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.
Introduction

With the economy booming, tax revenues are pouring into state treasuries, and most state governments are in excellent fiscal shape. 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. 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.

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. 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

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Figure 1

State Revenues as a Percentage of GDP

![Bar chart showing state revenues as a percentage of GDP from 1960 to 1997.](chart)

Source: U.S. Department of Commerce, Bureau of the Census and Bureau of Economic Analysis.
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). 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.
State Spending Trends in the 1990s

With 31 of the state governorships now held by Republicans and with almost half the state legislative chambers also controlled by the GOP, it would be natural to conclude that states have moved in a more fiscally conservative direction in the 1990s. But that conclusion would be wrong. While the growth of federal government spending has been slowing somewhat in the 1990s because of reductions in military spending, state budgets have continued to expand rapidly. Between 1990 and 1997 state government expenditures climbed by 56 percent, from $572 billion to $894 billion in current dollars. After adjusting for inflation, that represents a 27.2 percent increase. Since 1980 real state spending has increased by 78 percent.

As Table 1 shows, the three largest components of state budgets are education, welfare, and health. Health and hospital spending has been growing so rapidly that it has now supplanted highway spending as the third largest item in state budgets. Since 1980 state

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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. 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.

### 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.

### Table 1

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

<table>
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<tr>
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<tr>
<td>Education</td>
<td>$171,420</td>
<td>$226,694</td>
<td>$275,821</td>
<td>$104,401  61%</td>
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<tr>
<td>Public welfare</td>
<td>$86,198</td>
<td>$128,957</td>
<td>$203,204</td>
<td>$117,006  136%</td>
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<tr>
<td>Health and hospitals</td>
<td>$34,805</td>
<td>$52,411</td>
<td>$63,193</td>
<td>$28,388   82%</td>
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<tr>
<td>Highways</td>
<td>$48,819</td>
<td>$54,360</td>
<td>$60,204</td>
<td>$11,385   23%</td>
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<tr>
<td>Correction</td>
<td>$8,673</td>
<td>$21,212</td>
<td>$29,043</td>
<td>$20,370   235%</td>
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<tr>
<td>Governmental administration</td>
<td>$13,624</td>
<td>$22,556</td>
<td>$28,656</td>
<td>$15,033   110%</td>
</tr>
<tr>
<td>Interest on general debt</td>
<td>$13,183</td>
<td>$26,452</td>
<td>$26,310</td>
<td>$13,127   100%</td>
</tr>
<tr>
<td>Natural resources</td>
<td>$8,471</td>
<td>$12,173</td>
<td>$12,909</td>
<td>$4,437    52%</td>
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<tr>
<td>Police protection</td>
<td>$4,412</td>
<td>$6,346</td>
<td>$7,501</td>
<td>$3,089    70%</td>
</tr>
<tr>
<td>Parks and recreation</td>
<td>$3,012</td>
<td>$3,432</td>
<td>$3,900</td>
<td>$888      29%</td>
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<tr>
<td>Other and unallocable</td>
<td>$52,262</td>
<td>$69,332</td>
<td>$77,434</td>
<td>$25,173   48%</td>
</tr>
</tbody>
</table>
from 1990 to 1997 and the 10 states where it increased the least.

