Policy Analysis

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The State Spending Spree of the 1990s

by Dean Stansel and Stephen Moore

Executive Summary

Today, almost without exception, state governments are awash in tax revenues. Between 1992 and 1998 state revenues grew at almost twice the rate of inflation plus population growth. If states had restricted increases in spending and tax collection to the rate of inflation and population growth over the period 1992–98, the state tax burden would be $75.2 billion lower today, or $278 less per person. In Michigan, the excess tax burden from 1992 to 1998 came to $787 per person; in New Mexico, $661; in Minnesota, $573; in Connecticut, $535; and in Wisconsin, $520.

In 1999 state tax receipts are again exceeding expectations. States will also begin to receive from tobacco litigation settlements an additional revenue bonus worth $206 billion over the next 25 years.

As record tax revenues have poured into state coffers, state government expenditures have soared. In an era of almost no inflation, state budgets grew by 4.5 percent in 1996, 5 percent in 1997, and nearly 6 percent in 1998. Four states (Vermont, Florida, Nevada, and South Dakota) actually raised their spending by 10 percent or more in 1998. The states now spend roughly $600 (adjusted for inflation) more per person than they did in 1990. Seven states have permitted their budgets to mushroom by more than 30 percent after adjusting for population growth and inflation: Mississippi, Oregon, Arkansas, West Virginia, Texas, Missouri, and New Hampshire.

Over the past four years, only about one of every three dollars of the unexpected revenue surpluses has been returned to taxpayers. Unless states begin to cap expenditure growth and cut taxes to reduce the revenue intake of state governments, they may be faced at the end of this expansion with the same massive deficits that created tidal waves of red ink when the 1980s boom ended.

One of Jesse Ventura's most popular messages in his improbable but successful independent campaign for governor of Minnesota was a promise to "give back" the burgeoning budget surplus revenues to the taxpayers of the state. It is sad but revealing that so few of the governors of either party have promised to do the same despite multi-billion-dollar windfalls.

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Last year almost half the states had gigantic reserves of 10 percent or more.

Introduction

With the economy booming, tax revenues are pouring into state treasuries, and most state governments are in excellent fiscal shape.[1] Last year, the 50 states closed their books with a combined surplus of $36 billion. At 9 percent of expenditures, budget reserves are at their highest level in nearly two decades.[2] Predictably, those large surpluses have created intense political pressure in state capitals for new and expanded spending programs.

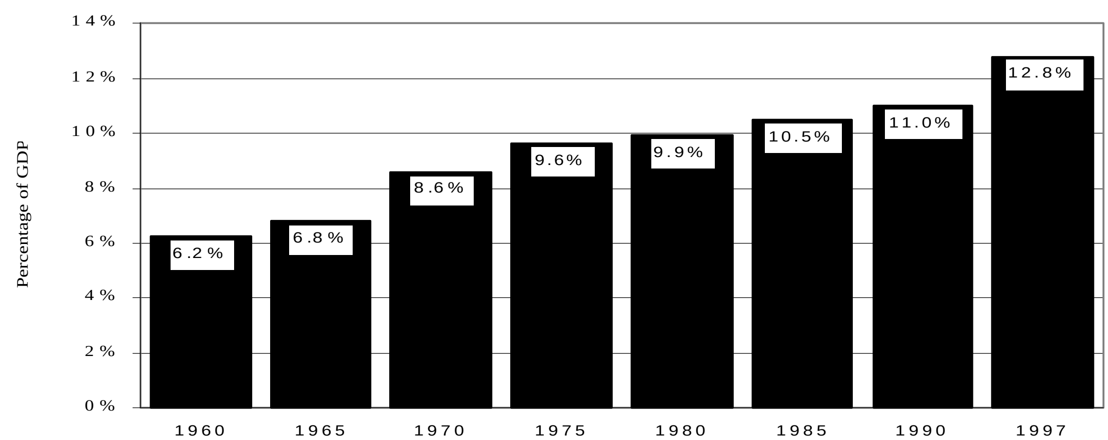
Ten years ago, the states were in the midst of a similar fiscal boom. Few states resisted the pressure to use their surplus revenues to create costly new spending programs. Then when the economy went into a downturn in 1990, the states found themselves in what many described as their worst fiscal crisis since the Depression. Then-governor Mario Cuomo of New York described the situation in his state: “We are broke down to the marrow of our bones.” That statement could have described the fiscal plight of about half the states in the early 1990s. Revenue growth slowed, but demands to meet all the new spending commitments did not.[3]

States *have* been building up their “rainy day” funds in recent years to protect against a recession. According to the National Association of State Budget Officers, last year all but 10 of the 50 states had end-of-year balances that exceeded the 3 to 5 percent of expenditures recommended by most financial analysts.[4] Almost half the states had gigantic reserves of 10 percent or more.

Yet even with those large revenue reserves, state spending has soared in recent years. By virtually every measure, state budgets have expanded faster in the 1990s than they did in the fiscally reckless 1980s. Moreover, since 1994 state budgets have grown 50 percent faster than the federal budget. Rather than returning excess revenue to state taxpayers, all too often today governors and state legislators across America are spending the taxpayers’ surplus.

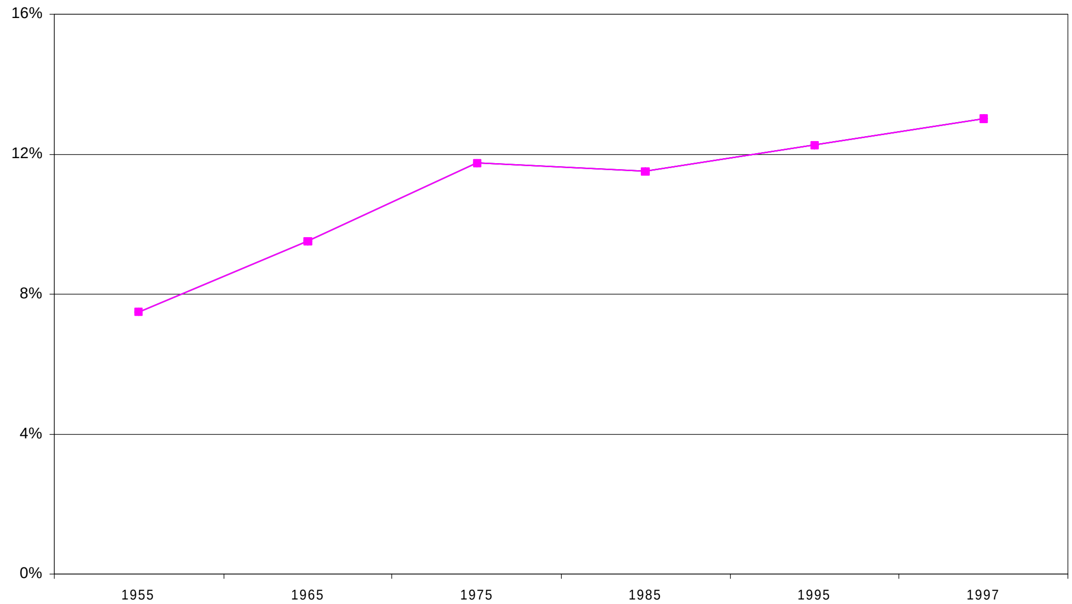
Some state officials have tried to justify the big budget hikes by arguing that vital public programs have been neglected by governors and state legislatures. The truth is that state governments have been on a long-term trend of rapid growth. State governments consume a larger share of gross national product today than ever before in history. Figure 1 shows that, since 1960, state revenue as a percentage of GDP has roughly doubled. And it is untrue that states are doing more because localities are doing less. Figure 2 shows that *combined* state and local taxes as a percentage of median family income have

Figure 1
State Revenues as a Percentage of GDP



Source: U.S. Department of Commerce, Bureau of the Census and Bureau of Economic Analysis.

Figure 2
State and Local taxes as a Percentage of Median Family Income, 1955–97 (two-income family)



Source: Tax Foundation.

almost doubled over the past four decades.

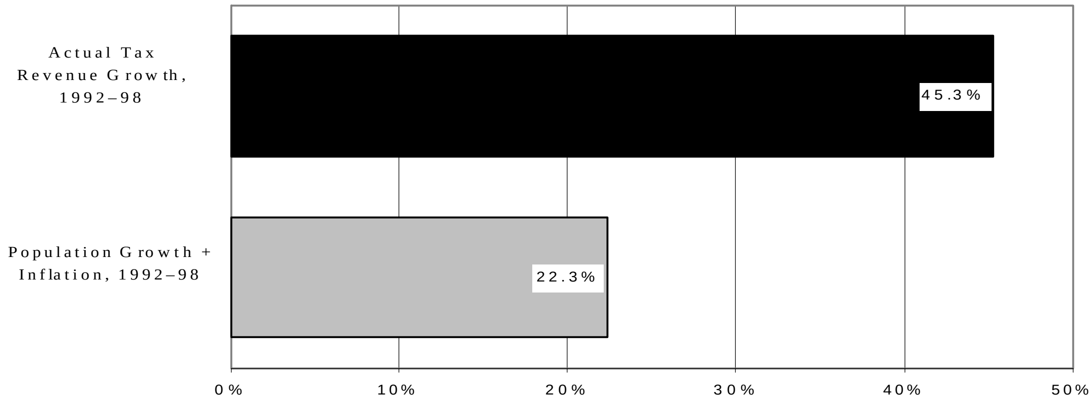
Many of the areas of state budgets that are said to be "underfunded" have actually seen dramatic increases over the past decade or more. Since 1970 state spending on education per student adjusted for inflation has roughly doubled. Since 1980 state highway spending has also risen faster than population and inflation. State health and welfare spending has risen three times faster than population and inflation. Surplus or not, there's no case for expanding state government still further.

While many Republican governors have been cutting taxes, those tax reductions have been inadequate to keep pace with the huge revenue windfalls from the strong economic expansion of the past six years. Since 1994, despite $15 billion in tax cuts, state tax collections have exceeded expectations by a cumulative $30 billion. About two-thirds of that revenue windfall were spent, rather than rebated to taxpayers.

The result has been that state tax revenues have dramatically outpaced population growth and inflation—which are considered a standard benchmark for normal revenue growth. From 1992 to 1998 state tax revenue grew by 45 percent, while population and inflation rose by a combined 22 percent (Figure 3). In 1998 alone, those excessive tax collections created a revenue windfall of $75 billion, or $278 per capita (Figure 4).[5] With 31 states now having Republican governors, most of whom tout themselves as tax-cutting fiscal conservatives, the results of our analysis are surprising. Since large budget surpluses are expected again in 1999 and 2000, this year's budgets signed into law by the governors will be critical in determining the future fiscal course of the states. The choice facing George W. Bush of Texas, Gray Davis of California, John Engler of Michigan, Tommy Thompson of Wisconsin, and most other governors this year is to dramatically cut taxes or to continue the spending spree on new and expanded state programs. This study shows that the states that use surpluses to cut high tax rates can be expected to experience the fastest economic growth in the future.

Tax reductions have been inadequate to keep pace with the huge revenue windfalls from the strong economic expansion of the past six years.

Figure 3
State Revenue Growth Outpaces Population and Inflation, 1992–98



State Spending Trends

to expand rapidly. Between 1990 and 1997

In the 1990s state budgets have continued to expand rapidly.

