

SPR

VOLUME 19

ISSUE 2

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With all the talk of federal tax cuts being imminent, states need to remind themselves that their own tax codes have many links to the federal tax code. That means some federal tax cuts will automatically have an effect on state tax collections.

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This winter started out much colder than its two predecessors did, at least in some parts of the country. The combination of colder temperatures and higher heating fuel prices has left many consumers suffering from sticker shock. The federal government and many states are trying to ease the financial burden created by paying for home heating.

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Death and Taxes

They say that only two things in life are certain: death and taxes. For states and the federal government, however, the two are linked. Death taxes provide a small but significant source of revenues to both the federal government and to states. Recent proposals to reduce federal taxes over 10 years, as currently proposed by Senators Phil Gramm and Zell Miller, include repeal of the federal death tax over the next several years. An analysis by the Washington, DC-based Center on Budget and Policy Priorities estimates the impact of the death tax proposal on states.

The proposal to repeal the federal estate tax is expected to cost the federal government about \$50 billion in revenue per year once the repeal is fully phased in. According to the Center, state losses would have been about \$5.5 billion if the repeal had been in effect in 2000 and would climb to \$9 billion by 2010 under the phased-in repeal contained in earlier federal legislation.

How the Estate Tax Works

The estate tax is one of the more complicated state taxes and its relationship to the federal estate tax makes it even more complicated. Basically, the federal government levies an estate tax that applies mainly to very large estates. It allows a credit against federal taxes owed for state estate taxes paid. The size of the allowable credit varies by the size of the estate.

In 35 states, the state tax is set exactly equal to the maximum allowable federal credit for each estate. These states are known as states with a “pickup” tax only, as they levy no separate state death or inheritance tax. They collect tax revenues but the total taxes owed by the estate are no different than if the state levied no tax at all (because the federal liability is reduced by the amount paid to the state). Since these states rely solely on the federal tax for their own tax collections, repeal of the federal tax would eliminate all the revenues they collect from the estate tax.

The next table shows estimates of the amount of money at stake for these states. The figures shown are the average annual federal credit claimed in each state over the calendar years 1995-1997. The Center used a three-year average because estate taxes can fluctuate widely from year to year if, for example, an extremely wealthy individual dies.

Two states among the 35 that levy the pickup tax only are excluded from the table. **Mississippi** and **New York** have eliminated their state taxes but continue to collect revenue from them because estates can take several years to move through probate. For the 33 states listed, the revenues total \$2.4 billion, a conservative estimate of the amount they stand to lose if the federal estate tax were repealed.

Average Annual State Collections from Federal Estate Pickup Tax, 1995-1997
(dollars in millions)

Rank	State	Amount	Rank	State	Amount
1	California	\$590.6	18	Kansas	\$32.8
2	Florida	429.3	19	Nevada	29.7
3	Texas	201.3	20	Colorado	28.6
4	Illinois	181.9	21	Maine	22.1
5	Massachusetts	88.3	22	South Carolina	21.4
6	Virginia	83.0	23	Hawaii	16.1
7	Michigan	80.1	24	Utah	14.6
8	North Carolina	67.0	25	Delaware	11.9
9	Missouri	66.0	25	New Mexico	11.9
10	Georgia	62.7	25	West Virginia	11.9
11	Washington	62.1	28	Vermont	11.7
12	Arkansas	54.7	29	Rhode Island	9.8
13	Arizona	51.7	30	Idaho	7.2
14	Minnesota	48.3	31	North Dakota	3.7
15	Wisconsin	47.3	32	Wyoming	3.6
16	Alabama	35.6	33	Alaska	1.2
17	Oregon	34.0			

The next table lists the revenue these same states collected from the estate tax in fiscal year 2000. The amounts are much higher for nearly every state and total \$4.3 billion, almost twice the total in the preceding table. This partly reflects the year-to-year variations that can occur in this tax but also reflects a general increase in the value of very large estates in recent years, since only very large estates are subject to the federal estate tax.

State Collections from Federal Estate Pickup Tax, FY 2000
(dollars in millions)

Rank	State	Amount	Rank	State	Amount
1	California*	\$937.0	17	Utah	\$65.1
2	Florida*	779.1	19	Kansas	62.9
3	Illinois*	360.0	20	Wyoming	50.8
4	Texas	249.1	21	Oregon	47.8
5	Michigan*	187.0	22	Maine	45.8
6	Massachusetts	166.5	23	South Carolina	42.7
7	Virginia*	165.6	24	Delaware	41.0
8	Georgia	155.0	25	Rhode Island	34.2
9	North Carolina*	152.7	26	Hawaii	22.8
10	Wisconsin	133.5	27	Arkansas	21.6
11	Missouri	132.7	28	West Virginia	21.1
12	Washington	86.9	29	New Mexico	16.1
13	Minnesota	82.5	30	Vermont	13.6
14	Arizona	80.6	31	Idaho	11.1
15	Nevada	76.7	32	North Dakota	6.1
16	Alabama*	68.0	33	Alaska*	1.8
17	Colorado	65.1			

* Projected revenues

In the remaining 15 states, a state inheritance or estate tax is levied on top of the federal pickup tax. An estate must pay the greater of the pickup tax or the state tax and can deduct from federal taxes the maximum allowable credit. In addition to Mississippi and New York, which repealed their state inheritance taxes, a number of other states are phasing out or reducing their state taxes. **Louisiana** and **Connecticut** also are phasing out their inheritance taxes. **Maryland, Ohio** and **Pennsylvania** are reducing their inheritance taxes and **Montana** and **South Dakota** passed an initiative or referendum eliminating the state tax.

The next table shows the Center's estimates for the portion of these states' collections that resulted from the federal credit for state taxes paid. As with the preceding tables, the amounts shown are the annual average for calendar years 1995-97 and the fiscal year 2000 estimate.