- 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>
<thead>
<tr>
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<td>U.S. Total</td>
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<td>$893,827</td>
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<td>Oregon</td>
<td>58.8%</td>
<td>1</td>
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<td>Texas</td>
<td>52.9%</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Mississippi</td>
<td>51.5%</td>
<td>3</td>
<td>31</td>
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<tr>
<td>Arkansas</td>
<td>48.1%</td>
<td>4</td>
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<td>Georgia</td>
<td>46.5%</td>
<td>5</td>
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<td>Idaho</td>
<td>46.1%</td>
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<tr>
<td>Utah</td>
<td>43.9%</td>
<td>7</td>
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<td>42.6%</td>
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<tr>
<td>Florida</td>
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<td>5</td>
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<td>Missouri</td>
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<td>10</td>
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<tr>
<td>Tennessee</td>
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<td>West Virginia</td>
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<tr>
<td>North Carolina</td>
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<tr>
<td>New Mexico</td>
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<td>Kentucky</td>
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<td>18</td>
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<td>Washington</td>
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<tr>
<td>Minnesota</td>
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<td>South Carolina</td>
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<td>Pennsylvania</td>
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<td>Delaware</td>
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<td>Illinois</td>
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<td>Alabama</td>
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<td>Montana</td>
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<td>Wisconsin</td>
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<td>Michigan</td>
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<td>31</td>
<td>7</td>
</tr>
<tr>
<td>South Dakota</td>
<td>25.4%</td>
<td>32</td>
<td>50</td>
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<tr>
<td>Virginia</td>
<td>24.3%</td>
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<td>Louisiana</td>
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<tr>
<td>Arizona</td>
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<td>California</td>
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<td>Ohio</td>
<td>20.7%</td>
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<tr>
<td>Iowa</td>
<td>20.5%</td>
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<td>Oklahoma</td>
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<td>Maine</td>
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<td>Maryland</td>
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<td>Connecticut</td>
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<tr>
<td>Massachusetts</td>
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<tr>
<td>New Jersey</td>
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<td>46</td>
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<tr>
<td>Vermont</td>
<td>10.4%</td>
<td>47</td>
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<td>Rhode Island</td>
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<tr>
<td>Wyoming</td>
<td>5.5%</td>
<td>49</td>
<td>48</td>
</tr>
<tr>
<td>Alaska</td>
<td>-0.6%</td>
<td>50</td>
<td>38</td>
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</table>
• 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.

• 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...
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

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

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<tr>
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<tbody>
<tr>
<td>U.S. Total</td>
<td>9.3%</td>
<td>$139.46</td>
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<td>$127.64</td>
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Greatest Budget Increase

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</thead>
<tbody>
<tr>
<td>New Hampshire</td>
<td>24.5%</td>
<td>$108.14</td>
<td>50</td>
<td>$86.84</td>
</tr>
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<td>West Virginia</td>
<td>22.2%</td>
<td>$216.62</td>
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<td>$177.31</td>
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<td>Oregon</td>
<td>22.1%</td>
<td>$169.60</td>
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<td>Mississippi</td>
<td>21.9%</td>
<td>$190.91</td>
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<td>$156.66</td>
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<td>Missouri</td>
<td>21.8%</td>
<td>$117.31</td>
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<td>21.0%</td>
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<td>Pennsylvania</td>
<td>17.5%</td>
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</tr>
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<td>Florida</td>
<td>16.7%</td>
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<td>$93.39</td>
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<tr>
<td>Kentucky</td>
<td>15.1%</td>
<td>$171.32</td>
<td>12</td>
<td>$148.80</td>
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</table>

