7%	
Illinois		4.6%
Indiana	3.4%	
Iowa		5.1%
Kansas		5.0%
Kentucky		4.2%
Louisiana	7.9%	
Maine	4.2%	
Maryland		5.1%
Massachusetts	5.2%	
Michigan	2.5%	
Minnesota		4.5%
Mississippi		5.0%
Missouri	3.9%	
Montana		5.4%
Nebraska		4.1%
Nevada	4.9%	
New Hampshire		4.4%
New Jersey	5.0%	
New Mexico		5.1%
New York		5.9%
North Carolina	4.3%	
North Dakota		6.5%
Ohio	3.5%	
Oklahoma	6.9%	
Oregon	4.0%	
Pennsylvania		4.7%
Rhode Island		4.6%
South Carolina	4.3%	
South Dakota		5.1%
Tennessee	4.0%	
Texas	5.6%	
Utah	4.0%	
Vermont		5.1%
Virginia		4.7%
Washington	5.0%	
West Virginia		4.9%
Wisconsin	4.0%	
Wyoming		8.6%
Average for group:	**4.7%**	**5.1%**

Source: U.S. BEA for income data; NCSL for state TEL classification.



Sources: NEA Research analysis of source data on TELs status of states (Waisanen, 2009, "State Tax and Expenditure Limits–2008," NCSL, http://www.ncsl.org/default.aspx?tabid=12633) and per capita income (BEA, Regional Economic Accounts, Table SA1-3, http://www.bea.gov/regional/spi/drill.cfm), adjusted for inflation (using Consumer Price Index–Urban) from U.S. Dept. of Labor, Bureau of Labor Statistics, ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt.

The TEF Premise

TELs is just more of the same, another in a long list of gimmicks that don't provide the kind of broad-based economic prosperity we have grown used to as Americans. It's time for a bold new economic idea. It's time for TEF.

TEF **–** which stands for **T**axes, **E**conomic development policies, and **F**unding for schools **–** is a simple and powerful economic idea whose central premise is that investing in education pays **–** *always.*

A fair and equitable tax system combined with a level economic playing field for business and adequate and equitable funding for public education is the best way to create and maintain a civilized, safe, and prosperous society.

For more information contact TEF@nea.org.

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