State Revenue from Credit Against Federal Estate Tax
(dollars in millions)

2000 Rank	State	CY Average	
		1995-97	FY 2000
1	New York	\$418	\$450
2	New Jersey	126	158
3	Connecticut	85	140
4	Maryland	70	78
5	Louisiana	43	50
6	Ohio	132	38
7	Kentucky	41	37
8	Iowa	28	35
9	Pennsylvania	141	30
10	New Hampshire	12	25
11	Mississippi	11	22
12	Indiana	47	21
13	Nebraska	17	20
14	Tennessee	41	11
15	Montana	5	8
16	South Dakota	3	6
17	Oklahoma	41	0

The total for the states listed is \$1.3 billion for 1995-97 and \$1.1 billion for fiscal year 2000. When combined with the losses from the 35 states with a pickup tax only, the Center estimates state losses would have totaled \$5.5 billion in 2000.

Other Tax Impacts

The impact of repeal of the federal estate tax is clear because of the straightforward linkages between the federal tax and state taxes. The impact of other proposed federal tax changes is less clear. The major components of proposed federal changes are listed below with discussion of their potential impacts.

***Reduce Marginal
Income Tax Rates***

The Gramm-Miller proposal would replace five current tax rate brackets with four. Most states with personal income taxes link to either federal adjusted gross income or federal taxable income. Since federal tax rates come into play further down on the tax form, these states would be unaffected by the proposal. The exceptions are the three states that link directly to federal tax liability: **North Dakota, Rhode Island** and **Vermont**. Since the proposal would reduce federal tax liability it would by definition also reduce these states' personal income tax revenues.

***Increasing the Child
Tax Credit***

The proposal would double the child tax credit, from \$500 to \$1,000. This credit comes into play after federal tax liability is calculated and is taken as a deduction from taxes owed. It should have no effect on state taxes unless a state has enacted its own child tax credit that is linked to the federal credit. In this case, the increase in the federal credit would increase the state credit as well and reduce state tax collections.

***Reducing the Marriage
Penalty***

The proposal would phase in the restoration of a provision that permits a married couple to exclude from their taxable income 10% of the lower-earning spouse's income, up to \$30,000. Since this proposal affects taxable income (rather than adjusted gross income) it would have an impact on those states whose tax codes link to federal taxable income. **Colorado, Hawaii, Idaho, Minnesota, North Carolina, Oregon, South Carolina** and **Utah** all use this as the starting point for their state personal income taxes. Assuming they conform to the federal tax code prospectively and do not require an annual action by the legislature to come into conformity, they would experience revenue losses from this proposal. If they do not conform prospectively, failure to update their conformity could allow them to dodge a federal tax change in this area.

***Expanding Education
Savings Accounts***

The proposal would increase the current limit on contributions to education savings accounts from \$500 annually to \$1,000 annually and continue to increase it by \$1,000 annually until it reached \$5,000 in 2006. This policy would have a minor impact on most states, assuming that the money deposited into such accounts would otherwise have been placed into taxable savings devices. Since the interest accrued on education savings accounts is not taxable if used to meet eligible expenses, the lower amount of taxable interest would reduce a taxpayer's adjusted gross income.

***Encourage Charitable
Deductions***

The proposal would allow the vast majority of taxpayers who do not itemize their deductions (instead taking the standard deduction) to deduct their charitable donations. In addition, taxpayers age 59 and over would be allowed to make tax- and penalty-free withdrawals from their IRAs for charitable donations.

Assuming the charitable donation allowance would appear in the same place on the tax form for non-itemizers that it currently appears for itemizers, it would not affect adjusted gross income but would reduce taxable income. As a result, the eight states listed on the preceding page would see a reduction in their tax collections.

In contrast, the ability to make tax- and penalty-free withdrawals from IRAs is trickier. Currently, if people make such withdrawals for the purpose of making charitable donations, the penalties they accrue become part of adjusted gross income. This proposal would reduce adjusted gross income and reduce taxes in all the states that link to adjusted gross income. It seems unlikely, however, that taxpayers commonly tap IRAs for the purpose of making charitable donations. Consequently the proposal should have relatively little impact on state revenues.

In summary, the repeal of the federal estate tax is the only current tax proposal that would have a major impact on every state's revenues. Other proposals would have uneven impacts, with the greatest impact on states linked to either federal tax liability or federal taxable income. In all cases states would be able to mitigate the impact of federal tax changes by passing their own legislation to "undo" the federal actions. Whether they would be willing to do so is a different matter.

Baby, It's Cold Outside

It has been a relatively cold winter in much of the United States and consumers are feeling the impact in two ways. First, they are using far more energy to heat their homes than they have in recent winters, which were comparatively mild. Second, the price of the fuels used to heat those homes has risen dramatically. The Department of Energy (DOE) estimates that heating oil prices this winter are about 40% higher than last winter and natural gas prices are about 70% higher than last winter. DOE initially projected a 29% increase in heating oil prices and a 40% increase in natural gas prices.

Heating oil prices are currently lower than first expected but an increased demand for home heating oil resulted in an upward revision in oil price estimates. While prices have eased some in recent weeks, DOE points out that the heating oil market is still relatively tight and subject to significant volatility. The increase in consumers' cost for natural gas results from higher demand (due to cold weather in November and December) and from higher residential prices. Although high oil prices have encouraged the current strength in gas prices, the predominant reason for high gas prices is uneasiness about the winter supply situation.

In December, President Clinton directed the Department of Health and Human Services (HHS) to release additional Low Income Home Energy

Assistance Program (LIHEAP) emergency funds for fiscal years (FYs) 2000 and 2001. This money helps states to assist low-income households facing continuing and substantial increases in home heating fuel prices.

Federal Actions

In FY 2000, HHS released a record amount of LIHEAP emergency funds. States received \$900 million in emergency funds in addition to \$1.1 billion for their block grant allotments. Of the \$900 million in emergency funds, \$300 million was contained in the FY 2000 appropriation bill and \$600 million was included in the FY 2000 emergency supplemental bill. Congress specified that the emergency funds included in the supplemental bill could be awarded in FY 2001 or later if they were not all expended in FY 2000. The president directed HHS to release the remaining FY 2000 funds on December 18, 2000.

For FY 2001, Congress appropriated \$1.4 billion for the block grant and \$300 million for emergency funds. HHS released all of the emergency FY 2001 funds on December 30, 2000. The president could request additional emergency funds in an emergency supplemental appropriation for FY 2001. The table shows state allotments for LIHEAP in FYs 2000 and 2001.