Smallest Budget Increase

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</thead>
<tbody>
<tr>
<td>Wyoming</td>
<td>-10.7%</td>
<td>$205.77</td>
<td>4</td>
<td>$230.45</td>
</tr>
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<td>Alaska</td>
<td>-9.3%</td>
<td>$388.98</td>
<td>1</td>
<td>$429.04</td>
</tr>
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<td>Nevada</td>
<td>-8.2%</td>
<td>$123.83</td>
<td>40</td>
<td>$134.94</td>
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<td>-7.2%</td>
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<td>34</td>
<td>$143.33</td>
</tr>
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<td>North Dakota</td>
<td>-6.4%</td>
<td>$185.87</td>
<td>8</td>
<td>$198.64</td>
</tr>
<tr>
<td>South Dakota</td>
<td>-0.4%</td>
<td>$136.92</td>
<td>32</td>
<td>$137.42</td>
</tr>
<tr>
<td>Vermont</td>
<td>0.1%</td>
<td>$163.21</td>
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<td>$163.00</td>
</tr>
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<td>Colorado</td>
<td>1.2%</td>
<td>$111.10</td>
<td>48</td>
<td>$109.74</td>
</tr>
<tr>
<td>New Jersey</td>
<td>1.8%</td>
<td>$119.02</td>
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<tr>
<td>Washington</td>
<td>2.7%</td>
<td>$161.17</td>
<td>19</td>
<td>$156.96</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>State</th>
<th>State &amp; Local Government Employment</th>
<th>Total Nonfarm Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Total</td>
<td>1.48%</td>
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</tr>
<tr>
<td>Nevada</td>
<td>5.58%</td>
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</tr>
<tr>
<td>Arizona</td>
<td>4.48%</td>
<td>2.73%</td>
</tr>
<tr>
<td>Idaho</td>
<td>3.67%</td>
<td>1.74%</td>
</tr>
<tr>
<td>Utah</td>
<td>3.49%</td>
<td>2.29%</td>
</tr>
<tr>
<td>Texas</td>
<td>3.06%</td>
<td>2.70%</td>
</tr>
<tr>
<td>New Mexico</td>
<td>3.04%</td>
<td>2.21%</td>
</tr>
<tr>
<td>Washington</td>
<td>2.78%</td>
<td>2.44%</td>
</tr>
<tr>
<td>Kentucky</td>
<td>2.65%</td>
<td>1.12%</td>
</tr>
<tr>
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<td>2.54%</td>
<td>0.75%</td>
</tr>
<tr>
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<td>2.48%</td>
<td>1.30%</td>
</tr>
<tr>
<td>Colorado</td>
<td>2.43%</td>
<td>1.41%</td>
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<tr>
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<td>2.37%</td>
<td>1.86%</td>
</tr>
<tr>
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<td>2.25%</td>
<td>1.81%</td>
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<tr>
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<td>2.25%</td>
<td>1.22%</td>
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<tr>
<td>Oregon</td>
<td>2.22%</td>
<td>0.95%</td>
</tr>
<tr>
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<td>0.92%</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>2.07%</td>
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</tr>
<tr>
<td>Louisiana</td>
<td>2.06%</td>
<td>0.82%</td>
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<tr>
<td>North Dakota</td>
<td>1.97%</td>
<td>0.74%</td>
</tr>
<tr>
<td>Florida</td>
<td>1.95%</td>
<td>3.15%</td>
</tr>
<tr>
<td>Kansas</td>
<td>1.95%</td>
<td>1.42%</td>
</tr>
<tr>
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<td>1.91%</td>
<td>1.97%</td>
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<td>1.90%</td>
<td>0.57%</td>
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<td>1.81%</td>
<td>0.16%</td>
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<tr>
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<td>1.74%</td>
<td>2.22%</td>
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<td>1.70%</td>
<td>2.50%</td>
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</tr>
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<td>1.13%</td>
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<tr>
<td>California</td>
<td>1.00%</td>
<td>1.82%</td>
</tr>
<tr>
<td>Pennsylvania</td>
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<td>-0.43%</td>
</tr>
<tr>
<td>Vermont</td>
<td>0.91%</td>
<td>1.50%</td>
</tr>
<tr>
<td>Maine</td>
<td>0.73%</td>
<td>1.64%</td>
</tr>
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<td>Maryland</td>
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<td>-0.58%</td>
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<td>0.78%</td>
</tr>
<tr>
<td>Rhode Island</td>
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<td>0.30%</td>
</tr>
<tr>
<td>New York</td>
<td>-0.88%</td>
<td>1.30%</td>
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</table>

property 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 6
America's Tax-Cutting Governors