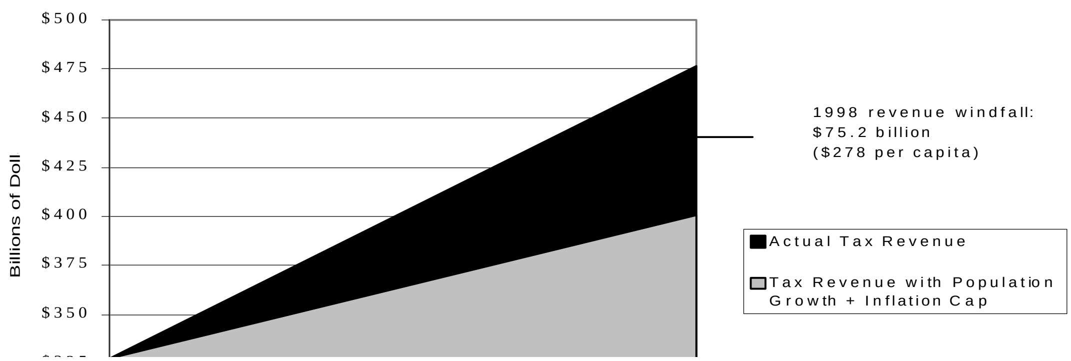
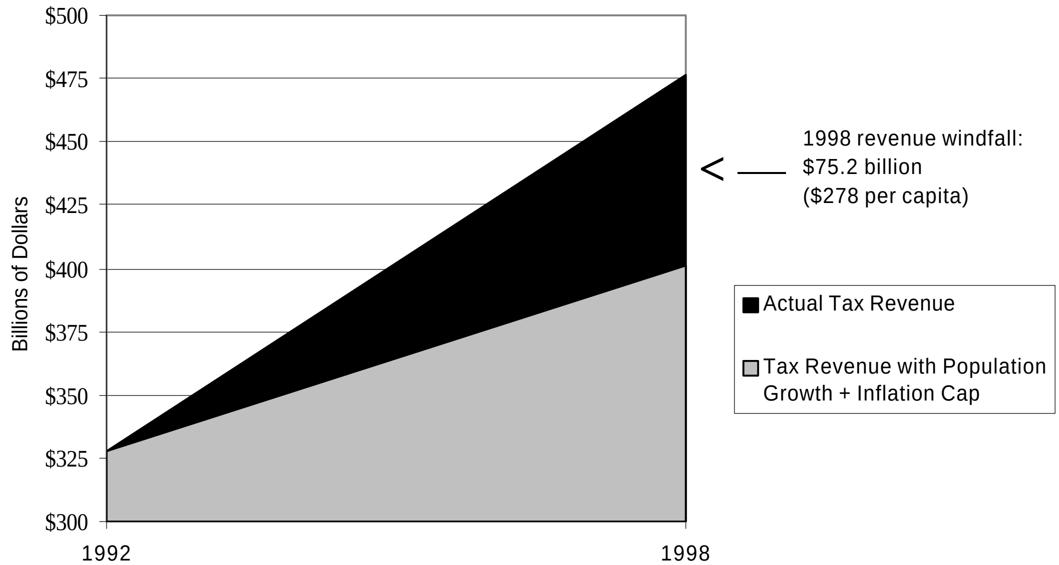


Figure 4
$75 Billion Revenue Windfall



Medicaid spending has doubled from 8 to 16 percent of total state budgets. In percentage terms, public welfare, administration, interest on general debt, and especially corrections have also been high-growth areas in state budgets since 1980.

No matter how it is measured, state spending has accelerated in the 1990s. As Figure 5 shows, real state spending has even been growing slightly faster in the 1990s than it did in the 1980s—when many state budgets doubled in size.[6] State expenditures expanded by 3.4 percent per year in the 1980s, after adjusting for inflation, compared to a 3.5 percent growth rate in the 1990s. On a per capita basis, real state spending has grown by 2.5 percent per year in the 1990s, slightly faster than in the 1980s.

State spending per $1,000 of personal income nudged upward by 0.1 percent per year in the 1980s. In the 1990s state outlays have grown at an annual rate of 1.3 percent above income growth. And there is no sign of a spending slowdown. Since 1996 state general fund spending has accelerated to 3.1 percent of real growth per year, compared to the 1.7 percent per year growth rate from 1990 to 1996.[7]

The Biggest Spending States

The nationwide spending totals for the states mask the huge diversity in budget trends among the states. Table 2 shows that the spending trends in individual states varied from a high of 58.8 percent in Oregon to Alaska's 0.6 percent *decline* in real spending. Alaska was the only state with an absolute decline in spending, and that was a result of the drop in oil prices, which has severely reduced the state's oil tax revenues.

- Three states increased real spending by more than 50 percent from 1990 to 1997: Oregon (58.8 percent), Texas (52.9 percent), and Mississippi (51.5 percent).
- Three other states increased real spending by less than 10 percent from 1990 to 1997: Alaska (0.6 percent *decline*), Wyoming (5.5 percent), and Rhode Island (8.1 percent).

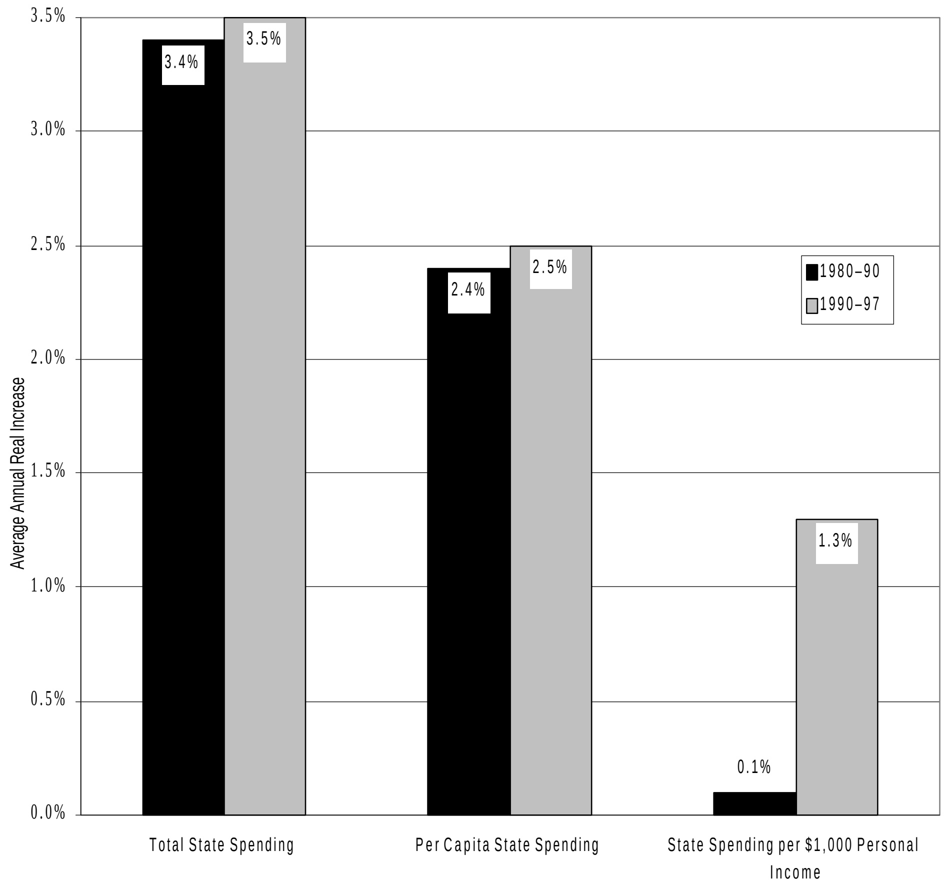
To control for differences in state populations, government spending and tax figures are often measured on a per capita basis. Table 3 shows the 10 states where real per capita state spending increased the most

In the 1990s state outlays have grown at an annual rate of 1.3 percent above income growth.

Table 1
Shifting Spending Priorities: State Spending by Function (in millions of 1997 dollars)

				1980–97 Real Increase	
	1980	1990	1997	Mil. $	Percentage
Education	$171,420	$226,694	$275,821	$104,401	61%
Public welfare	$86,198	$128,957	$203,204	$117,006	136%
Health and hospitals	$34,805	$52,411	$63,193	$28,388	82%
Highways	$48,819	$54,360	$60,204	$11,385	23%
Correction	$8,673	$21,212	$29,043	$20,370	235%
Governmental administration	$13,624	$22,556	$28,656	$15,033	110%
Interest on general debt	$13,183	$26,452	$26,310	$13,127	100%
Natural resources	$8,471	$12,173	$12,909	$4,437	52%
Police protection	$4,412	$6,346	$7,501	$3,089	70%
Parks and recreation	$3,012	$3,432	$3,900	$888	29%
Other and unallocable	$52,262	$69,332	$77,434	$25,173	48%

Figure 5
State Spending Growth Up Slightly in the 1990s



from 1990 to 1997 and the 10 states where it increased the least.

The spending trends in individual states varied from a high of 58.8 percent in Oregon to Alaska's 0.6 percent *decline* in real spending.

- Real per capita spending grew by more than 35 percent in four states: Mississippi (43.0 percent), Oregon (39.9 percent), Arkansas (38.2 percent), and West Virginia (36.3 percent). Mississippi moved from the 41st highest spending state in 1990 to the 26th in 1997. Oregon moved up 16 rankings: from the 29th to the 13th highest spending state.
- Real per capita spending *declined* in three states: Alaska (9.8 percent), Arizona (1.2 percent), and Wyoming (0.3 percent) and grew by less than 6 percent in two others: Nevada (3.6 percent) and Vermont (5.8 percent). Arizona's per capita spending ranking improved from 26th to 46th in the nation. Nevada's per capita spending position improved from 19th highest to 32nd highest.

Another way to express government spending and tax figures, which controls for differences in the size of state economies, is on a per $1,000 of personal income basis. Table 4 shows the 10 states where state spending per $1,000 of personal income increased the most from 1990 to 1997—led by once-frugal New Hampshire—and the 10 states where it increased the least.

- State spending per $1,000 of personal income grew by more than 20 percent in six states: New Hampshire (24.5 percent), West Virginia (22.2 percent), Oregon (22.1 percent), Mississippi (21.9 percent), Missouri (21.8 percent), and Arkansas (21.0 percent).