LIHEAP Block Grant Allotments and Emergency Funds

(Dollars in Thousands)

State	FY 2000	FY 2001	State	FY 2000	FY 2001
Alabama	\$21,385	\$14,202	Nebraska	\$16,126	\$15,554
Alaska	18,705	8,833	Nevada	3,161	3,165
Arizona	6,702	6,662	New Hampshire	22,086	13,295
Arkansas	12,134	10,860	New Jersey	90,756	66,051
California	81,402	76,913	New Mexico	8,916	8,614
Colorado	27,733	26,976	New York	286,034	215,438
Connecticut	46,593	35,329	North Carolina	38,195	30,864
Delaware	6,950	4,661	North Dakota	13,691	12,775
DC	5,674	5,433	Ohio	88,792	86,294
Florida	22,005	21,408	Oklahoma	13,441	13,020
Georgia	24,169	17,871	Oregon	19,271	19,695
Hawaii	1,581	1,663	Pennsylvania	145,947	115,063
Idaho	9,917	10,015	Rhode Island	17,580	11,711
Illinois	101,467	98,139	South Carolina	14,773	11,164
Indiana	45,245	44,057	South Dakota	11,659	10,472
Iowa	32,912	31,415	Tennessee	22,686	22,150
Kansas	14,951	14,459	Texas	52,205	37,327
Kentucky	22,936	22,314	Utah	12,972	12,541
Louisiana	18,944	14,515	Vermont	13,456	9,904
Maine	39,720	22,488	Virginia	38,094	31,872
Maryland	32,190	26,788	Washington	31,320	32,099
Massachusetts	95,893	70,578	West Virginia	15,029	14,859
Michigan	97,126	93,544	Wisconsin	62,756	60,132
Minnesota	70,049	66,640	Wyoming	5,115	4,996
Mississippi	16,373	12,214	Other	31,095	32,465
Missouri	39,948	38,680	TOTAL	2,000,000	1,700,000
Montana	12,140	11,825			

Source: Administration for Children and Families, Department of Health and Human Services

State Actions

In response to the additional federal funds that have been released, many states have adopted both higher income eligibility limits in their LIHEAP programs and higher benefit levels based on a greater need for assistance this winter. Eighteen states have increased their income eligibility limits: **Alaska, Arkansas, Colorado, Connecticut, Georgia, Illinois, Indiana, Kansas, Massachusetts, Maine, Nebraska, North Dakota, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island and South Carolina.** Thirty-one states have increased or plan to increase their benefit levels. Furthermore, states are experiencing enrollment increases, even without program changes.

Eligibility Under the LIHEAP program, states may set the maximum income level for eligibility at 150% of the federal poverty guidelines (FPG) or 60% of the state's median income (SMI), whichever is higher. The following table shows each state's FY 2000 and FY 2001 eligibility standard for the "heat" component of the program. Other LIHEAP components include "crisis," "cooling" and "weatherization." Although states can have a different poverty level for each component, the majority of states use the same poverty level for all components.

State Poverty Guidelines for LIHEAP

State	FY 2000	FY 2001	State	FY 2000	FY 2001
Alabama	125 FPG	125 FPG	Montana	125 FPG	125 FPG
Alaska	140 FPG	150 FPG	Nebraska	130 FPG	116 FPG
Arizona	125 FPG	125 FPG	Nevada	150 FPG	150 FPG
Arkansas	110 FPG	125 FPG	New Hampshire	45 SMI	60 SMI
California	60 SMI	60 SMI	New Jersey	150 FPG	175 FPG
Colorado	150 FPG	185 FPG	New Mexico	150 FPG	150 FPG
Connecticut	150 FPG	60 SMI	New York	150 FPG	60 SMI
Delaware	150 FPG	150 FPG	North Carolina	110 FPG	110 FPG
District of Columbia	150 FPG	150 FPG	North Dakota	150 FPG	60 SMI
Florida	125 FPG	125 FPG	Ohio	150 FPG	150 FPG
Georgia	115 FPG	150 FPG	Oklahoma	110 FPG	110 FPG
Hawaii	150 FPG	150 FPG	Oregon	60 SMI	60 SMI
Idaho	133 FPG	133 FPG	Pennsylvania	110 FPG	150 FPG
Illinois	125 FPG	150 FPG	Rhode Island	175 FPG	60 SMI
Indiana	125 FPG	150 FPG	South Carolina	125 FPG	150 FPG
Iowa	150 FPG	150 FPG	South Dakota	140 FPG	140 FPG
Kansas	130 FPG	150 FPG	Tennessee	125 FPG	125 FPG
Kentucky	110 FPG	110 FPG	Texas	125 FPG	125 FPG
Louisiana	150 FPG	150 FPG	Utah	125 FPG	125 FPG
Maine	125 FPG	170 FPG	Vermont	125 FPG	125 FPG
Maryland	150 FPG	150 FPG	Virginia	130 FPG	130 FPG
Massachusetts	175 FPG	200 FPG	Washington	125 FPG	125 FPG
Michigan	110 FPG	110 FPG	West Virginia	110 FPG	110 FPG
Minnesota	50 SMI	50 SMI	Wisconsin	150 FPG, 60 SMI	150 FPG, 60 SMI
Mississippi	125 FPG	125 FPG	Wyoming	150 FPG	150 FPG
Missouri	125 FPG	125 FPG			

Source: LIHEAP Clearinghouse based on state plans and interviews with state directors

Massachusetts increased its income eligibility level from 175% of FPG to 200% after the first round of FY 2000 emergency funds were released during February and March 2000. State legislative action during the spring authorized continuation of the 200% eligibility level, which is close to 60% of the state's median income.

Connecticut, North Dakota, New Hampshire, New York and Rhode Island increased their income eligibility limits to 60% of SMI. **Colorado** increased its income eligibility limit to 185% of FPG, **Maine** to 170% of FPG and **New Jersey** to 175% of FPG.

