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STATE POLICY REPORTS

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State and Local Finances in FY 2009 2

The Census Bureau has released its state and local finance series for fiscal year (FY) 2009. The combined state-local data allow meaningful comparisons of tax structures and burdens among the states. This issue focuses on the revenue highlights of the newly released data.

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ISSUE 2

STATE POLICY REPORTS

In This Issue

State Tax Collections: Generally Good News **2**

The Rockefeller Institute released a new quarterly summary of state tax collections, covering the third calendar quarter of 2011 (July-September). Tax collections for that quarter offered generally encouraging news but also some cause for concern.

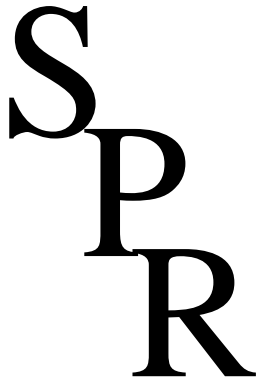
Letter to the Editor: PAYGO Revisited **6**

Iris J. Lav and Elizabeth McNichol of the Center on Budget and Policy Priorities (CBPP) submitted a response to an article that appeared in *Reports*, Volume 29, Issue 21.

Technical Notes **9**

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Do State Personal Income Taxes Inhibit Growth? 2

A number of states are reportedly contemplating major reductions in their personal income taxes, or even outright elimination of the tax. One group of experts argues that states with lower tax rates have experienced stronger economic growth, while another challenges those findings. *Reports* suspects that economic growth over the period in question had more to do with state reliance on specific industries that were doing well (e.g., natural resources, the federal government) or poorly (e.g., automobiles) than it had to do with tax policy.

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REVISED ISSUE 4

In This Issue

The 2012 Camelot Index

2

The Camelot Index was developed by *Reports* founding editor Hal Hovey. It is based on the premise that most people share a common set of preferences: fewer taxes are better than more, small class sizes are better than large, low death rates are better than high, less crime is better than more and so on.

Many studies incorporate such preferences, but they often focus on just one area. For example, a study may attempt to identify the “healthiest” state but ignore the fact that health care isn’t delivered in a vacuum; it may be traded off with something else.

The Camelot Index brings together measures of economic vitality, health, education, crime, society and government. In the current Index, many states rank consistently across measures, while others do quite well on some measures but not on others. Plains states continue to do well, with three states (one a new entrant) still ranking among the top five.

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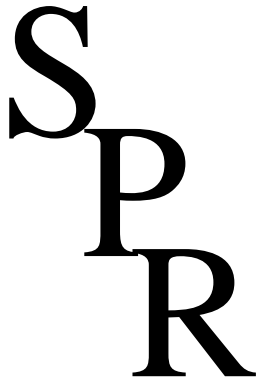
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Should the Feds Get Out of the Highway Business? 2

The federal government has been heavily involved in highway construction for decades. Since 1956, the Highway Trust Fund has been used to collect federal transportation tax revenues and finance transportation projects around the country. Tax revenues are redistributed to states as grants, awarded based on federally determined program allocations and funding levels. However, this program structure has created funding disparities for some states and skewed incentives for all of them. Consequently, the idea of devolving the federal highway system to states gets aired every so often.

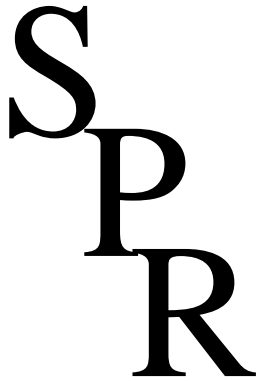
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Index of State Economic Momentum 2

State economies continued to improve as 2012 began. Personal income data from the final calendar quarter of 2011 show continued growth even without the extra fiscal assistance the federal government provided during and after the recession. While a number of states still reported job losses, the losses were relatively small and were partly attributable to the government sector. Moreover, there is a tightening in state results, with fewer states exceeding or lagging the national average by extraordinary amounts.

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In This Issue

State Spending on Higher Education 2

In recent years, state spending on higher education has come into focus as the revenue effects of the Great Recession made it hard for many states to maintain funds for higher education expenditures. While overall spending on higher education has increased, state spending as a percent of total expenditures has decreased since FY 2007. The decrease in state funding has implications both for the cost of public higher education and the federal funding states receive.

