

# PRINCIPLES FOR PROGRESSIVE STATE BUDGETING

Fiscal responsibility promises to be focus of political debate over the next two years. Republicans will clamor to cut state budgets to the bone, especially benefits and entitlements, while simultaneously refusing to discuss tax increases or other revenue-generators. Progressives are going to need to have answers, and below are some principles for short-term belt-tightening and longer-term fiscal health that any progressive candidate should keep in mind.

## Four Principles

1. **During Economic Crises Spend on Benefits and Raise Taxes:** States are constrained from deficit spending, so the rule in times of economic contraction should be do the least harm possible. This means a spending emphasis on benefits and entitlements, which have the highest multiplier effects<sup>iii</sup>. Indeed, the impact of increased taxes, especially when targeted at high earners, is much less economically destructive than cuts to benefits. When dealing with cyclical deficits states should not hesitate to balance the budget through increased taxes.
2. **Address Core Programs:** Long-term fiscal health requires that states deal with their four major areas of funding: Education, Entitlements, Corrections and Transportation. We need to have a progressive budgeting take on each of these items.
  - **Entitlements:** Health care will continue to drive state budgets, especially with the Medicaid eligibility expansion included in the recent Health Care Affordability Act. There are a number of ways to bend the cost curve on health, and by building upon what the Federal government is already doing with Medicare, states have the market share necessary to change provider practices and billing structures:
    - *Payment Reform:* The current fee-for-service billing model creates perverse incentives in health care that drive prices up and promote the overuse of health care services. Amongst the numerous reforms that could reduce this dynamic is episode-of-care based reimbursement which pays providers for illness or injury being treated (appendicitis or a broken leg) rather than for the various services being provided (blood tests and surgical procedures). The Commonwealth Fund estimates that this change could save the U.S. health care system up to \$229 billion over the next ten years<sup>iii</sup>.
    - *Pharmaceutical Reform:* Newer drugs are not always the most effective or efficient medicines to use. Direct to doctor marketing, and direct to consumer advertising are strong forces promoting the use of these new products, however. By developing evidence-based formularies for state health care programs<sup>iv</sup>, by creating government paid academic detailers to counteract direct to doctor marketing<sup>v</sup>, and by prohibiting pharmaceutical representatives from offering gifts to doctors<sup>vi</sup>, states can ensure that drugs are prescribed based on the quality of the product, not the persuasiveness of its advertising campaign.
    - *Coordinated Care and Preventative Care:* The elderly and disabled account for 65 percent of all Medicaid expenditures despite making up only 22 percent of Medicaid enrollees<sup>vii</sup>. This is primarily due to the higher level of the chronic health ailments these individuals face. Untreated or poorly-treated chronic health problems force frequent hospitalizations, emergency room visits and other

expensive health interventions. Carefully monitoring health and coordinating care for individuals with chronic conditions can lead to better health outcomes for individuals and lower costs for states<sup>viii</sup>.

- Corrections: Sentencing structures in the United States are overly punitive and prohibitively expensive. The U.S. accounts for just 5% of the world's population but a quarter of its prisoners<sup>ix</sup>. Indeed, one out of every 31 U.S. adults is in prison, jail or on parole or probation<sup>x</sup>. There are a number of relatively straightforward reforms that could reduce expensive prison time for non-violent offenders while still maintaining safe communities.
  - *Reduced Sentences for Non-violent Offenders*: Numerous states have decreased their prison populations by either overturning mandatory minimum requirements or by reducing prison time for non-violent drug offenders. For instance, Kansas reduced its prison population by 5 percent by diverting drug possession offenders from prison to mandatory drug treatment, and by eliminating higher prison sentences for repeat drug possession offenses<sup>xi</sup>.
  - *Earned Time Policies*: Numerous states have instituted policies that reduce prisoner sentences in exchange for voluntary substance abuse treatment, participating in educational opportunities, and maintaining a clean disciplinary record while in prison. From 1997-2006, the State of New York estimated that it saved almost \$370 million through the use of earned time policies<sup>xii</sup>.
  - *Prisoner Re-Entry Programs*: Individuals leaving prison have high rates of substance abuse problems, a high incidence of mental illness, and low work skills. They have a high incidence of AIDS and many have incurred debts such as child support arrearages that have built up while they were in prison<sup>xiii</sup>. A more comprehensive re-entry program that wraps case management services, substance abuse treatment, mental health assessments and arrearage forgiveness, and work training, can lower recidivism and reduce the prison population<sup>xiv</sup>.
  - *Early interventions*: The early levels of stress and abuse a child undergoes have a dramatic impact on their future likelihood of incarcerations. Evidence based early intervention such as home visiting programs have a huge impact on a child's ability to learn, academic success and likelihood of committing a crime. Long-term corrections policies should integrate their efforts with child safety and child welfare programs to stop criminal behavior before it begins<sup>xv</sup>.
- Transportation: Transportation policy should focus on the cessation of large scale highway expansion projects and a movement of available funds towards road maintenance and mass transit.
  - *Fix-it-First*: Long-term, the need for denser urban centers, and a low-emissions transportation system will promote a move towards a more sustainable transportation system. Lowering the number of large-scale capital projects would promote the use of transit, and increase incentives to live closer to city centers. In times of fiscal distress, states should limit new

road projects, and instead use available funding for the maintenance and repair of the existing road system. For every \$1 invested in repair work states save \$14 in long term constructions costs<sup>xvi</sup>, and, in addition, fix-it-first projects create 16% more jobs than new construction projects<sup>xvii</sup>.