Illinois increased income levels from 125% to 150% of FPG. **Pennsylvania** increased its income eligibility for the second time in FY 2001, from 135% of FPG to 150% of FPG. Legislation also has been introduced in Pennsylvania to permanently expand the eligibility requirements and to set aside \$17.5 million in state funds for the program.

Benefit Levels Most states have increased or plan to increase LIHEAP benefits. **Iowa** will increase its benefits by 50%, **Illinois** by 30%, **Indiana** by 10%, **Pennsylvania** by 30% and **Wisconsin** by 18%. **Nebraska** will increase its benefits by 10% for all fuel types and make a supplemental payment to all households if funds are left over.

The next table shows the most recent information available on LIHEAP heating benefit levels. The overall consideration for states in establishing benefit levels is the annual LIHEAP allocation. Beyond that, states establish benefits based on a variety of criteria tailored to the needs and characteristics of their low-income populations.

Program Duration In addition to changes in benefit levels and eligibility limits, some states have implemented longer program operation and expanded outreach efforts. **Connecticut** extended its energy assistance application deadline by one month and increased funding for a statewide outreach campaign. **Iowa** also extended its program by six weeks and **Maine** opened its program a few weeks earlier in order to issue benefits sooner. **Pennsylvania's** governor extended the deadline by three months to April 30, 2001.

LIHEAP Heating Assistance Benefit Levels

State	Fiscal Year	Minimum	Maximum	Mean
Alabama	2001		\$190	\$138
Alaska	2001	\$134	2,345	
Arizona	2001	50	300	150
Arkansas	2001	36	251	87
California	2000	119	351	217
Colorado	2001	100	700	
Connecticut	2001	180	515	
Delaware	2000	100	400	205
District of Columbia	2001		600	250
Florida	2001	37	140	90
Georgia	2000	65	194	
Hawaii	2000			100
Idaho	2000	72	575	
Illinois	2001			397
Indiana	2001	100	300	275
Iowa	2001			306
Kansas	2000			287
Kentucky	2001			92
Louisiana	2001	50	190	139
Maine	2001		525	350
Maryland	2000	170	550	262
Massachusetts	2000			440
Michigan	2001	1	881	
Minnesota	2001	100	1,200	475
Mississippi	2001	180	559	
Missouri	2000	122	257	185
Montana	2001	80	1,454	373
Nebraska	2001		561	200
Nevada	2001	90	540	233
New Hampshire	2001	240	1,200	630
New Jersey	2001			
New Mexico	2001		300	
New York	2001	150	400	
North Carolina	1999	10	200	40
North Dakota	2001			329
Ohio	2000	42	242	128
Oklahoma	2001	42	226	110
Oregon	2001			285
Pennsylvania	2001			284
Rhode Island	2001	300	1,200	
South Carolina	2001	100	300	
South Dakota	2001	165	690	440
Tennessee	2000	100	250	200
Texas	2001		1,000	
Utah	2001		375	210
Vermont	2001	10	670	450
Virginia	2001			246
Washington	2000	25	700	301
West Virginia	2001		400	73
Wisconsin	2001		750	351
Wyoming	2001	45	622	

Source: LIHEAP Clearinghouse based on state plans and interviews with state directors

The following table shows each state's heating program duration planned for FY 2001. Generally, states take and process LIHEAP applications during the time periods listed on the table, although the actual application period can vary depending on the amount of funding available.

Nine states (**Arizona, Arkansas, California, Florida, Louisiana, Mississippi, New Mexico, South Dakota** and **Texas**) and the **District of Columbia** operate LIHEAP year-round. Nineteen states and the District of Columbia have early application periods for the elderly or disabled: **Alabama, Alaska, Arkansas, Colorado, Georgia, Idaho, Iowa, Maine, Maryland, Massachusetts, Montana, New Hampshire, North Carolina, South Carolina, South Dakota, Utah, Virginia, West Virginia** and **Wisconsin**.

LIHEAP Program Duration for Heating

<u>State</u>	<u>Duration</u>	<u>State</u>	<u>Duration</u>
Alabama	seasonal	Montana	10/01 - 3/30
Alaska	11/01 - 4/30	Nebraska	10/01 - 3/31
Arizona	year round	Nevada	9/01 - 4/30
Arkansas	year round	New Hampshire	11/29 - 4/30
California	year round	New Jersey	8/01 - 2/28
Colorado	11/01 - 4/30	New Mexico	year round
Connecticut	10/15 - 3/30	New York	11/13 - 3/31
Delaware	10/01 - 3/31	North Carolina	11/01 - 11/13
District of Columbia	year round	North Dakota	10/01 - 11/13
Florida	year round	Ohio	10/01 - 5/31
Georgia	11/01 - 1/31	Oklahoma	12/04 - 12/23
Idaho	12/01 - 5/30	Oregon	10/01 - 1/31
Illinois	9/01 - 4/30	Pennsylvania	11/06 - 4/30
Indiana	11/06 - 5/31	Rhode Island	9/15 - 4/30
Iowa	11/01 - 4/15	South Carolina	10/15 - 2/28
Kansas	1/15 - 3/31	South Dakota	year round
Kentucky	11/01 - 12/14	Tennessee	opens 8/02
Louisiana	year round	Texas	year round
Maine	8/01 - 3/31	Utah	11/01 - 3/31
Maryland	10/18 - 3/03	Vermont	7/15 - 2/28
Massachusetts	11/01 - 4/30	Virginia	2nd Tues. in Oct - 2nd Fri. in Nov.
Michigan	1/01 - 9/30	Washington	10/01 - 6/20
Minnesota	09/01 - 5/01	West Virginia	12/04 - funds exhausted
Mississippi	year round	Wisconsin	10/01 - 5/15
Missouri	11/01 - 3/31	Wyoming	10/01 - 2/28

Source: LIHEAP Clearinghouse based on state plans and interviews with state directors

New State Policy Directions

Even with the additional funds, some states are unable to serve their eligible populations. In December, the director of the **New Hampshire** Governor's Office of Energy and Community Services testified before the U.S. Senate Energy and Natural Resources Committee. She told Congress that New Hampshire, faced with the worst energy crisis in 20 years, projects an ability to serve fewer than 12% of the households eligible for LIHEAP. The average household in New Hampshire using heating oil will spend 67% more to heat its home this winter than it spent last winter.