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Should States Adopt Combined Reporting? 2

With state corporate income tax revenues on the decline as a share of total state tax revenues for the past two decades, numerous states have attempted to address corporate tax avoidance strategies. Combined reporting requires multi-state corporations to calculate corporate income taxes based on the entire corporate group's combined profits resulting from a unitary business function within a given state, including those of all subsidiaries involved. Combined reporting requirements are intended to reduce a corporation's ability to engage in corporate tax avoidance strategies. Some suggest that this could improve the fairness in a state's corporate tax system and raise tax revenue without harming the state's economy.

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Federal Tax Reform and the States

2

At a recent congressional hearing, five tax experts presented testimony to the Senate Finance Committee on the impact of federal tax reform on states. Inasmuch as many observers believe federal tax reform is imminent, it's probably a good idea to know what the experts are saying, and what Congress is hearing.

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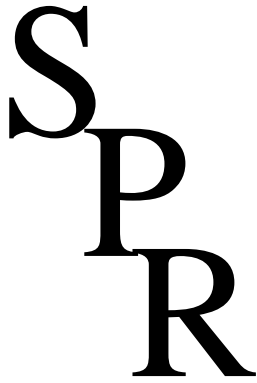
The Local Angle **2**

The impact of a recession is different for local governments than for states. First, while states may face reductions or increases in federal aid during such periods, local governments almost always face reductions in state aid. Second, because they lack the range of revenue options that states have, local governments can be less flexible in dealing with shortfalls. And finally, the property tax (on which most local governments rely) behaves much differently than the sales or income tax, especially in the last recession that was driven by a collapse of the housing sector. Accordingly, the outlook for local governments at this juncture of the recovery is different—and worse—than for states.

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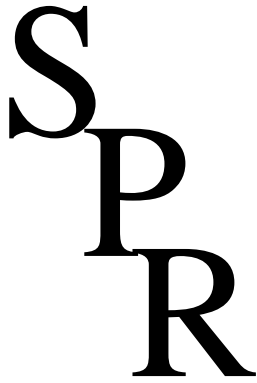
In This Issue

Continuum of State Fiscal Stress 2

In fiscal year (FY) 2011, it was evident that states had emerged from the Great Recession and were beginning to put their fiscal houses back in order. Two significant risks remained: the loss of federal fiscal assistance in FY 2012 and a sputtering economic recovery. As FY 2012 progressed, those two risks proved formidable, as states saw some slippage in their fiscal positions. The question now is whether FY 2012 was a blip in states' recovery or a transition into another period of fiscal distress.

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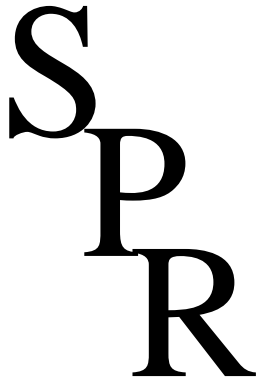
The improvement in state economies has slowed since the beginning of calendar year 2012. Personal income data from the first calendar quarter of 2012 show continued but slower growth compared to the final quarter of 2011. Employment growth remained fairly stable, though many states continue to deal with manufacturing and government job losses. Western states are growing at the fastest rate.

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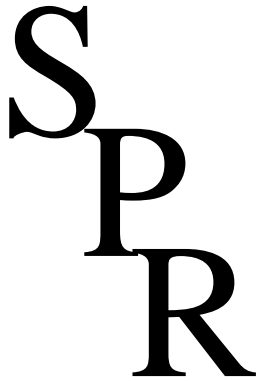
States and the Fiscal Cliff 2

Washington, DC, and state capitals are abuzz over “the fiscal cliff” and what it means to the nation and to states. In evaluating that impact, it’s important to consider both the direct effects on taxes and spending, as well as the indirect effects on consumer confidence and the economy. It’s possible—and a little unsettling—that the former may be more benign than the latter.

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How States Address Municipal Bankruptcies 2

Chapter 9, Title 11 of the U.S. Bankruptcy Code provides for bankruptcy for municipalities as a way to restructure their debt. Since 1937, 633 municipal entities have filed for Chapter 9 bankruptcy protection. While states themselves cannot file for bankruptcy, they do play a role in the outcome for these financially distressed municipalities. However, the interaction between state governments and municipalities filing for bankruptcy differs widely among states. While states such as **New York, Pennsylvania and Michigan** have taken on a larger role in aiding and guiding failing cities, other states such as **California and Alabama** have traditionally distanced themselves from municipalities filing for Chapter 9.

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All Eyes on Kansas **2**

Major tax reform was recently signed into law in Kansas. It reduces and flattens the personal income tax structure, repeals numerous tax credits and exempts certain business income from taxation, among other changes. The new law is intended to create a business-friendly environment, boost the state's economic growth and create new jobs. Its critics worry that lower state revenues will put public services at risk.