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<thead>
<tr>
<th>Governor</th>
<th>State</th>
<th>Tax Cut</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jane Hull</td>
<td>Arizona</td>
<td>$120 million business tax cut</td>
</tr>
<tr>
<td>Mike Huckabee</td>
<td>Arkansas</td>
<td>$80 million income tax cut</td>
</tr>
<tr>
<td>John Rowland</td>
<td>Connecticut</td>
<td>10 percent income tax cut</td>
</tr>
<tr>
<td>Tom Carper</td>
<td>Delaware</td>
<td>17 percent reduction in top income tax rate</td>
</tr>
<tr>
<td>Zell Miller*</td>
<td>Georgia</td>
<td>Cut income tax &amp; phased out sales tax on food</td>
</tr>
<tr>
<td>Benjamin Cayetano</td>
<td>Hawaii</td>
<td>18 percent reduction in top income tax rate</td>
</tr>
<tr>
<td>Philip Batt*</td>
<td>Idaho</td>
<td>$40 million property tax cut</td>
</tr>
<tr>
<td>Terry Branstad*</td>
<td>Iowa</td>
<td>10 percent income tax rate cut</td>
</tr>
<tr>
<td>Bill Graves</td>
<td>Kansas</td>
<td>Property &amp; income tax cuts</td>
</tr>
<tr>
<td>Parris Glendening</td>
<td>Maryland</td>
<td>10 percent income tax cut</td>
</tr>
<tr>
<td>Paul Cellucci</td>
<td>Massachusetts</td>
<td>$1 billion income tax cut</td>
</tr>
<tr>
<td>John Engler</td>
<td>Michigan</td>
<td>24 tax cuts, including 10 percent income tax cut</td>
</tr>
<tr>
<td>Arne Carlson*</td>
<td>Minnesota</td>
<td>20 percent property tax cut</td>
</tr>
<tr>
<td>Kirk Fordice</td>
<td>Mississippi</td>
<td>Capital gains &amp; income tax cuts</td>
</tr>
<tr>
<td>Ben Nelson*</td>
<td>Nebraska</td>
<td>Income tax rate cuts</td>
</tr>
<tr>
<td>Christine Whitman</td>
<td>New Jersey</td>
<td>30 percent income tax rate cut</td>
</tr>
<tr>
<td>Gary Johnson</td>
<td>New Mexico</td>
<td>Income tax rate cut &amp; gas tax cut</td>
</tr>
<tr>
<td>George Pataki</td>
<td>New York</td>
<td>20 percent income tax rate cut</td>
</tr>
<tr>
<td>James Hunt</td>
<td>North Carolina</td>
<td>Cuts in income tax &amp; sales tax on food</td>
</tr>
<tr>
<td>Frank Keating</td>
<td>Oklahoma</td>
<td>Income tax rate cut</td>
</tr>
<tr>
<td>Tom Ridge</td>
<td>Pennsylvania</td>
<td>$2 billion income tax cuts</td>
</tr>
<tr>
<td>Lincoln Almond</td>
<td>Rhode Island</td>
<td>10 percent income tax rate cut</td>
</tr>
<tr>
<td>David Beasley*</td>
<td>South Carolina</td>
<td>Phaseout of car tax</td>
</tr>
<tr>
<td>William Janklow</td>
<td>South Dakota</td>
<td>25 percent property tax cut</td>
</tr>
<tr>
<td>Don Sundquist</td>
<td>Tennessee</td>
<td>Blocked income tax</td>
</tr>
<tr>
<td>George W. Bush</td>
<td>Texas</td>
<td>$1 billion property tax cut</td>
</tr>
<tr>
<td>Michael Leavitt</td>
<td>Utah</td>
<td>Property &amp; sales tax cuts</td>
</tr>
<tr>
<td>Howard Dean</td>
<td>Vermont</td>
<td>Income tax cut</td>
</tr>
<tr>
<td>Jim Gilmore</td>
<td>Virginia</td>
<td>Phaseout of car tax</td>
</tr>
<tr>
<td>Tommy Thompson</td>
<td>Wisconsin</td>
<td>15 percent income tax rate cut</td>
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*Left office in 1999.
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<th>Personal Income Tax</th>
<th>Corporate Income Tax</th>
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<td>5</td>
</tr>
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<td>7</td>
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<tr>
<td>California</td>
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<td>9.3</td>
</tr>
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<td>D.C.</td>
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<tr>
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<td>3</td>
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<tr>
<td>Indiana</td>
<td>3.4</td>
<td>3.4</td>
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<tr>
<td>Iowa</td>
<td>9.98</td>
<td>8.98</td>
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<td>6.45</td>
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<td>Kentucky</td>
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<td>Louisiana</td>
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<td>Maryland</td>
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<tr>
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<td>6.93</td>
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<tr>
<td>Wyoming</td>
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</table>
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.” 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.

Because state income tax codes have a graduated rate structure, 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>
<thead>
<tr>
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<td>$2,238</td>
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<td>9.9%</td>
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<td>4.4%</td>
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<td>16.3%</td>
<td>$1,939</td>
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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

![Graph showing state budget surpluses from 1979 to 1998.]