States also are looking outside the LIHEAP program for help. In **Kansas**, legislation will be introduced to set aside up to \$5 million of the severance tax collected on gas and oil produced in Kansas to aid low-income utility users.

Iowa lawmakers currently are debating whether to reduce the 5% sales tax on home-heating bills. If the proposal is approved, the sales tax will not be applied to bills issued in February or March. One legislator proposed adding \$20 million to LIHEAP and expanding its eligibility requirements to include families with moderate incomes. He also recommended waiving late fees assessed on home heating bills.

Colorado's governor signed a \$10 million bill that had been fast-tracked through the legislature to help low-income individuals pay their heating bills. Funding comes from surplus revenues from taxes on oil and gas production. An additional 20,000 households might be served and the average LIHEAP benefit will double.

Ohio's governor has asked the state's gas utilities to create a fund of at least \$5 million to help low-income customers pay their bills. He also instructed the Public Utilities Commission of Ohio to expand a 60-day moratorium on utility disconnections for customers who can't pay their bills. The governor also created a new program to help low-income households ineligible for LIHEAP. In response to his request, Columbia Gas of Ohio announced the creation of a \$3.5 million emergency assistance fund. East Ohio Gas and Cincinnati Gas & Electric Co. agreed to provide the Salvation Army with \$1 million and \$500,000, respectively, for energy assistance to low-income families.

Welfare Reform Outcomes

In recent weeks, four studies have been released that look at various impacts of the federal welfare reform legislation enacted in 1996. These studies are unique because they provide a long-term assessment of welfare reform. Until recently, most studies provided preliminary results. These studies have implications both for federal policymakers, who are preparing for the 2002 reauthorization of the welfare reform law, and for state policymakers, who are deciding how to spend welfare surpluses.

Welfare Reform and Children

One study looks at how various welfare reform policies affect children. It finds that providing financial support to working parents helps children and raises their school achievement. A second study concludes that the willingness of employers to hire welfare recipients is closely tied to the tight labor market. Another study finds that a surprisingly high number of families leaving welfare in **Washington** state are returning to public assistance within a year. It also estimates the number of families at risk of reaching their five-year lifetime limit on benefits. The last study finds that those remaining off the rolls in **Oregon** aren't able to earn enough money to break the cycle of poverty.

The Manpower Demonstration Research Corporation (MDRC) recently released the first comprehensive look at how welfare reform policies affect children. It finds that providing financial support to working parents improves children's achievement in school.

The report looks at 11 different employment-based welfare and antipoverty programs in six states (**California, Florida, Georgia, Michigan, Minnesota** and **Wisconsin**). These programs began operating between 1991 and 1994, prior to the passage of the federal welfare reform law. Four of the programs offer generous earnings supplements designed to make work more financially rewarding. Six programs provide only mandatory employment services (such as education, training or immediate job search) in which parents who fail to comply are subject to sanctions in the form of reduced welfare grants. One program places time limits on families' eligibility for welfare benefits but combines them with mandatory employment services and a small earnings supplement.

The report's main findings:

- The programs that included an earnings supplement increased both parental employment and income and had positive effects on elementary school-aged children, such as higher school achievement, reduced behavior problems, increased positive social behavior and/or improved overall health.
- Adding mandatory employment services did not reduce the positive effects of earnings supplements on children.
- The programs with mandatory employment services boosted parental employment without increasing income and had few positive or negative effects on children.
- The program with time limits led to an increase in parental employment and a modest increase in income but produced few positive or negative effects on children.

The general conclusions are subject to several caveats. First, the effects of earnings supplements on children are modest when considered in the context of these children's high levels of disadvantage. Second, the positive effects were most pronounced for the children of long-term welfare recipients. Third, all of the conclusions are limited to preschool-aged and elementary school-aged children. The study found that some programs had negative effects on adolescents when single mothers went to work. Finally, the programs included do not represent the full range of supplements, participation mandates, and time limits currently in effect.

Welfare Reform and the Economy

The Public Policy Institute of California released a report on the results of a detailed survey conducted in 1998 and 1999 of more than 3,000 employers in four major metropolitan areas: Los Angeles, Chicago, Cleveland and Milwaukee. The survey focuses on employers' willingness to hire welfare recipients, the extent to which they have already done so and the nature of their experiences with these new employees.

The report concludes that overall demand for welfare workers is strong; however, hiring rates for welfare recipients are very sensitive to job vacancy rates. This suggests that employer demand for these workers will diminish significantly during an economic downturn.

Another key finding is that hiring is strongest at establishments that are easily accessible to welfare recipients. Overall, the study finds many positive employment results for welfare recipients. For all cities, the jobs pay an average of \$7 per hour and generally provide 40 hours of work per week. Employers are willing to contribute to health care coverage in two-thirds of the jobs. High turnover and weak job performance were problems in one-fourth to one-third of the cases in all four cities. Absenteeism was particularly pervasive and was often linked to child care and transportation issues.

Welfare Reform and Work

The Washington State Institute for Public Policy released the first long-term assessment of **Washington's** welfare program. The study addresses the following questions:

- How has Washington's welfare caseload changed over time? Has the length of time clients stay on welfare changed since 1997?
- What are the factors associated with long-term stays on welfare?
- How many families initially reach the five-year time limit?
- What are the characteristics and circumstances of clients at risk of reaching this time limit?

Welfare Reform and Poverty

The report finds that a surprisingly high number of families leaving welfare returned to the rolls within a year. One-third of the 3,045 welfare families followed had to reapply for benefits. The study estimates that almost 8,000 welfare recipients are at risk of reaching the five-year time limit on benefits between August 2002 and July 2003. These cases represent approximately 13% of the average monthly caseload from November 1999 through September 2000. The high-risk recipients are more likely to have less education and work experience, more children and a longer previous record of receiving welfare assistance.