The ACA and Medicaid: To Expand or Not to Expand **7**

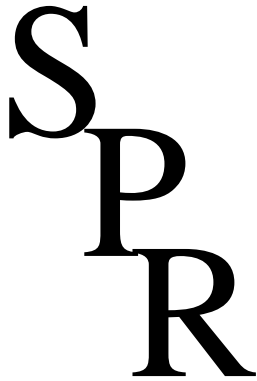
In light of the recent U.S. Supreme Court ruling on the Affordable Care Act (ACA), which essentially makes the Medicaid expansion portion of the law optional, many states are now faced with the tough decision of how to proceed. The decision of whether to expand Medicaid is complicated by uncertainties at the federal level as well as a number of political, fiscal and policy considerations that come into play for states.

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August 2012



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A Pause in State Tax Collections 2

Recent reports on state tax collections are giving mixed messages: while revenues are positive on a year-over-year basis, the rate of growth is modest.

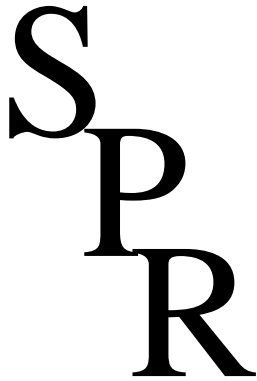
When Government Spending Declines 5

The group that represents the state officials who oversee the home energy assistance program just released state data on the number of people who received such assistance last year. Not surprisingly, a cut in federal funding led to both a cut in beneficiaries and in benefit levels.

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Index of State Economic Momentum 2

The improvement in state economies has started to regain momentum after falling off in the June 2012 update. Personal income data from the second calendar quarter of 2012 show faster growth than the first quarter, but slower growth compared to the final quarter of 2011. Employment growth remained fairly stable, though many states continue to deal with manufacturing and government job losses. Western states continue to dominate the index.

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Health Insurance Coverage: Mixed Messages 2

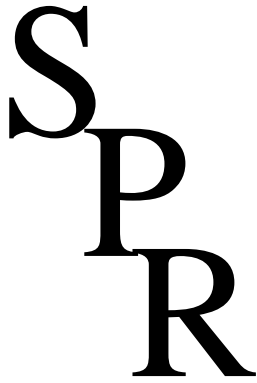
The newest data on health insurance coverage shows that while private employers are reducing coverage, young adults who can now remain on their parents' plans are doing so. Meanwhile, Medicaid coverage is increasing.

How Federal Budget Problems Can Affect States 6

Moody's Investor Service has placed on review 28 issuances of GARVEE bonds, a financing vehicle put at risk by the potential sequester of certain federal highway funding. Chalk it up as another example of state exposures to federal budget problems.

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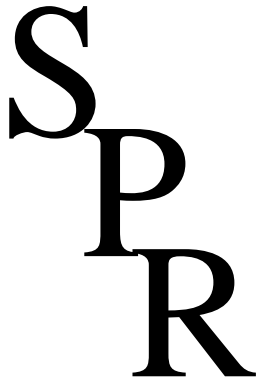
Fiscal Threats to States in a Nutshell 2

In June 2011, the State Budget Crisis Task Force was developed to examine the fiscal challenges confronting state and local governments. Its research identified six specific threats to states' near- and long-term fiscal sustainability. Moreover, the report warned that if these threats were not addressed, they could affect essential state functions such as providing K-12 education, investing in infrastructure and state borrowing.

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Sorting Out

2

Twenty years ago, former Congressional Budget Office director Alice Rivlin authored a proposal for sorting out federal versus state-local responsibilities. *Reports* summarized her recommendations in a 2009 article that explored whether the time for her ideas might have come. Alas, it wasn't to be. But with renewed focus on federal budget deficits, the time once again seems ripe for a discussion about who does what.

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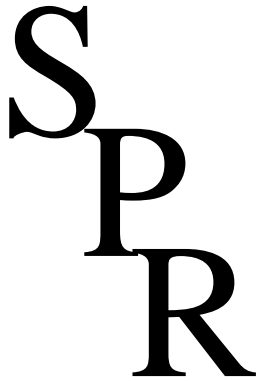
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Seeking to Sustain a Recovery

After modest improvements in fiscal years (FYs) 2010 and 2011, state economies and budgets generally continued to strengthen in FY 2012. As a result, states have undertaken the long, slow process of recovering from the recession that devastated their budgets in FYs 2008-2009. States have adjusted to the loss of federal fiscal assistance after FY 2011, and state economies seem to have regained momentum after getting off to a rough start in 2012.

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