1998 and previous editions.
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.\(^\text{18}\) Forty states had reserves larger than 5 percent in FY98, and 21 of those had reserves that were 10 percent or larger (Table 9).\(^\text{19}\) 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.\(^\text{20}\) 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

<table>
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<tr>
<td>Kansas</td>
<td>19.7%</td>
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<td>Colorado</td>
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<tr>
<td>Nevada</td>
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<tr>
<td>Arizona</td>
<td>15.5%</td>
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<tr>
<td>Oregon</td>
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<tr>
<td>Maryland</td>
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<tr>
<td>North Dakota</td>
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<tr>
<td>Mississippi</td>
<td>13.1%</td>
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<tr>
<td>Michigan</td>
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<tr>
<td>Wyoming</td>
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<tr>
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<tr>
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<tr>
<td>South Carolina</td>
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<tr>
<td>Maine</td>
<td>10.0%</td>
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</tr>
<tr>
<td>Rhode Island</td>
<td>10.0%</td>
<td></td>
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Figure 9
Increasing Tax Collections


Figure 10
Increasing Spending Hikes

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. 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. 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.
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. In that year there were 14.4 million Americans on welfare; by the end of 1998 the number had dipped to 8.4 million. Since welfare is the second largest item in state budgets, reduced welfare payments have saved billions of dollars. 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

---

**Figure 11**

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

![Graph showing real federal grants to state and local governments from 1980 to 1998](source: Budget of the U.S. Government—Historical Tables, FY 1999, Table 12.1, pp.203–4.)
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 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.

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

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<tr>
<td><strong>High-Tax States Total</strong></td>
<td></td>
<td>5.5%</td>
<td>9.9%</td>
</tr>
<tr>
<td><strong>Low-Tax States</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Hampshire</td>
<td>$658</td>
<td>5.5%</td>
<td>15.2%</td>
</tr>
<tr>
<td>South Dakota</td>
<td>$882</td>
<td>5.9%</td>
<td>17.9%</td>
</tr>
<tr>
<td>Texas</td>
<td>$1,061</td>
<td>14.0%</td>
<td>27.0%</td>
</tr>
<tr>
<td>Tennessee</td>
<td>$1,066</td>
<td>9.8%</td>
<td>24.6%</td>
</tr>
<tr>
<td>Colorado</td>
<td>$1,141</td>
<td>17.8%</td>
<td>34.3%</td>
</tr>
<tr>
<td>Mississippi</td>
<td>$1,142</td>
<td>5.9%</td>
<td>22.8%</td>
</tr>
<tr>
<td>Alabama</td>
<td>$1,159</td>
<td>6.7%</td>
<td>18.2%</td>
</tr>
<tr>
<td>Nebraska</td>
<td>$1,176</td>
<td>4.8%</td>
<td>15.1%</td>
</tr>
<tr>
<td>Arkansas</td>
<td>$1,180</td>
<td>7.2%</td>
<td>21.9%</td>
</tr>
<tr>
<td>Missouri</td>
<td>$1,184</td>
<td>5.4%</td>
<td>15.4%</td>
</tr>
<tr>
<td><strong>Low-Tax States Total</strong></td>
<td></td>
<td>10.5%</td>
<td>23.7%</td>
</tr>
</tbody>
</table>

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). Consequently, 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 anaemic 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.”

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). 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). 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. 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.

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. 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. 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.

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-
mous conclusion is that there is no connection between school funding and school performance.

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.

**Table 11**

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

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

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. 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.

Notes


5. Details for individual states are available at www.cato.org or by written request.


16. New Hampshire's slow growth of tax revenue from 1992 to 1998, a time of economic prosperity, can perhaps be explained in part by the fact that New Hampshire does not have an income tax, revenues from which tend to grow faster than personal income. Most of New Hampshire's tax revenue comes from the sales tax.


25. Ibid.


29. Moore, "Taxing Lessons from the States."

30. Moore and Stansel.


32. Flynn.


35. U.S. Department of Education, Tables 133, 168, pp. 136, 171. The 10 highest spending jurisdictions by 1994-95 per pupil spending were New Jersey, New York, the District of Columbia, Alaska, Connecticut, Rhode Island, Massachusetts,
Maryland, Pennsylvania, and Delaware. The 10 lowest spending states were Utah, Mississippi, Idaho, Tennessee, Alabama, Arkansas, New Mexico, Louisiana, North Dakota, and South Dakota.


37. Ibid.


41. Vedder.

42. See Stansel.

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 effectuated 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.