A new University of Oregon study finds that welfare reform in **Oregon** is getting recipients off the rolls but is not breaking the cycle of poverty. The average take-home earnings of those employed were \$1,016 a month. A quarter of the families interviewed had no health insurance, 80% reported paying bills late, 40% depended on assistance from family or friends, 30% had eaten at a food kitchen or received a food box and 20% had skipped meals because of a lack of money.

Higher levels of education were associated both with higher rates of employment and lower rates of poverty. The most significant finding was that the small increases in earnings led to large decreases in benefits, such as health coverage, child care assistance and Food Stamps. In addition, 35% of people leaving Temporary Assistance for Needy Families (TANF) returned to TANF at some time. The report included the following recommendations:

1. Increase the eligibility limits for Food Stamps, the Oregon Health Plan and child care assistance.
2. Boost access to higher education and job training. Allow education to count as a work activity.
3. Change the policy that requires a parent of a child three months of age to seek and accept employment and instead allow the parent to care for the baby at home until the child is one year old.
4. Make the state Earned Income Tax Credit and the Child Care Tax Credit refundable.

News from the Tobacco Front

Reports readers may recall that in Volume 18, Issue 7, an article updating developments in the Master Settlement Agreement between states and the tobacco industry discussed the difficulty of securing any information about actual payments being made under the terms of the agreement. This continues to be the case, with anecdotal stories from various states surfacing occasionally but no comprehensive data being publicly released by any of the groups charged with overseeing the settlement.

As it was able to do last spring, *Reports* has secured a copy of a memo prepared by the independent auditor charged with calculating the payments that participating manufacturers must make to states under the terms of the settlement agreement. The memo, dated January 8, 2001, reports the initial payments that were due to states on or before January 10, 2001.

These amounts represent the third year of initial payments under the agreement. The initial payments last for five years, after which states will receive only the annual payment, in April of each year. The table lists the amounts of the initial payment in each year.

Initial Payments Under the Tobacco Agreement

Year	Amount
1998	\$2,400,000,000
1999	
2000	\$2,472,000,000
2001	\$2,546,160,000
2002	\$2,622,544,800
2003	\$2,701,221,144

Adjustments to Initial Payments

Under the terms of the settlement agreement, initial payments are subject to an annual volume reduction. This reduction essentially reduces (or enhances) payments based on the amount by which the volume of cigarettes shipped in a calendar year declined (or increased) relative to the volume shipped in the base year, 1997. For the year 2000, the volume adjustment is shown below. The succeeding table shows the impact on states.

The Volume Adjustment (\$ in thousands)	
Base Payment	\$2,546,160
Multiplier	0.98
Subtotal	\$2,495,237
Volume Reduction	0.1534596
Volume Adjustment	\$382,918
Adjusted Payment	\$2,163,242

Impact of the Volume Adjustment on January 2001 Initial Payments
(\$ in thousands)

Jurisdiction	State Share	Original Allocation	Adjusted Allocation	State Loss
Alabama	1.6161308%	\$41,149	\$34,961	\$6,188
Alaska	0.3414187%	8,693	7,386	1,307
American Samoa	0.0152170%	387	329	58
Arizona	1.4738845%	37,527	31,884	5,644
Arkansas	0.8280661%	21,084	17,913	3,171
California	12.7639554%	324,991	276,115	48,875
Colorado	1.3708614%	34,904	29,655	5,249
Connecticut	1.8565373%	47,270	40,161	7,109
Delaware	0.3954695%	10,069	8,555	1,514
District of Columbia	0.6071183%	15,458	13,133	2,325
Florida	0.0000000%	0	0	0
Georgia	2.4544575%	62,494	53,096	9,399
Guam	0.0219371%	559	475	84
Hawaii	0.6018650%	15,324	13,020	2,305
Idaho	0.3632632%	9,249	7,858	1,391
Illinois	4.6542472%	118,505	100,683	17,822
Indiana	2.0398033%	51,937	44,126	7,811
Iowa	0.8696670%	22,143	18,813	3,330
Kansas	0.8336712%	21,227	18,034	3,192
Kentucky	1.7611586%	44,842	38,098	6,744
Louisiana	2.2553531%	57,425	48,789	8,636
Maine	0.7693505%	19,589	16,643	2,946
Maryland	2.2604570%	57,555	48,899	8,656
Massachusetts	4.0389790%	102,839	87,373	15,466
Michigan	4.3519476%	110,808	94,143	16,664
Minnesota	0.0000000%	0	0	0
Mississippi	0.0000000%	0	0	0
Missouri	2.2746011%	57,915	49,205	8,710
Montana	0.4247591%	10,815	9,189	1,626
Nebraska	0.5949833%	15,149	12,871	2,278
Nevada	0.6099351%	15,530	13,194	2,336
New Hampshire	0.6659340%	16,956	14,406	2,550
New Jersey	3.8669963%	98,460	83,652	14,807
New Mexico	0.5963897%	15,185	12,901	2,284
New York	12.7620310%	324,942	276,074	48,868
North Carolina	2.3322850%	59,384	50,453	8,931
North Dakota	0.3660138%	9,319	7,918	1,402
Northern Marianas	0.0084376%	215	183	32
Ohio	5.0375098%	128,263	108,974	19,290
Oklahoma	1.0361370%	26,382	22,414	3,968
Oregon	1.1476582%	29,221	24,827	4,395
Pennsylvania	5.7468588%	146,324	124,318	22,006
Puerto Rico	1.1212774%	28,550	24,256	4,294
Rhode Island	0.7189054%	18,304	15,552	2,753
South Carolina	1.1763519%	29,952	25,447	4,504
South Dakota	0.3489458%	8,885	7,549	1,336
Tennessee	2.4408945%	62,149	52,802	9,347
Texas	0.0000000%	0	0	0
Utah	0.4448869%	11,328	9,624	1,704
Vermont	0.4111851%	10,469	8,895	1,575
Virginia	2.0447451%	52,062	44,233	7,830
Virgin Islands	0.0173593%	442	376	66
Washington	2.0532582%	52,279	44,417	7,862
West Virginia	0.8864604%	22,571	19,176	3,394
Wisconsin	2.0720390%	52,757	44,823	7,934
Wyoming	0.2483449%	6,323	5,372	951
TOTAL	100.0000000%	\$2,546,160	\$2,163,242	\$382,918

As the tables show, the decline in the volume of cigarettes shipped between the base year and 2000 was about 15.3%. This is noteworthy because the volume adjustment for 1999 was 14%. Both adjustments were calculated relative to the same base year (1997), meaning there was a relatively small reduction in the volume of cigarettes shipped between 1999 and 2000. The small reduction in the last year stands in marked contrast to the large reduction between 1997 and 1999, when several price increases were implemented, in part to finance the settlement payments.