Table 2
Total State Expenditure (millions of 1997 dollars), 1990–97

State	Increase, 1990–97	Rank	1997	Rank	1990	Rank
U.S. Total	27.2%	---	$893,827	---	$702,591	---
Oregon	58.8%	1	$12,388	27	$7,803	29
Texas	52.9%	2	$48,887	3	$31,974	3
Mississippi	51.5%	3	$9,006	31	$5,943	31
Arkansas	48.1%	4	$7,685	32	$5,188	34
Georgia	46.5%	5	$21,975	13	$15,004	14
Idaho	46.1%	6	$3,674	43	$2,515	44
Utah	43.9%	7	$6,818	36	$4,738	37
Nevada	42.6%	8	$5,130	39	$3,598	41
Florida	40.4%	9	$37,464	5	$26,687	8
Missouri	39.1%	10	$14,230	21	$10,229	22
Tennessee	38.4%	11	$14,284	20	$10,323	21
West Virginia	38.1%	12	$7,145	34	$5,174	35
North Carolina	37.9%	13	$22,864	11	$16,576	12
New Mexico	37.7%	14	$7,059	35	$5,125	36
New Hampshire	37.2%	15	$3,324	45	$2,423	46
Colorado	35.8%	16	$10,861	28	$7,998	28
Kentucky	35.6%	17	$12,949	23	$9,548	26
Nebraska	35.5%	18	$4,802	40	$3,544	42
Washington	33.2%	19	$22,207	12	$16,667	11
Minnesota	32.2%	20	$18,443	15	$13,950	16
South Carolina	32.2%	21	$12,847	25	$9,717	25
Pennsylvania	30.4%	22	$39,296	4	$30,136	5
Delaware	30.2%	23	$3,404	44	$2,614	43
Illinois	30.2%	24	$35,302	8	$27,115	7
Alabama	30.0%	25	$12,945	24	$9,961	24
Montana	29.9%	26	$3,204	46	$2,466	45
Wisconsin	29.8%	27	$18,200	16	$14,025	15
Kansas	29.7%	28	$7,496	33	$5,780	32
Hawaii	29.4%	29	$6,093	37	$4,708	38
Indiana	28.0%	30	$16,370	17	$12,794	18
Michigan	27.2%	31	$36,092	7	$28,376	6
South Dakota	25.4%	32	$2,070	50	$1,651	50
Virginia	24.3%	33	$19,287	14	$15,518	13
Louisiana	23.4%	34	$14,286	19	$11,572	20
Arizona	22.3%	35	$12,419	26	$10,154	23
California	21.4%	36	$117,643	1	$96,888	1
Ohio	20.7%	37	$37,407	6	$31,004	4
Iowa	20.5%	38	$9,348	30	$7,760	30
Oklahoma	19.9%	39	$9,593	29	$8,004	27
Maine	18.8%	40	$4,441	41	$3,740	39
Maryland	16.7%	41	$16,200	18	$13,877	17
New York	14.6%	42	$83,243	2	$72,652	2
Connecticut	13.8%	43	$13,826	22	$12,145	19
North Dakota	12.5%	44	$2,426	47	$2,156	47
Massachusetts	12.0%	45	$25,791	10	$23,017	10
New Jersey	11.7%	46	$29,430	9	$26,356	9
Vermont	10.4%	47	$2,123	49	$1,923	49
Rhode Island	8.1%	48	$4,002	42	$3,703	40
Wyoming	5.5%	49	$2,127	48	$2,016	48
Alaska	-0.6%	50	$5,722	38	$5,759	33

Table 3
Per Capita Total State Expenditure (1997 dollars), 1990–97

State	Increase, 1990–97	Rank	1997	Rank	1990	Rank
U.S. Total	18.6%	---	$3,340	---	$2,817	---
Greatest Spending Increase						
Mississippi	43.0%	1	$3,298	26	$2,306	41
Oregon	39.9%	2	$3,819	13	$2,730	29
Arkansas	38.2%	3	$3,046	33	$2,204	45
West Virginia	36.3%	4	$3,935	12	$2,887	21
Texas	34.1%	5	$2,515	50	$1,876	50
Missouri	32.0%	6	$2,634	48	$1,995	49
New Hampshire	30.1%	7	$2,834	42	$2,179	46
Nebraska	29.2%	8	$2,898	38	$2,242	44
Pennsylvania	29.0%	9	$3,269	29	$2,533	32
Kentucky	28.1%	10	$3,313	24	$2,586	30
Smallest Spending Increase						
Alaska	-9.8%	50	$9,392	1	$10,412	1
Arizona	-1.2%	49	$2,726	46	$2,760	26
Wyoming	-0.3%	48	$4,433	5	$4,446	2
Nevada	3.6%	47	$3,059	32	$2,953	19
Vermont	5.8%	46	$3,605	19	$3,406	9
New Jersey	7.6%	45	$3,655	16	$3,398	11
Maryland	9.9%	44	$3,180	30	$2,893	20
Rhode Island	10.0%	43	$4,053	9	$3,686	8
Massachusetts	10.2%	42	$4,216	7	$3,825	6
North Dakota	11.9%	41	$3,785	14	$3,383	12

Between 1990 and 1996 the number of state and local government employees grew from fewer than 15.4 million to nearly 16.8 million.

- State spending per $1,000 of personal income *declined* in six states: Wyoming (10.7 percent), Alaska (9.3 percent), Nevada (8.2 percent), Arizona (7.2 percent), North Dakota (6.4 percent), and South Dakota (0.4 percent). In Wyoming and Alabama that decline in spending has been attributable to the decline in oil prices.

State and Local Bureaucracies in the 1990s

Between 1990 and 1996 the number of state and local government employees grew from fewer than 15.4 million to nearly 16.8 million.[8] That is an increase of 9.2 percent, or 1.5 percent per year. As Figure 6 shows, state and local bureaucracies are growing faster in the 1990s than they did in the 1980s. In contrast, private-sector nonfarm employment growth has been slower than it was in the 1980s.

- The number of state and local government employees increased by 1.28 percent per year in the 1980s. In the 1990s state employment has accelerated to 1.48 percent per year.
- Total nonfarm private-sector employment growth *declined* from 1.91 percent per year in the 1980s to 1.46 percent per year in the 1990s.
- In the 1980s state and local government employment growth lagged behind total nonfarm employment growth (1.28 to

Table 4
Total State Expenditure per $1,000 Personal Income, 1990–97

State	Increase, 1990–97	Rank	1997	Rank	1990	Rank
U.S. Total	9.3%	---	$139.46	---	$127.64	---
Greatest Budget Increase						
New Hampshire	24.5%	1	$108.14	50	$86.84	50
West Virginia	22.2%	2	$216.62	3	$177.31	6
Oregon	22.1%	3	$169.60	14	$138.90	26
Mississippi	21.9%	4	$190.91	7	$156.66	15
Missouri	21.8%	5	$117.31	43	$96.33	47
Arkansas	21.0%	6	$163.08	18	$134.79	32
Texas	19.5%	7	$114.91	46	$96.13	48
Pennsylvania	17.5%	8	$133.05	33	$113.19	40
Florida	16.7%	9	$109.02	49	$93.39	49
Kentucky	15.1%	10	$171.32	12	$148.80	18
Smallest Budget Increase						
Wyoming	-10.7%	50	$205.77	4	$230.45	2
Alaska	-9.3%	49	$388.98	1	$429.04	1
Nevada	-8.2%	48	$123.83	40	$134.94	31
Arizona	-7.2%	47	$133.00	34	$143.33	20
North Dakota	-6.4%	46	$185.87	8	$198.64	4
South Dakota	-0.4%	45	$136.92	32	$137.42	29
Vermont	0.1%	44	$163.21	17	$163.00	9
Colorado	1.2%	43	$111.10	48	$109.74	44
New Jersey	1.8%	42	$119.02	42	$116.91	36
Washington	2.7%	41	$161.17	19	$156.96	14

The privatization trend should lead to reduced bureaucracies, not expanded ones.

1.91 percent per year).

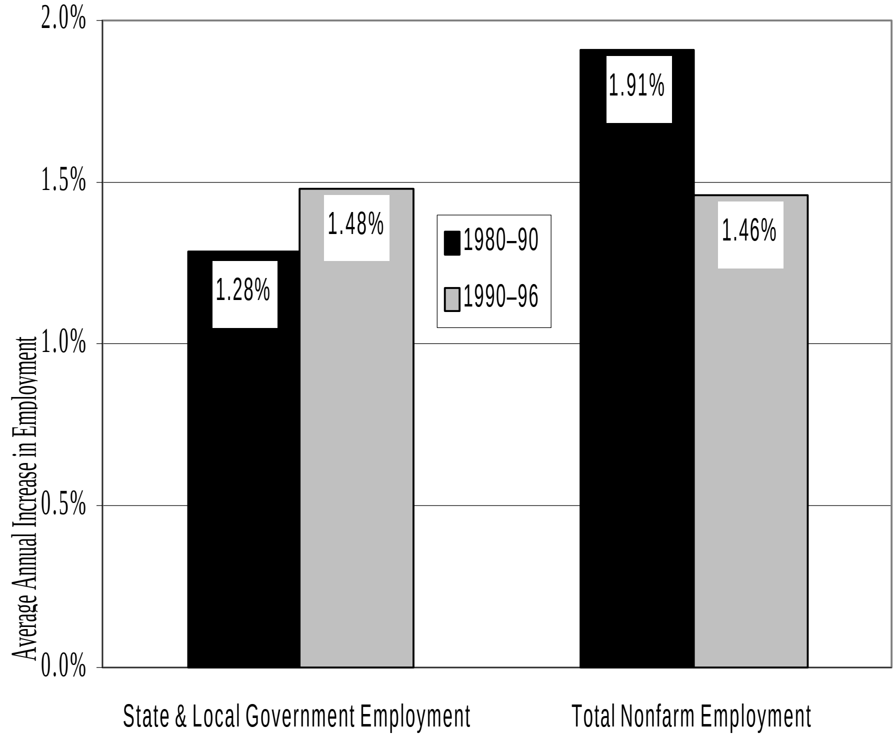
- In the 1990s the growth of state and local government bureaucracies is outpacing total nonfarm employment growth (1.48 to 1.46 percent per year).

While total U.S. state and local employees increased by 1.48 percent per year from 1990 to 1996, as Table 5 shows, the record in individual states varied widely from a high of 5.58 percent per year in Nevada to New York's 0.88 percent per year *decline*.

- Six states increased their state and local bureaucracies by more than 3 percent per year from 1990 to 1996: Nevada (5.58 percent), Arizona (4.48 percent), Idaho (3.67 percent), Utah (3.49 percent), Texas (3.06 percent), and New Mexico (3.04 percent).
- State and local government employment has *declined* in two states: New York (0.88 percent per year) and Rhode Island (0.20 percent); it has grown by less than 0.5 percent per year in three others: New Jersey (0.21 percent per year), Massachusetts (0.28 percent), and Michigan (0.42 percent).

The increased growth in the size of state

Figure 6
State and Local Bureaucracies Outpace Growth of the Private Sector in the 1990s



States increased their tax burdens by an unprecedented amount in 1990 and 1991.

and local bureaucracies has come at a time when more and more governments are turning to contracting out and other forms of privatization. The privatization trend should lead to reduced bureaucracies, not expanded ones. In addition, numerous states have imposed so-called hiring freezes, yet their payrolls continue to expand. For instance, Arkansas has been under a hiring freeze for more than a decade now, but the state added 2,000 additional employees a year from 1990 to 1996. Total state employment there increased by 20 percent over those six years.[9]

What Drives Spending? Revenue Growth

The first half of the 1990s was a period of economic stagnation, steeply rising tax burdens, and rising state expenditures on welfare and health care.[10] States increased their tax burdens by an unprecedented amount in 1990 and 1991. Moreover, rates of income taxes, the most destructive of state taxes,[11] were raised substantially in many states. Govs. Pete Wilson of California, James Florio of New Jersey, Lowell Weicker of Connecticut, Bruce Sundlun of Rhode Island, Bob Casey of Pennsylvania, and George Voinovich of Ohio all enacted "soak the rich" income tax increases. Those states suffered substantial losses of jobs, income, and investment capital relative to the rest of the nation following those tax hikes.[12]

In 1995 the trend was dramatically reversed. Twenty-eight states enacted tax cuts that year. "[Nineteen ninety-five] was the largest tax-cutting year for states in a decade," concluded economists Arthur Laffer and Victor Canto in their annual report ranking the tax competitiveness of the states.[13] In 1996 another 28 states cut their tax burdens, and in 1997 and 1998, 30 states cut taxes.

