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## State and Local Receipts and Business Cycles

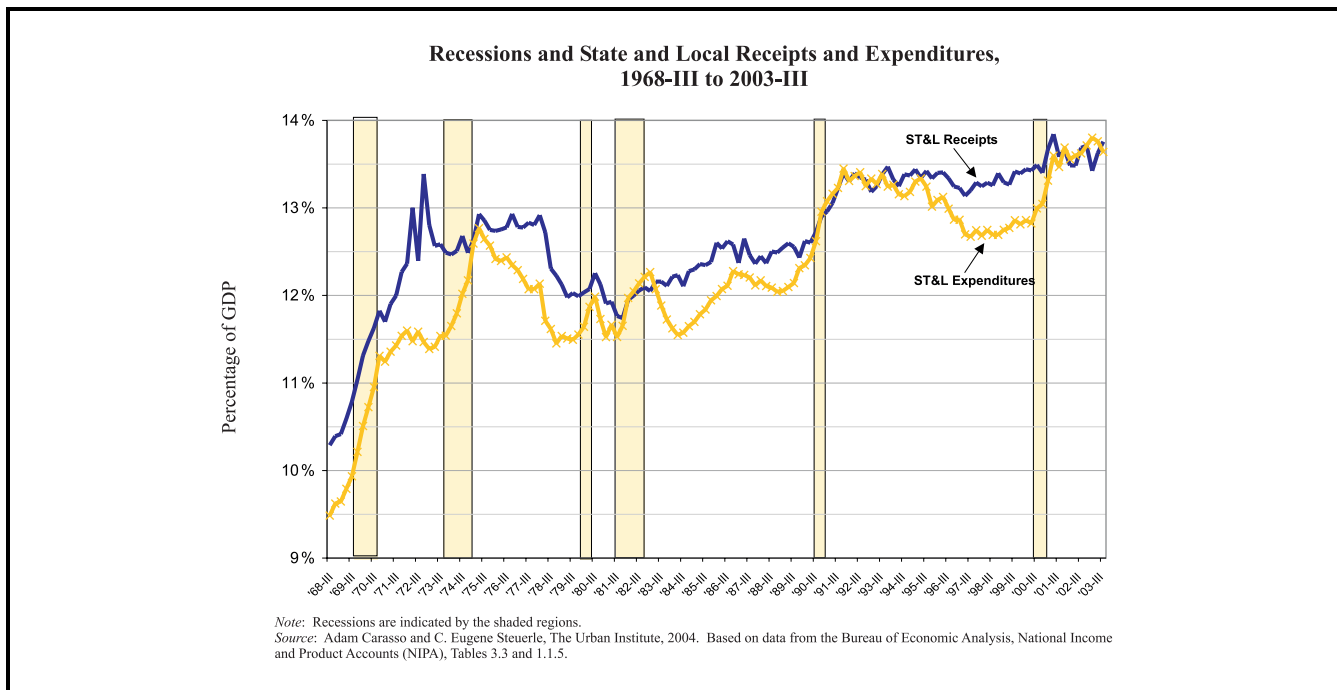
By Adam Carasso and  
C. Eugene Steuerle

The behavior of state and local receipts around the end of a business cycle is historically mixed, but the last three recessions exhibit a common trend: Receipts trail expenditures during the recession and may continue to do so for 1-2 years afterwards. State and local receipts, as measured by the Bureau of Economic Analysis (BEA), include federal grants-in-aid and private sector contributions to state social insurance and pension trusts funds, rainy day funds, and tobacco funds, in addition to income, excise, and property tax receipts. Since some of these funds have long-term obligations, receipts typically exceed expenditures as can be seen in the chart.

While in all recessions shown here, growth in expenditures outpaced growth in receipts, the 1981-82 recession was the first (dating to the beginning of the

BEA series in 1929) in which state and local expenditures actually *exceeded* revenues for a time. This phenomenon has held true for the last two recessions. Receipts exceeded expenditures for a quarter following the 1981-82 recession; for nearly two years following the 1990-91 recession; and, since the 2000-01 recession, receipts have alternately lagged or drawn about even with expenditures for six straight quarters (up to 2003-II).

Why didn't this pattern hold true for previous recessions? One reason was that the steep growth in state and local receipts that occurred before 1973 — driven by bracket creep, property appreciation, and increases in federal grants-in-aid — did not continue. Since the 1970s, concern over the size of government has curbed growth in tax receipts in particular. A second reason was the lesser scope and cost of federal income-tested programs like Medicaid in the 1970s — the costs of these programs would typically spike around recessions and then decline in periods of economic expansion. During the 1990s, however, program coverage and benefit expansions, plus soaring drug costs, changed the dynamic so that Medicaid grew whether the economy was in an upturn or a downturn.



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