The tables also show that, as a result of the volume adjustment, states will collect \$383 million less in initial payments than were specified in the original agreement. The initial payments are not subject to an inflation adjustment, in contrast to the annual payments, which are made in April of each year.

The numbers shown here for each state vary from actual payments that will flow to the states. Each of the participating manufacturers has made over- or under-payments in prior periods. These amounts and any interest relating to them may be added or subtracted to the amounts listed on the table.

That Was Then, This Is Now

The evidence continues to seem contradictory. On the one hand are headlines such as, “Fiscal 2000 Tax Revenue Growth: Strongest of the Last Decade,” as reported by the Fiscal Studies Program at The Nelson A. Rockefeller Institute of Government. On the other hand are headlines such as, “More States Complaining of Economic Pinch,” as reported by Stateline.org. So, which is it?

Both, probably. State revenue collections and measures of the national economic growth both suggest that the national economy experienced a marked slowdown in the fourth quarter of 2000. This means that states may have had an excellent fiscal year 2000 (which ended for 46 states in June) but may now be having an equally bad fiscal year 2001.

Reports has begun to collect newspaper articles that cover state fiscal condition and finds that more than two dozen states are now reporting shortfalls—or potential shortfalls—in their current state budgets. On the other hand, more than a dozen states still are enjoying strong state economies and budgets. The chart on the next page summarizes the information that has been gathered to date.

Regional Trends The chart shows some correlation between where a state is located and how it is doing. States in the industrial Midwest—**Michigan, Ohio, Indiana, Illinois** and **Wisconsin**—all appear among those that are struggling with shortfalls.

Press Coverage of State Fiscal Condition

State	Continued Strength	Slowdown	Notes
Alabama		X	Shortfall in education trust fund
Alaska			
Arizona	X		
Arkansas			
California	X		1/4-cent sales tax cut
Colorado	X		State may bump into spending cap
Connecticut		X	Governor warned cuts may be needed
Delaware		X	Medicaid deficit
Florida			
Georgia			
Hawaii	X		
Idaho	X		\$280 million accumulated surplus
Illinois		X	Revenue weakness
Indiana		X	Revenue weakness
Iowa		X	Revenue weakness
Kansas		X	Revenue weakness
Kentucky		X	Revenue weakness; Medicaid
Louisiana		X	Medicaid (prescriptions); recent revenue improvement
Maine		X	FY 02-03 shortfall estimated at \$250-300 million
Maryland			
Massachusetts		X	Revenue weakness (October-December)
Michigan		X	Revenue weakness
Minnesota	X		\$3 billion surplus by 2003
Mississippi		X	\$50 million budget cut in 11/00
Missouri		X	Revenue weakness
Montana	X		Growing surplus
Nebraska			
Nevada	X		Spending pressures from rapid population growth
New Hampshire			
New Jersey	X		
New Mexico	X		Anticipate a \$300-500 million surplus in FY 01
New York	X		
North Carolina		X	Revenue weakness; Medicaid
North Dakota		X	Tax collections down 3.3% from last year
Ohio		X	Revenue weakness; Medicaid
Oklahoma			
Oregon		X	Impact of voter-approved tax cut
Pennsylvania			
Rhode Island			
South Carolina		X	\$500 million deficit estimated for FY 02
South Dakota	X		Concern that slowdown may be imminent
Tennessee		X	Shortfall estimated at \$129 million or more
Texas	X		State may bump into spending cap
Utah	X		State may bump into spending cap
Vermont		X	Medicaid growth
Virginia		X	Slowdown but commitment to cut car tax
Washington		X	Governor proposed cuts to prepare for slowdown
West Virginia		X	Revenue weakness
Wisconsin		X	Revenue weakness
Wyoming			
TOTAL	14	25	

Several states from the Rocky Mountains and West—**California, Colorado, Utah, Idaho, New Mexico** and **Montana**—report continuing strength in their fiscal positions. But there are exceptions to these generalizations. **Minnesota** remains in very strong fiscal position while **Oregon** expects to face a budget shortfall and **Washington** is wary of one.

The Sales Tax as the Culprit?

One trend that many observers have noted is that state sales tax collections are a particular source of weakness for several states. On February 8, 2001, *The New York Times* reported, “Circumstances differ in each state, but for the most part the reductions are caused by lower-than-expected sales tax revenue in December and January, reflecting reduced holiday spending by consumers.” Conventional wisdom holds that states with sales taxes are feeling the effects of a slowdown in consumer spending, while states more reliant on income taxes still are doing well.

To be sure, several of the states with revenue shortfalls point to low sales tax collections as a main reason they are missing their revenue estimates. Among the states with potential shortfalls is **Tennessee**, which relies heavily on sales taxes. But several “sales tax-reliant” states are doing well. These include **Nevada, New Mexico, South Dakota** (although the governor has expressed some doubt as to how long South Dakota will continue to escape a downturn) and **Texas**.

Conversely, a few of the states that lack a sales tax completely (and therefore rely heavily on income taxes) are having difficulty. These include **Delaware** and **Oregon**, both of which have no sales tax. Oregon’s difficulties stem not so much from slow revenue growth as from a voter-approved tax cut and Delaware’s problems rest more on the spending side of the ledger than on the revenue side.

Medicaid as the Culprit?

Part of the reason for the inconsistencies noted above is that tax collections aren’t the only problem. To be sure, many states are seeing problems in their sales tax collections. But many of the same states—and many states where revenues remain reasonably strong—also are struggling to meet increased spending demands in their Medicaid programs.