In Michigan John Engler has cut taxes more than 20 times in eight years in office and is now planning to cut the state income tax from 4.3 to 3.9 percent starting in 2000. New Jersey's Christine Todd Whitman cut income taxes by 30 percent in 1995. Wisconsin's Tommy Thompson has cut income and prop-

Table 5
Average Annual Change in State and Local Employment and Nonfarm Employment, 1980–90 and 1990–96

	State & Local Government Employment				Total Nonfarm Employment			
State	1990–96	Rank	1980–90	Rank	1990–96	Rank	1980–90	Rank
U.S. Total	1.48%	---	1.28%	---	1.46%	---	1.91%	---
Nevada	5.58%	1	3.11%	3	5.22%	1	4.50%	1
Arizona	4.48%	2	2.73%	5	4.18%	4	3.87%	3
Idaho	3.67%	3	1.74%	17	4.19%	3	1.55%	32
Utah	3.49%	4	2.29%	9	4.73%	2	2.77%	10
Texas	3.06%	5	2.70%	6	2.53%	14	1.95%	24
New Mexico	3.04%	6	2.21%	11	3.02%	8	2.23%	19
Washington	2.78%	7	2.44%	8	1.99%	26	2.91%	8
Kentucky	2.65%	8	1.12%	30	2.15%	21	1.97%	22
South Dakota	2.54%	9	0.75%	36	3.21%	6	1.95%	23
Arkansas	2.48%	10	1.30%	24	2.73%	11	2.21%	20
Colorado	2.43%	11	1.41%	22	3.75%	5	1.97%	21
North Carolina	2.37%	12	1.86%	14	2.21%	19	2.74%	11
Tennessee	2.25%	13	1.81%	16	2.44%	15	2.30%	18
Minnesota	2.25%	14	1.22%	27	2.26%	17	1.85%	26
Oregon	2.22%	15	0.95%	31	2.83%	9	1.79%	27
Missouri	2.20%	16	0.92%	33	1.50%	34	1.76%	28
Wisconsin	2.07%	17	0.65%	39	2.14%	22	1.69%	31
Louisiana	2.06%	18	0.82%	34	2.19%	20	0.07%	48
North Dakota	1.97%	19	0.74%	37	2.53%	13	0.81%	45
Florida	1.95%	20	3.15%	2	2.32%	16	4.18%	2
Kansas	1.95%	21	1.42%	21	2.03%	24	1.43%	35
South Carolina	1.91%	22	1.97%	12	1.37%	35	2.66%	13
Delaware	1.90%	23	0.57%	41	1.35%	37	2.98%	7
Montana	1.81%	24	0.16%	45	3.19%	7	0.59%	46
Georgia	1.74%	25	2.22%	10	2.79%	10	3.31%	5
New Hampshire	1.70%	26	2.50%	7	1.63%	32	2.80%	9
Hawaii	1.63%	27	1.94%	13	0.03%	46	2.72%	12
Alabama	1.60%	28	1.21%	28	1.84%	27	1.89%	25
Mississippi	1.50%	29	0.66%	38	2.56%	12	1.22%	39
Connecticut	1.40%	30	1.22%	26	-0.42%	49	1.30%	37
Illinois	1.38%	31	0.18%	44	1.19%	39	0.87%	43
Virginia	1.30%	32	1.23%	25	1.30%	38	2.99%	6
Nebraska	1.30%	33	0.93%	32	2.25%	18	1.52%	33
West Virginia	1.29%	34	-0.54%	49	1.73%	30	-0.25%	49
Oklahoma	1.28%	35	1.61%	19	2.09%	23	0.50%	47
Wyoming	1.25%	36	3.03%	4	1.84%	28	-0.57%	50
Alaska	1.09%	37	3.47%	1	1.68%	31	3.46%	4
Indiana	1.06%	38	1.13%	29	1.84%	29	1.71%	30
Ohio	1.04%	39	0.45%	42	1.36%	36	1.12%	41
Iowa	1.03%	40	0.63%	40	1.99%	25	1.00%	42
California	1.00%	41	1.82%	15	0.36%	42	2.41%	16
Pennsylvania	0.93%	42	-0.43%	48	0.44%	41	0.84%	44
Vermont	0.91%	43	1.50%	20	1.09%	40	2.55%	14
Maine	0.73%	44	1.64%	18	0.16%	45	2.49%	15
Maryland	0.63%	45	-0.58%	50	0.26%	44	2.41%	17
Michigan	0.42%	46	0.05%	46	1.52%	33	1.43%	34
Massachusetts	0.28%	47	-0.39%	47	0.29%	43	1.18%	40
New Jersey	0.21%	48	0.78%	35	0.02%	47	1.74%	29
Rhode Island	-0.20%	49	0.30%	43	-0.35%	48	1.25%	38
New York	-0.88%	50	1.30%	23	-0.61%	50	1.31%	36

Source: Samuel Ehrenhalt, "The New Geography of Government Jobs: Hiring in State and Local Government Shifts to South and West, and to Medium and Small States," Center for the Study of the States, Albany, N.Y., Government Employment Report no. 2, December 1997.

By fiscal year 1997, real per capita state revenues had reached a high of $3,884.

Table 6
America's Tax-Cutting Governors

Governor	State	Tax Cut
Jane Hull	Arizona	$120 million business tax cut
Mike Huckabee	Arkansas	$80 million income tax cut
John Rowland	Connecticut	10 percent income tax cut
Tom Carper	Delaware	17 percent reduction in top income tax rate
Zell Miller*	Georgia	Cut income tax & phased out sales tax on food
Benjamin Cayetano	Hawaii	18 percent reduction in top income tax rate
Philip Batt*	Idaho	$40 million property tax cut
Terry Branstad*	Iowa	10 percent income tax rate cut
Bill Graves	Kansas	Property & income tax cuts
Parris Glendening	Maryland	10 percent income tax cut
Paul Cellucci	Massachusetts	$1 billion income tax cut
John Engler	Michigan	24 tax cuts, including 10 percent income tax cut
Arne Carlson*	Minnesota	20 percent property tax cut
Kirk Fordice	Mississippi	Capital gains & income tax cuts
Ben Nelson*	Nebraska	Income tax rate cuts
Christine Whitman	New Jersey	30 percent income tax rate cut
Gary Johnson	New Mexico	Income tax rate cut & gas tax cut
George Pataki	New York	20 percent income tax rate cut
James Hunt	North Carolina	Cuts in income tax & sales tax on food
Frank Keating	Oklahoma	Income tax rate cut
Tom Ridge	Pennsylvania	$2 billion income tax cuts
Lincoln Almond	Rhode Island	10 percent income tax rate cut
David Beasley*	South Carolina	Phaseout of car tax
William Janklow	South Dakota	25 percent property tax cut
Don Sundquist	Tennessee	Blocked income tax
George W. Bush	Texas	$1 billion property tax cut
Michael Leavitt	Utah	Property & sales tax cuts
Howard Dean	Vermont	Income tax cut
Jim Gilmore	Virginia	Phaseout of car tax
Tommy Thompson	Wisconsin	15 percent income tax rate cut

*Left office in 1999.

erty taxes. George W. Bush of Texas enacted a $1 billion property tax cut in 1997. Table 6 shows the tax cuts enacted by the governors in recent years.

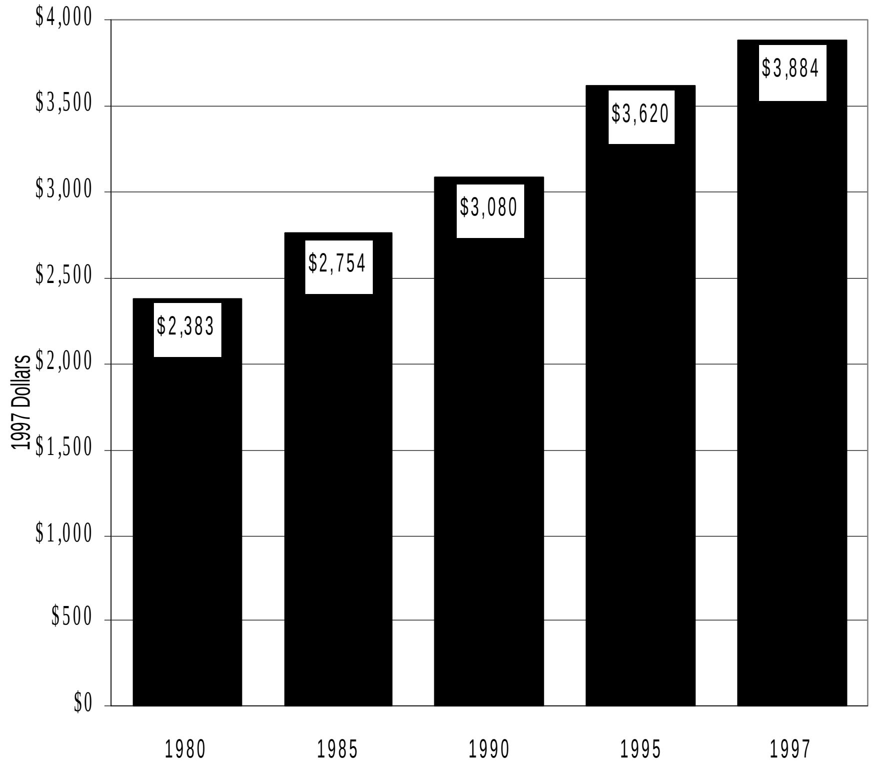
Despite the accolades that governors have received for their tax-cutting campaigns, our analysis suggests that, in most cases, recent tax cuts have not offset the legislated tax increases of the early 1990s. Table 7 shows that there are 11 states that have higher personal income tax rates today than they did at the start of the decade. There are eight more states that have higher statutory corporate tax rates.