- *Look for Long-term Value:* Large-scale road building projects tie up large portions of state budgets, promote higher carbon emissions, and create suburban sprawl. State transportation planning should focus limited transportation budgets on projects that create the most economic development, not on projects that increase capacity or speed up traffic flow. With this criteria in mind, states should, to the extent possible, place transit projects and road projects in the same pool to ensure states get the most economic development impact for their investment.
- *Increase the Gas Tax:* Higher gas prices and the concurrent move towards fuel efficiency have created a crunch in the traditional model of DOT financing. While VMT taxes have been proposed and actually provide a more sustainable funding model long term, the implementation of a VMT tax system raises civil liberties concerns, and reduces the incentive for more fuel efficient cars. States should help finance the system by significantly increasing the gas tax.
- *Education:* Despite independent governance, school districts would benefit from statewide centralization of some administrative functions. In addition, states should better target which students they subsidize in their higher education systems, by ensuring that wealthier students pay a greater share of their education costs than poorer students do.
  - *Centralization of Education Procurement:* Despite local jurisdiction over school operations and some curriculum decisions, independent school districts do not capitalize on their combined purchasing power to get the best possible prices on goods and services. A statewide procurement system for books, supplies, IT and support services, could lower school costs and increase available resources.
  - *Buy Benefits at all Levels of Government:* Teachers traditionally purchase benefits through their school districts. By combining school district purchasing power with all state, county, and municipal levels of government, schools could increase the insurance purchasing pool, improve overall benefit levels and decrease costs. The savings associated with a statewide government employee insurance pool could be increased by combining this pool with Medicaid and SCHIP eligible populations.
  - *Increase Tuition, Increase Financial Aid:* Currently, state university and technical school programs are funded by a combination of general tax revenues and tuition dollars. General revenues subsidize higher education in order to keep tuition levels artificially low. Higher user fees in the form of tuition increases would allow states to fully fund their post-secondary systems without using general revenue taxes. Higher tuition would create access problems for lower-income students, but this could be rectified by increasing access to need-based financial aid. Though a larger financial aid

program may necessitate the use of general revenue taxes, it would be at a fraction of the cost of the current universal tuition subsidy.

3. **Increase Revenue by Closing Loopholes and Enforcing Existing Tax Law.** Despite GOP rhetoric, tax increases will be necessary to alleviate the current structural deficit faced in most states. Unfortunately the easiest revenue enhancers to pass—fees, sin taxes—are usually the most regressive in nature. A progressive agenda should focus on enforcing the theoretical progressivity of current tax structures and not resorting to gimmicks.
  - Avoid the Easy Fixes: Sales taxes, sin taxes and fee increases are generally the preferred route to revenue enhancement in state government. The income tax has been overly politicized, and corporate tax increases face challenges from well funded lobbies and pet in-state industries. The three preferred revenue enhancers, however, fall disproportionately on the lower tiers of the income ladder. They are inherently regressive taxation policies.
  - Close Sales Tax Loopholes: The federal government allows states to extend their sales tax to 168 types of services including such industries as legal work, accounting and automobile repair. The majority of states, however, fail to tax even one-third of the allowable services. By taxing allowable services states can garner additional revenue, reduce volatility in sales tax receipts and, because many untaxed services are used more frequently by upper income individuals, states can make their overall tax system more progressive<sup>xviii</sup>.
  - Combined Reporting: In many states, large corporations are able to avoid paying their fair share of state corporate taxes by artificially assigning the majority of their profits to low-tax states. One state response to this gaming of the system is combined reporting, which taxes corporations for the proportion of business they do in the state. It allows states to reclaim corporate revenue that otherwise would have been lost to low-tax states<sup>xix</sup>.
4. **Cut Smart.** Cuts should be based on low-priority functions. Across-the-board cuts hinder performance on all government programs and delegitimize the efforts of the public sector as a whole. Cuts, when necessary, should be centered on the programs we can afford to do without.

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<sup>iii</sup> Schoen, Cathy; Guterman, Stuart; Shih, Anthony; Lau, Jennifer; Kasimow, Sophie; Gauthier, Anne & Davis, Karen. (December 2007). *Bending the Cost Curve: Options for Achieving Savings and Improving Value in U.S. Health Spending*. The Commonwealth Fund Commission on a High Performance Health System. Retrieved April 15, 2010 from [http://www.commonwealthfund.org/~media/Files/Publications/Fund%20Report/2007/Dec/Bending%20the%20Curve%20Options%20for%20Achieving%20Savings%20and%20Improving%20Value%20in%20U%20S%20Health%20Spending/Schoen\\_bendingthecurve\\_1080%20pdf.pdf](http://www.commonwealthfund.org/~media/Files/Publications/Fund%20Report/2007/Dec/Bending%20the%20Curve%20Options%20for%20Achieving%20Savings%20and%20Improving%20Value%20in%20U%20S%20Health%20Spending/Schoen_bendingthecurve_1080%20pdf.pdf)

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