California's fiscal situation in the 1990s is illustrative. In 1991 Gov. Pete Wilson enacted a $7 billion increase in income and sales taxes—the largest tax increase of any state in the nation ever. But in the mid and late 1990s

Table 7
State Top Income Tax Rates, 1990 vs. Today

State	Personal Income Tax 1990	Personal Income Tax Today	Personal Income Tax %change	Corporate Income Tax 1990	Corporate Income Tax Today	Corporate Income Tax %change
Alabama	5	5	0%	5	5	0%
Alaska	0	0	0%	9.4	9.4	0%
Arizona	7	5.17	-26.1%	9.3	9	-3.2%
Arkansas	7	7	0%	6	6.5	+8.3%
California	9.3	9.3	0%	9.3	8.84	-4.9%
Colorado	5	5	0%	5.5	5	-9.1%
Connecticut	0	4.5	New Tax	11.5	8.5	-26.1%
Delaware	7.7	6.4	-16.9%	8.7	8.7	0%
D.C.	9.5	9.5	0%	10	9.975	-0.3%
Florida	0	0	0%	5.5	5.5	0%
Georgia	6	6	0%	6	6	0%
Hawaii	10	8.75	0%	6.4	6.4	0%
Idaho	8.2	8.2	0%	8	8	0%
Illinois	3	3	0%	7.3	7.3	0%
Indiana	3.4	3.4	0%	7.9	7.9	0%
Iowa	9.98	8.98	-10.0%	12	12	0%
Kansas	5.95	6.45	+8.4%	6.75	7.35	+8.9%
Kentucky	6	6	0%	8	8.25	+3.1%
Louisiana	6	6	0%	8	8	0%
Maine	8.5	8.5	0%	8.93	8.93	0%
Maryland	5	4.85	-3.0%	7	7	0%
Massachusetts	5.95	5.95	0%	9.5	9.5	0%
Michigan	4.6	4.4	-4.3%	2.35	2.3	-2.1%
Minnesota	8	8.5	+6.3%	9.8	9.8	0%
Mississippi	5	5	0%	5	5	0%
Missouri	6	6	0%	5	6.25	+25.0%
Montana	11	11	0%	6.75	6.75	0%
Nebraska	6.41	6.68	+4.2%	7.24	7.81	+7.9%
Nevada	0	0	0%	0	0	0%
New Hampshire	0	0	0%	8	7	-12.5%
New Jersey	3.5	6.37	+82.0%	9	9	0%
New Mexico	8.5	8.2	-3.5%	7.6	7.6	0%
New York	7.875	6.85	-13.0%	9	9	0%
North Carolina	7	7.75	+10.7%	7	7	0%
North Dakota	3.92	5.544	+41.4%	10.5	10.5	0%
Ohio	6.9	7.201	+4.4%	8.9	8.5	-4.5%
Oklahoma	7	6.75	-3.6%	6	6	0%
Oregon	9	9	0%	6.6	6.6	0%
Pennsylvania	2.1	2.8	+33.3%	8.5	9.99	+17.5%
Rhode Island	6.4288	10.494	+63.2%	9	9	0%
South Carolina	7	7	0%	5	5	0%
South Dakota	0	0	0%	0	0	0%
Tennessee	0	0	0%	6	6	0%
Texas	0	0	0%	0	0	0%
Utah	7.2	7	-2.8%	5	5	0%
Vermont	7.84	9.9	+26.3%	8.25	9.75	+18.2%
Virginia	5.75	5.75	0%	6	6	0%
Washington	0	0	0%	0	0	0%
West Virginia	6.5	6.5	0%	9.375	9	-4.0%
Wisconsin	6.93	6.77	-2.3%	7.9	7.9	0%
Wyoming	0	0	0%	0	0	0%

Figure 7
Per Capita State Revenues, 1980–97



Because state income tax codes have a graduated rate structure, unless state law-makers are continually cutting taxes, tax burdens will automatically rise.

California has cut taxes under Wilson. Yet, as the *Los Angeles Times* reported, "Wilson the tax cutter has not come close to matching Wilson the tax raiser. Tax increases at the start of Wilson's administration in 1991 hover at $3.6 billion a year above recent cuts."[14] The overall tax burden is far higher now than in 1990. Even in Arizona, a state that led the nation in income tax cuts in the 1990s under former governor Fife Symington, tax revenues have outpaced population growth and inflation.

Figure 7 shows that by fiscal year 1997, real per capita state revenues had reached a high of $3,884. That represents an increase of 26.1 percent since 1990, a growth rate of 3.4 percent per year compared to the lower 1980s growth rate of 2.6 percent per year. This revenue tide is mainly attributable to strong national economic growth. In recent years as the economy has picked up steam, revenue growth has accelerated. In fiscal year 1996 state tax revenues increased by 5.4 percent over the prior year; in FY97 they rose by 6.2 percent; and in FY98 they rose by 7.4 percent.[15]

Because state income tax codes have a graduated rate structure, meaning that revenues rise faster than income growth, unless state lawmakers are continually cutting taxes, tax burdens will automatically rise. That has indeed been the case over the last two years, as personal income has lagged behind revenue, growing only about 5 percent per year over that period. Population has grown by 1 percent per year over that period.

The States' $75 Billion Revenue Bonanza

A reasonable benchmark for state tax revenue collections is the growth of a state's population plus inflation. In fact, several states cap spending or taxes, or both, at that level.

In this section we estimate the size of excess tax collections by states by measuring how much states' actual revenue intake has exceeded inflation plus population growth over the course of the current economic

Table 8
$75 Billion Revenue Windfall in 1998 (tax revenue figures in millions of dollars)

State	Actual Tax Revenue 1992	Actual Tax Revenue 1998	Actual 1992–98 Increase	1992–98 Population Growth	1992–98 CPI-U Growth	1992–98 Population Growth + Inflation	Est. 1998 Revenue with Pop. Growth + Inflation Cap	1998 Revenue Windfall	1998 per Capita Revenue Windfall	Rank
U.S. Total	$327,822	$476,250	45.3%	6.0%	16.3%	22.3%	$401,004	$75,246	$278	
Michigan	$11,279	$21,263	88.5%	3.7%	16.3%	20.0%	$13,540	$7,723	$787	1
New Mexico	$2,238	$3,971	77.5%	9.9%	16.3%	26.2%	$2,824	$1,148	$661	2
Minnesota	$7,450	$11,797	58.4%	5.7%	16.3%	22.0%	$9,088	$2,708	$573	3
Connecticut	$6,059	$8,804	45.3%	0.1%	16.3%	16.4%	$7,051	$1,752	$535	4
Wisconsin	$6,911	$11,056	60.0%	4.4%	16.3%	20.7%	$8,341	$2,715	$520	5
Kansas	$2,802	$4,667	66.6%	4.4%	16.3%	20.7%	$3,383	$1,285	$489	6
Mississippi	$2,494	$4,282	71.7%	5.4%	16.3%	21.8%	$3,037	$1,245	$452	7
Massachusetts	$9,903	$14,497	46.4%	2.6%	16.3%	18.9%	$11,776	$2,721	$443	8
Delaware	$1,340	$1,972	47.2%	7.8%	16.3%	24.1%	$1,662	$310	$417	9
Missouri	$5,131	$8,250	60.8%	4.7%	16.3%	21.0%	$6,211	$2,038	$375	10
North Dakota	$755	$1,113	47.5%	0.4%	16.3%	16.8%	$881	$232	$364	11
California	$46,128	$68,237	47.9%	5.9%	16.3%	22.2%	$56,367	$11,871	$363	12
Rhode Island	$1,276	$1,826	43.1%	-1.2%	16.3%	15.1%	$1,470	$357	$361	13
Colorado	$3,533	$5,992	69.6%	14.7%	16.3%	31.1%	$4,631	$1,361	$343	14
Indiana	$6,476	$9,740	50.4%	4.5%	16.3%	20.8%	$7,822	$1,918	$325	15
Ohio	$12,115	$17,961	48.3%	1.9%	16.3%	18.2%	$14,320	$3,641	$325	16
Illinois	$13,463	$19,929	48.0%	3.6%	16.3%	19.9%	$16,142	$3,787	$314	17
North Carolina	$9,010	$13,792	53.1%	10.4%	16.3%	26.8%	$11,421	$2,370	$314	18
Utah	$1,988	$3,279	64.9%	15.4%	16.3%	31.8%	$2,619	$659	$314	19
Virginia	$7,025	$10,626	51.2%	6.4%	16.3%	22.7%	$8,620	$2,006	$295	20
Georgia	$7,267	$11,590	59.5%	13.0%	16.3%	29.4%	$9,401	$2,188	$286	21
Florida	$14,412	$22,385	55.3%	10.5%	16.3%	26.8%	$18,273	$4,112	$276	22
Nevada	$1,817	$3,152	73.5%	31.1%	16.3%	47.4%	$2,679	$473	$271	23
Kentucky	$5,081	$7,214	42.0%	4.7%	16.3%	21.1%	$6,151	$1,063	$270	24
Arkansas	$2,748	$4,017	46.2%	6.0%	16.3%	22.3%	$3,362	$654	$258	25
Tennessee	$4,526	$6,991	54.5%	8.3%	16.3%	24.7%	$5,642	$1,349	$248	26
Maryland	$6,502	$9,127	40.4%	4.7%	16.3%	21.1%	$7,872	$1,256	$245	27
Nebraska	$1,890	$2,670	41.3%	3.8%	16.3%	20.1%	$2,269	$400	$241	28
Montana	$951	$1,383	45.4%	7.0%	16.3%	23.4%	$1,173	$210	$238	29
Oregon	$3,313	$4,950	49.4%	10.4%	16.3%	26.7%	$4,197	$753	$229	30
Iowa	$3,602	$4,902	36.1%	2.0%	16.3%	18.3%	$4,261	$642	$224	31
South Carolina	$3,936	$5,669	44.1%	6.6%	16.3%	22.9%	$4,837	$833	$217	32
Idaho	$1,391	$2,091	50.4%	15.3%	16.3%	31.6%	$1,830	$261	$212	33
Washington	$8,468	$11,914	40.7%	10.6%	16.3%	27.0%	$10,750	$1,164	$205	34
Oklahoma	$3,874	$5,361	38.4%	4.4%	16.3%	20.8%	$4,679	$682	$204	35
Louisiana	$4,250	$5,857	37.8%	2.3%	16.3%	18.6%	$5,041	$816	$187	36
South Dakota	$565	$810	43.3%	3.2%	16.3%	19.6%	$676	$134	$182	37
Vermont	$763	$1,014	32.9%	3.7%	16.3%	20.0%	$916	$98.2	$166	38
Maine	$1,664	$2,146	29.0%	0.8%	16.3%	17.1%	$1,949	$197	$158	39
Texas	$17,031	$24,664	44.8%	11.9%	16.3%	28.2%	$21,833	$2,831	$143	40
West Virginia	$2,352	$3,000	27.6%	0.3%	16.3%	16.6%	$2,743	$257	$142	41
Alabama	$4,218	$5,742	36.1%	5.2%	16.3%	21.5%	$5,125	$617	$142	42
Arizona	$4,827	$7,176	48.7%	20.7%	16.3%	37.0%	$6,615	$562	$120	43
Pennsylvania	$16,270	$20,310	24.8%	0.2%	16.3%	16.5%	$18,953	$1,358	$113	44
New York	$30,110	$37,059	23.1%	0.5%	16.3%	16.9%	$35,185	$1,873	$103	45
New Jersey	$12,803	$15,555	21.5%	3.7%	16.3%	20.0%	$15,365	$190	$23	46
New Hampshire	$856	$1,026	19.8%	6.4%	16.3%	22.7%	$1,051	-$25	-$21	47
Hawaii	$2,710	$3,174	17.1%	3.6%	16.3%	19.9%	$3,250	-$76	-$63	48
Wyoming	$646	$704	8.9%	3.8%	16.3%	20.1%	$776	-$72	-$150	49
Alaska	$1,603	$1,157	-27.8%	4.7%	16.3%	21.0%	$1,939	-$782	-$1,273	50

Sources: Cato Institute; Bureau of the Census; and Center for the Study of the States.

If every state had strictly adhered to a revenue cap from 1992 through 1998, taxpayers would have saved a combined total of $75 billion.

expansion that began in early 1992. The answer is provided in Figure 4. If every state had strictly adhered to such a revenue cap from 1992 through 1998, taxpayers would have saved a combined total of $75 billion, or $278 per capita, in 1998 alone. In other words, even if states had passed $75 billion in tax cuts in 1998, their revenues still would have grown by about 22 percent, or 3.4 percent per year—the level of inflation and population growth. Instead, state tax collections climbed by 45 percent (6.4 percent per year).

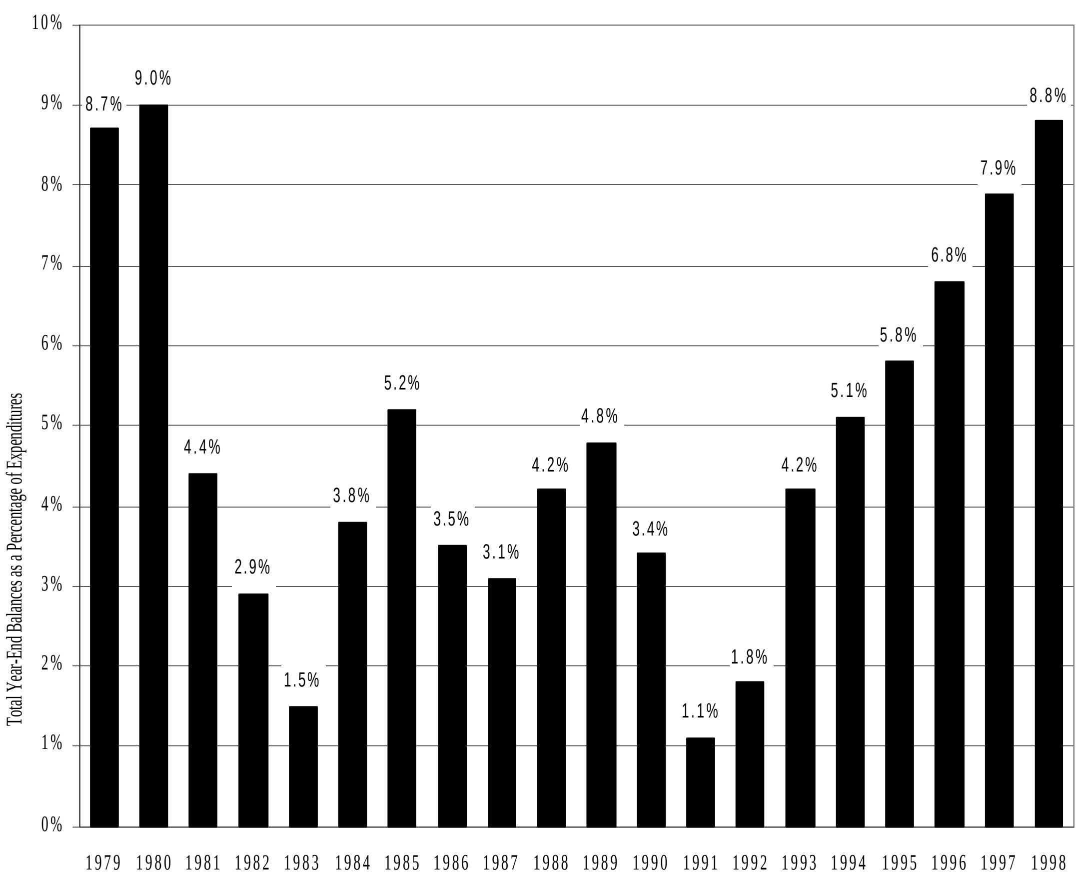
As Table 8 shows, the size of the revenue windfall varies substantially from state to state. Taxpayers in five states would have saved more than $500 per capita in 1998: Michigan ($787), New Mexico ($661), Minnesota ($573), Connecticut ($535), and Wisconsin ($520). There were only four states where tax revenues grew more slowly than population and inflation from 1992 to 1998: Alaska, Wyoming, Hawaii, and New Hampshire.[16]

Whatever Happened to the Taxpayers' Surplus?

One of the most contentious issues in state capitals today is what to do with the huge revenue surpluses. As Figure 8 shows, year-end balances in the states are at their highest levels in nearly two decades. The states closed their books on FY98 with a combined surplus of $36 billion, or 9 percent of expenditures.[17]

Many budget experts believe that those reserves are larger than is fiscally necessary.

Figure 8
State Budget Surpluses, 1979–98



Source: National Governors' Association and National Association of State Budget Officers, *The Fiscal Survey of the States*, December 1998 and previous editions.

1998 and previous editions.

Table 9
21 States with 1998 Reserves of 10% or More

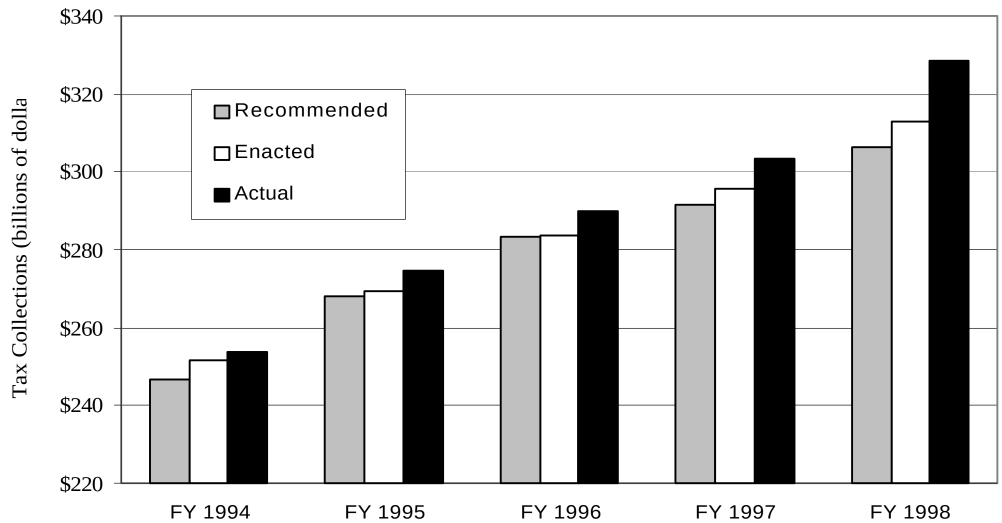
State	Balance as Percentage of Expenditures
Alaska	142.3%
Nebraska	29.2%
Delaware	28.4%
Indiana	23.0%
Minnesota	21.5%
Iowa	20.4%
Kansas	19.7%
Colorado	17.4%
Nevada	15.7%
Arizona	15.5%
Oregon	15.2%
Maryland	13.3%
North Dakota	13.3%
Mississippi	13.1%
Michigan	12.9%
Wyoming	12.6%
Texas	11.5%
Oklahoma	11.2%
South Carolina	10.5%
Maine	10.0%
Rhode Island	10.0%

As revenue poured in faster than expected, spending increased right along with it.

While financial analysts do take state reserves into account when assigning state bond ratings, most recommend a reserve in the range of 3 percent to 5 percent.[18] Forty states had reserves larger than 5 percent in FY98, and 21 of those had reserves that were 10 percent or larger (Table 9).[19] Greater-than-expected revenues are the cause of the large accumulating surpluses. Over the past four years, state tax collections—from sales, personal income, and corporate income taxes, the three main sources of state revenue—have exceeded expectations by a total of $30 billion.[20] Figure 9 illustrates that, in each of the last five fiscal years, projected state tax collections have steadily risen over the course of the budget cycle. The aggregate revenue surplus over revenues recommended in the governors' budgets came to $54.4 billion. Those rising revenues have coincided with rising spending increases (Figure 10). That is, as revenue poured in faster than expected, spending increased right along with it. The aggregate excess spending over levels recommended by the governors was $63.7 billion from 1994 to 1998.

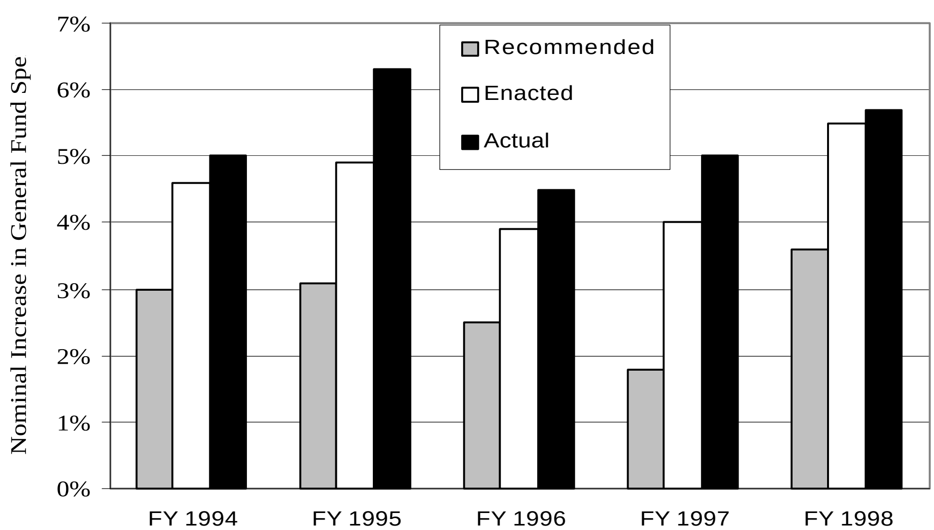
Take FY98, for example. In early 1997 when governors put forth their recommended budgets for FY98, they projected that tax collections would come in at $306 billion, and they proposed increasing spending by 3.6 percent. Later in 1997, when FY98 budgets were enacted by the state legislatures, tax collection estimates had risen to $317 billion. Those enacted budgets called for an increase in spending of 5.5 percent. The final numbers for FY98

Figure 9
Increasing Tax Collections



Source: National Governors' Association and National Association of State Budget Officers, *The Fiscal Survey*

Figure 10
Increasing Spending Hikes



Source: National Governors' Association and National Association of State Budget Officers, *The Fiscal Survey of the States*, May 1998 and previous editions.

reported by the states indicated that tax collections came in at $328 billion, a $22 billion windfall over and above the original estimate of $306 billion. Furthermore, although the governors had originally called for only a 3.6 percent increase in spending in FY98, when all was said and done, spending rose by 5.7 percent.

As a result, instead of increasing spending by $13.8 billion in FY98, as the governors had originally proposed, the states increased spending by $22.1 billion. That amounts to more than $8 billion in unexpected spending hikes in a single year. In addition, by allowing their budget reserves to rise well above the recommended level of 3 to 5 percent of expenditures, state governments held onto another $16 billion of taxpayer funds. So, while many state legislators argue that tax cuts are "unaffordable," last year they collected about $25 billion of unexpected tax receipts—more than $350 per family of four—that could have been used to provide additional tax relief, but were not.

Why State Budgets Should Be Falling, Not Rising

State lawmakers allege that their budgets are rising because they are facing increased demands to spend in the 1990s. For example, state policymakers typically argue that with the renewed emphasis on states' rights and federalism under the Republican Congress, the federal government is devolving more spending responsibilities to the states—for example, in the areas of welfare and criminal justice—without a commensurate increase in resources.

The truth is, however, that federal spending on grants to states and localities has been growing, not falling. Federal grants to state and local governments did decline in the 1980s, from $155.7 billion in 1980 to $144.7 billion in 1990 after adjusting for inflation—a reduction of 7.1 percent. But as Figure 11 indicates, the largest reductions occurred in the first two years of the Reagan administration, 1981 and 1982. Real federal aid remained level throughout the mid-1980s and has surged since 1987. From 1990 to 1998, federal aid rose by almost half in real terms, from $144.7 billion to $215.9 billion.[21] So real federal aid is about 40 percent higher now than it was in 1980.

It is not even clear that federal aid is an unmixed blessing for states as they attempt to balance their budgets. Federal dollars almost always come with costly strings attached. The federal government collects those dollars from taxpayers all over the country, skims some off the top for administrative and other costs, and then sends the remainder to the 50 states with numerous one-size-fits-all restrictions on how the money can be spent. Invariably, that creates enormous winners and losers among the states, often attributable primarily to the political seniority of each state's congressional representatives. In fact, in Mississippi and West Virginia, homes of influential Sens. Trent Lott and Robert Byrd, the federal government spends more than $1.50 for every dollar of federal taxes paid by residents.[22] In contrast, federal spending in Connecticut and New Jersey amount to only about 70 cents for every dollar of federal taxes paid by the residents.

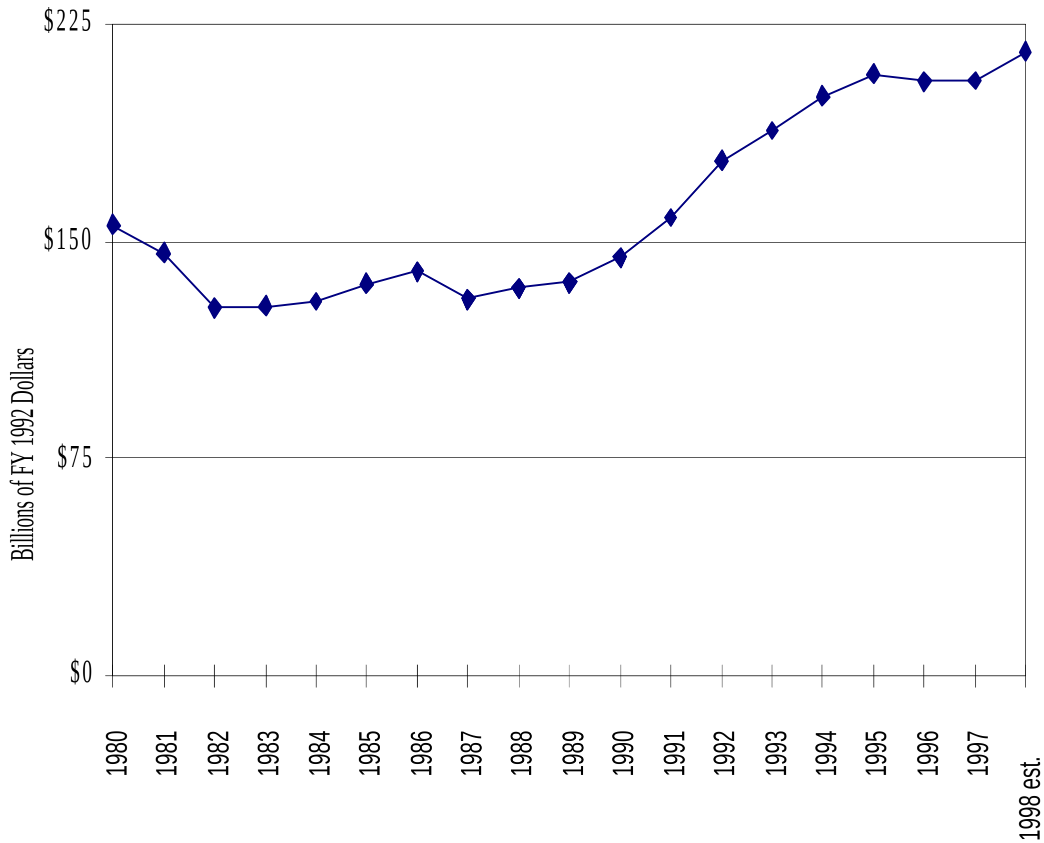
It is true that there are certain high-priority areas of state budgets for which the public is demanding more funding. One of those areas is law enforcement. As the public continues to adopt a "lock 'em up" attitude toward criminals, state spending on prisons, police, and the courts has more than roughly doubled.

Yet there is a series of factors that have generated substantial budgetary savings for states in the 1990s and should be contributing to shrinking state budgets. Most of those factors are related to the robust U.S. economy.

The first factor is declining interest rates. States are large net borrowers. They borrow to fund highways, school construction, prisons, and other capital spending. In 1997 state governments spent $26.3 billion on interest payments. But long-term interest rates over the past six years have fallen by more than 200 basis points. Therefore, as Table 1 indicated, after doubling in the 1980s from $13.2 billion to $26.5 billion, interest payments on state debt (in real terms) have actually declined slightly in the 1990s. Hence, debt service has cost states less in recent years.

From 1990 to 1998, federal aid rose by almost half in real terms, from $144.7 billion to $215.9 billion.

Figure 11
Real Federal Grants to State and Local Governments, 1980–98



Source: *Budget of the U.S. Government—Historical Tables, FY 1999*, Table 12.1, pp.203–4.

Welfare rolls have fallen by 42 percent nationwide since 1994.

The second factor has been the impact of a strong economy and welfare reform legislation on welfare caseloads. Welfare reform has been an astonishing success story in the states and at the national level. Following the lead of the states, the federal government in 1996 adopted work requirements, time limits, and new eligibility restrictions for welfare benefits. The result has been that welfare rolls have fallen by 42 percent nationwide since 1994.[23] In that year there were 14.4 million Americans on welfare; by the end of 1998 the number had dipped to 8.4 million.[24] Since welfare is the second largest item in state budgets, reduced welfare payments have saved billions of dollars.[25] Unfortunately, states have misallocated much of those savings to new areas of spending, such as day care and job training, where governmental programs are of dubious efficacy.

A third factor that should be restraining state expenditures has been the dramatic slowdown in health care cost increases in recent years. As the private sector has moved to greater reliance on patient cost sharing, managed care, and competition, the inflation rate for health care in the United States has fallen from 9 to about 3 percent since 1990. This too has generated an unexpected fiscal benefit for states, because aside from the federal government, the states are the largest purchasers of health care services. If medical inflation were as high today as it was in 1990, states would be spending $5 billion to $10 billion more per year on Medicaid and other health and hospital services.

A final economic factor benefiting the states has been the steady decline in unemployment. Each year states spend about $20 billion on unemployment benefits.[26] Today the unemployment rate is at its lowest level in 20 years, and the problem in many states is not a shortage of jobs but a shortage of workers. The increase in the number of workers paying into unemployment compensation systems and the decline in the number of unemployed drawing benefits have created huge and in some cases unprecedented surpluses in state unemployment insurance trust funds.

When those four factors are taken together, it would be reasonable to expect that state spending would be flat or even declining slightly—even without a long-overdue reconsideration of the scope of state government. Instead, the budgetary savings have simply helped finance an explosion of expenditures in other areas of state budgets.

The Economic Case for State Tax Cuts

There is increasing evidence that their tax and budget policies can have a significant impact on the relative economic performance of states. Studies have consistently shown that states with high and rising tax burdens are more likely to suffer economic decline, while those with lower and falling tax burdens are more likely to enjoy robust economic growth.[27] For example, a 1996 study by the Federal Reserve Board of Atlanta examined state economic performance from 1960 to 1992 and found that "tax rates [average and marginal] are negatively related to growth and are sufficiently variable over time to reasonably explain variations in growth rates."[28]

A study by the Joint Economic Committee of Congress examined the economic growth records of the 10 states that had raised taxes the most in fiscal years 1990 through 1993 and the 10 states that had cut taxes the most during that same period. The top 10 tax-hiking states experienced a net gain of only 3,000 new jobs, an increase in the unemployment rate of 2.2 percentage points, and a $484 real *decline* in personal income per family of four.[29] In contrast, the top 10 tax-cutting states saw 653,000 net new jobs, an increase in the unemployment rate of only 0.6 percentage points, and a $300 real *increase* in personal income per family of four.

The contrast was even greater when only income tax changes were considered. The top 10 income-tax-hiking states experienced the net *loss* of 182,000 jobs, a 2.3 percentage point increase in the unemployment rate, and a $613 real *decline* in personal income per family of four. The top 10 income-tax-cutting states saw 975,000 net new jobs, an increase in the unemployment rate of only 0.3 percentage points, and a $148 real *increase* in personal income per family of four. Other studies have found similar correlations between high taxes and slow economic growth.

We have updated the 1993 Joint Economic Committee analysis using Census Bureau data through 1997. We find that the negative relationship between taxes and growth at the state level is still as pronounced as ever. Table 10 shows our findings. The 10 states with the highest per capita state tax burdens in 1990 experienced economic growth that was at most half the rate of that of the 10 states with the lowest per capita state tax burdens.

- Population growth was 10.5 percent in the lowest tax states vs. only 5.5 percent in the highest tax states.
- Real personal income grew by 23.7 percent in the lowest tax states but by only 9.9 percent in the highest tax states.
- Job growth was 14.9 percent in the lowest tax states, compared to only 3.9 percent in the highest tax states.

States with high and rising tax burdens are more likely to suffer economic decline, while those with lower and falling tax burdens are more likely to enjoy robust economic growth.

Is Cutting State Taxes Fiscally Irresponsible?

In recent years proposals to reduce or even cap state taxes have been resisted for two reasons. First, opponents maintain that state tax cuts will deplete state treasuries of funds needed to pay the bills and keep the budget in balance. Second, opponents claim that the highest priority for any unexpected tax revenues should be to fix the schools, rather than to cut taxes. This section examines the validity of each of those claims.

The first issue is whether tax reductions

Table 10
1990s Economic Growth in 10 Highest Tax States and 10 Lowest Tax States

State	1990 per Capita State Tax Revenue (1997 $)	U.S. Rank	Population Growth 1990–97	U.S. Rank	Real Personal Income Growth 1990–97	U.S. Rank	Employment Growth 1990–97	U.S. Rank
U.S. Total	$1,446		7.3%		16.5%		9.1%	
High-Tax States								
Alaska	$3,435	1	10.2%	13	6.1%	47	15.8%	12
Hawaii	$2,578	2	6.7%	23	3.6%	50	3.8%	43
Delaware	$2,074	3	9.3%	16	17.3%	21	7.0%	35
Connecticut	$1,968	4	-0.6%	49	10.0%	40	-6.0%	50
New York	$1,953	5	0.8%	47	7.5%	46	-1.6%	49
Massachusetts	$1,913	6	1.7%	43	11.2%	36	3.2%	46
Minnesota	$1,910	7	6.8%	21	18.1%	17	11.9%	20
Washington	$1,861	8	14.5%	7	25.5%	10	18.0%	7
California	$1,782	9	7.8%	18	7.7%	45	4.5%	42
Wyoming	$1,657	10	5.8%	28	13.4%	34	6.7%	37
High-Tax States Total			**5.5%**		**9.9%**		**3.9%**	
Low-Tax States								
New Hampshire	$658	50	5.5%	30	15.2%	29	5.6%	40
South Dakota	$882	49	5.9%	26	17.9%	18	14.1%	14
Texas	$1,061	48	14.0%	8	27.0%	8	15.8%	11
Tennessee	$1,066	47	9.8%	15	24.6%	11	13.3%	16
Colorado	$1,141	46	17.8%	5	34.3%	3	24.6%	4
Mississippi	$1,142	45	5.9%	25	22.8%	13	9.1%	30
Alabama	$1,159	44	6.7%	22	18.2%	16	17.3%	8
Nebraska	$1,176	43	4.8%	35	15.1%	30	10.9%	24
Arkansas	$1,180	42	7.2%	20	21.9%	14	9.5%	29
Missouri	$1,184	41	5.4%	33	15.4%	26	13.2%	17
Low-Tax States Total			**10.5%**		**23.7%**		**14.9%**	

Revenue growth is often faster than anticipated in tax-cutting states and slower than anticipated in tax-raising states.

lead to a subsequent deterioration in a state's fiscal condition. The evidence from the 1990s indicates that they do not. If tax cuts contribute to fiscal deterioration, then the bond ratings of states that cut taxes should be worse than those of states that raise them. A comparison of tax-raising and tax-cutting states in the early 1990s found that the average Moody's bond rating in 1995 of the tax-cutting states was between Aaa and Aa. The average Moody's bond rating of the tax-raising states was between Aa and A1. Moreover, the tax-cutting states had much larger budget reserves (7.1 percent of state expenditures) than the tax-increasing states (1.7 percent).[30]

Because state tax cuts can stimulate economic development in a state, whereas state tax hikes can retard it, revenue growth is often faster than anticipated in tax-cutting states and slower than anticipated in tax-raising states. After California's record $7 billion tax hike in 1991, actual revenue growth came in below projections in each of the next three years. The same was true in New Jersey. New York is perhaps the most amazing story of all. Tax increases in the late 1980s produced anemic revenue growth for the state treasury. But revenues have been climbing so rapidly since Gov. George Pataki's tax cuts in 1995 that, according to the Empire Foundation, a New York taxpayer watchdog group, "Even when the final and deepest phase of New York's income cut was implemented [in 1997], the state's resurgent economy generated more income tax revenue under Gov. George Pataki than it ever did under former Gov. Mario Cuomo."[31]

An analysis by state budget analyst Michael Flynn of the American Legislative Exchange Council finds that the New York experience was not unique. Table 11 shows that in the 15 states that cut income taxes by at least $75 million between 1995 and 1998, income tax revenues climbed by a robust 10 percent or more in every state except Michigan (where income tax revenues fell by 18 percent). In 8 of the 15 states income tax revenue growth was at or above the rate for all 50 states (29 percent).[32] Clearly, tax cuts can be an act of fiscal prudence and provide an economic stimulus for states.

The second objection to tax cuts is that money should be reserved for underfunded public schools. It is understandable that politicians are sensitive to this argument. Public opinion polls consistently show that education is a top priority in our society. But the reality is that school funding already has been rising dramatically for a very long time. In 1970 spending on the public schools was roughly $3,400 per pupil (in today's dollars).[33] By 1997 per pupil expenditures had nearly doubled to $6,600, even after adjusting for inflation. Smaller class sizes are the latest fad in public education. But class sizes have been steadily declining for the past quarter century. Since 1970 the number of pupils per teacher has declined by 23 percent, from 22.6 to 17.3.

There is no evidence that greater funding has led to better schools.[34] If more money were the answer to improving education, then the highest spending states would have the finest education systems in the land, and the lowest spending states would be performing poorly. But state officials who believe that increased education funding is the key to better school performance may be interested to learn that in 1997 the 10 highest spending states spent twice as much as the 10 lowest spending states, but average SAT scores in the more frugal states were 16 percent higher than in the big-spending states.[35]

As does any monopoly, the government's educational monopoly tends to provide poor service for its customers and have inflated costs. Per pupil spending in our public school system is nearly double the average tuition at America's private schools.[36] That private tuition figure includes all of the nation's most expensive nonsectarian private schools, like Sidwell Friends where Washington's elite send their children. When those exclusive high-cost schools are omitted, the contrast between the cost of public and private schools is even greater. Public education spending per student is more than two and a half times the average tuition at Catholic schools, many of which are in the inner cities, and double the tuition at other religious schools.[37] For a fraction of the price, those schools provide a better education than do most government-run schools. They spend less because they have less bureaucracy, concentrate on the basics, impose discipline, and are held accountable for their performance by parents and students who are there by choice.

Tax cuts can be an act of fiscal prudence and provide an economic stimulus for states.

There is no debate that America's schools need to do a better job of educating our children if the nation is to remain internationally competitive in the next century. Spending more money on the public schools, however, has been tried in earnest for decades, and it has yielded at best mixed results. As education analysts John Chubb and Terry Moe of the Brookings Institution have noted:

> As for money, the relationship between it and effective schools has been studied to death. The unani-

Table 11
Revenue Growth in Tax-Cutting States ($ millions)

State	FY95–98 Personal Income Tax Cuts	FY95–98 Personal Income Tax Revenue Growth Amount	Percentage
Arizona	-$408	$396	28%
California	-$431	$8,433	48%
Connecticut	-$533	$1,160	52%
Georgia	-$140	$1,226	34%
Iowa	-$154	$724	48%
Massachusett	-$395	$1,823	32%
Michigan	-$462	-$1,003	-18%
Minnesota	-$465	$1,076	31%
Nebraska	-$84	$248	35%
New Jersey	-$752	$865	19%
New York	-$4,046	$2,469	15%
North Carolina	-$226	$1,454	34%
Ohio	-$721	$535	10%
Oregon	-$343	$696	27%
Pennsylvania	-$81	$1,299	27%

Per capita savings on taxes would have been $278 this year if every state had implemented a population plus inflation tax cap.

mous conclusion is that there is no connection between school funding and school performance.[38]

New solutions, including choice in education, charter schools, teacher pay for performance, and ending tenure to get rid of bad teachers, would seem to be much more promising ways to improve the schools than simply writing larger checks to an ailing public school system.

Simple Rules for Restoring Fiscal Discipline to the States

Over the past several years state politicians have proven themselves either unwilling or unable to return their multi-billion-dollar revenue windfalls to taxpayers through tax relief. With more surpluses likely on the way in 1999, states should consider the following steps to restore fiscal discipline.

Tax and Expenditure Limitations

One successful strategy employed by some states to prevent squandering budget surpluses has been to constitutionally require excess tax revenues to be returned to taxpayers. Such measures are called tax and expenditure limitations. The evidence suggests that states with tax and expenditure limitations have done a better job of restraining state government growth than have states without such disciplining measures.[39] California, Colorado, Missouri, and Washington each have constitutional tax limitations that restrict the growth of revenues to the rate of population growth plus inflation. Those states generally require that any revenue in excess of that amount be rebated to the people. For example, in 1997 Colorado rebated $142 million in tax revenues to taxpayers, while Missouri gave back $318 million in rebate tax credits.[40]

As the data in Table 8 (discussed earlier) indicated, the per capita savings on taxes would have been $278 this year if every state had implemented a population plus inflation tax cap prior to the current expansion.

Cut Anti-Growth Income and Corporate Tax Rates First

Most of the economic evidence indicates that not all tax cuts are the same. States with no or flat-rate income taxes have outperformed their neighbors in terms of job growth, population growth, and income gains. The real personal income growth in states with no or low income taxes was 223 percent between 1962 and 1994, but it was only 175 percent in states with high income tax rates.[41] The first priority of states in cutting taxes should be to reduce excessive personal and corporate income tax rates.

Supermajority Vote Requirement to Raise Taxes

Thirteen states, including Arizona, California, and Nevada, have adopted measures requiring that any tax increase by the legislature must pass by a supermajority vote in both houses. Most require a two-thirds vote, but others require three-fourths or three-fifths. Those measures have been highly effective at deterring routine tax increases during nonemergencies.[42] Supermajority requirements are most effective when they are applied to *all* tax increases—whether in income taxes, business taxes, sales taxes, or excise taxes.

Pass Tobacco Settlement Funds Back to Taxpayers

Last November 46 states reached an agreement with the tobacco industry on a $206 billion settlement of their suit over the medical treatment costs of smoking-related illnesses.[43] Previously, four other states—Florida, Minnesota, Mississippi, and Texas—had reached separate agreements worth $40 billion. State coffers will soon start to see the impact of this huge settlement, with total annual payments starting at $4.5 billion and rising to $9 billion.

At least six states have already decided to spend this windfall on things such as children's programs and nursing homes, having approved legislation even before the settlement was final.[44] That is the wrong approach. Ultimately, the tobacco settlement payments will be borne by consumers in the form of higher prices. Thus, the windfall to state treasuries should be rebated to all state taxpayers or returned to smokers via a reduction in tobacco taxes.

Conclusion

Gov. Jesse Ventura's improbable victory in November was propelled in part by his promise to pass back surpluses to taxpayers. Few others have followed his lead. Republican governors have boasted of their tax cutting, but those tax cuts have in almost all cases been insufficient to return to taxpayers the excess money that states have garnered from the economic expansion. Nationwide, only one-third of the surplus money has been dedicated to tax cuts. State legislators have irresponsibly treated the excess tax collections as if they were lottery winnings.

The states should restrain spending and pass back revenue surpluses to the American workers and businesses who created them in the first place.

Thirteen states have adopted measures requiring that any tax increase by the legislature must pass by a supermajority vote in both houses.

Notes

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Maryland, Pennsylvania, and Delaware. The 10 lowest spending states were Utah, Mississippi, Idaho, Tennessee, Alabama, Arkansas, New Mexico, Louisiana, North Dakota, and South Dakota.

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39. For a comprehensive examination of the effectiveness of state tax and expenditure limitations, see Dean Stansel, "Taming Leviathan: Are Tax and Spending Limits the Answer?" Cato Institute Policy Analysis no. 213, July 25, 1994.

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43. Constitutional scholar Robert Levy has argued that those tobacco settlements are inconsistent with justice and the rule of law. "Most damning," says Levy, "the settlement rewards attorneys general and their co-conspirators in the plaintiffs' bar, who have retroactively subverted the law to punish the sale of a legal product by a deep-pocketed and unpopular industry—without notice, opportunity for fair trial, or evidence. By eliminating the requirement to prove that smoking caused a particular injury, and by rejecting all claims that smokers are personally responsible, the states have effected a shakedown—no better than extortion—grounded on this repugnant rule: the states need money; the industry has money; ergo, the industry pays and the states collect." Robert Levy, "Tobacco Extortion: Round 3," *San Diego Tribune*, November 29, 1998. Another problem with the tobacco settlements is that they are inconsistent with justice and the rule of law. See Robert A. Levy, "Tobacco Medicaid Litigation: Snuffing Out the Rule of Law," Cato Institute Policy Analysis no. 275, June 20, 1997.

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