Delaware, Louisiana, Kentucky, Ohio, North Carolina and **Vermont** are among the states that have identified Medicaid spending as a problem in their state budgets. This doesn’t mean Medicaid isn’t a problem in other states. It may just be that attention is more focused on revenue shortfalls in some cases or that revenue growth is sufficient to cover increased Medicaid spending in other cases.

The Medicaid “problem” is a familiar one that states are not anxious to revisit. In the early 1990s, increased Medicaid spending, combined with slow revenue growth, threw many states into budget turmoil.

At the time, the national economy was weak and Medicaid spending began to increase by 10% or more annually. The recession of the early 1990s lasted for only three quarters but state fiscal conditions suffered for about three years. Even though the national economy was growing (albeit slowly), the pressure on state budgets from Medicaid increases diverted funds from other programs and contributed to widespread tax increases. Clearly, states do not relish the thought of returning to this set of circumstances.

But What A Year 2000 Was!

One thing that may help states weather this storm a little bit better than they weathered the last one is their strong fiscal position going into the current slowdown. The National Association of State Budget Officers (NASBO) reports that states held balances (surpluses plus rainy day funds) equal to 4.8% of state general fund spending in fiscal year 1989, the year before fiscal conditions started to deteriorate.

In contrast, state balances at the end of fiscal year 2000 were estimated to be 8.3% of general fund spending. For the current year, NASBO estimates year-end balances will be 6.2% of expenditures. Even if this turns out to be a generous estimate—as now appears possible—most states should hold sufficient reserves to cover both Medicaid costs and revenue shortfalls in the current year.

States' strong fiscal position owes in no small part to stellar revenue collections during fiscal year 2000. The Rockefeller report referenced at the beginning of this article finds that state tax collections increased 8.7% between fiscal years 1999 and 2000. If states hadn't cut taxes the growth would have been an even higher 9.4%. This is the highest rate of annual revenue growth the Institute has recorded since it began tracking state revenue collections in the early 1990s.

The following table shows each state's revenue performance. The fact that the U.S. average falls as high as it does on the table can be explained in one word: **California**. When a state as large as California registers revenue growth of 20.5%, it has a major impact on the national average.

The impact that California has on national totals masks the unremarkable performance that many states experienced. Twenty states registered year-over-year revenue growth of less than 5%, which is fairly low by recent standards. Some of the slowdown resulted from legislated tax cuts but some of it certainly was a precursor to current revenue woes.

Regional trends are evident but not compelling. Among the states with the strongest growth, only **Virginia** represents the South. Five states from the West appear among the above-average states, four from the East and three from the Midwest. Surprisingly, the three top-ranking states lack a broad-based personal income tax.

Percent Change in State Tax Revenue, Fiscal Year 1999 to 2000

Rank	State	Percent	Rank	State	Percent
1	Alaska	45.7%	25	Texas	6.6%
2	New Hampshire	23.2	27	Vermont	6.4
3	Wyoming	23.0	28	Maine	6.1
4	California	20.5	28	Nevada	6.1
5	Minnesota	13.2	30	Kansas	6.0
5	Nebraska	13.2	31	South Dakota	5.7
7	Oregon	12.3	32	Florida	5.3
8	Virginia	11.2	33	Pennsylvania	5.2
9	Maryland	9.9	34	Kentucky	5.0
10	Massachusetts	9.7	35	Iowa	4.8
11	Idaho	9.5	36	Mississippi	4.3
12	New Jersey	9.4	37	Arkansas	4.2
12	Wisconsin	9.4	38	Hawaii	4.1
	U.S. Average	8.7	38	Oklahoma	4.1
14	Colorado	8.6	40	North Dakota	3.8
15	Georgia	8.3	41	Indiana	3.6
16	Rhode Island	8.2	41	North Carolina	3.6
17	Arizona	8.0	43	Louisiana	3.4
17	Tennessee	8.0	44	Washington	3.3
19	Utah	7.9	45	Michigan	3.2
20	New York	7.8	45	Missouri	3.2
21	Illinois	7.3	47	Montana	3.0
21	Ohio	7.3	48	South Carolina	2.8
23	New Mexico	6.8	49	West Virginia	1.2
24	Connecticut	6.7	50	Delaware	1.1
25	Alabama	6.6			

There also is some correlation between the states that did well in fiscal year 2000 and the states that are doing well now. Among the states with above-average tax collections in 2000, most are currently reporting stable revenue collections. Exceptions include **Virginia**, **Massachusetts** and **Wisconsin**, each of which has seen some weakness in its tax collections.

Many of the states currently reporting strong fiscal condition are among the top-ranking states on the table. **California**, **Minnesota** and **Idaho** have all received press coverage for their consideration of major tax cuts or major new spending initiatives during their current legislative sessions.

States listed at the bottom the table represent more states that are reporting potential shortfalls than states that are reporting fiscal health. Many of these bottom-ranking states appear among those with weak revenues. **Montana** is a notable exception; its budget surplus continues to grow in spite of modest revenue growth in the last fiscal year.

It is difficult to make generalizations about the relationship between how state revenues fared in fiscal year 2000 and how a state is doing in fiscal year 2001. What does seem certain is that exceptional revenue growth last year will help states deal with whatever is dealt them this year in terms of economic slowdowns and Medicaid costs. The real uncertainty lies in knowing whether the downturn will be short-lived and whether states hold enough in reserves to get through it without major tax increases or budget cuts.

Technical Notes

Federal Tax Cuts and States. The analysis by The Center on Budget & Policy Priorities on the impact on states of repealing the federal death tax is available via the Center's web site (www.cbpp.org).

LIHEAP. Information on energy prices is from the Department of Energy's *Short-Term Energy Outlook* (January 2001) (www.eia.doe.gov). Most of the information on state actions came from state LIHEAP plans, a survey of LIHEAP directors by HHS in late 2000 or www.stateline.org. Additional information on LIHEAP can be found on the LIHEAP Clearinghouse website at <http://www.ncat.org/liheap/>.

Welfare. MDRC's report, *How Welfare and Work Policies Affect Children: A Synthesis of Research*, is available at www.mdrc.org. The Public Policy Institute of California's report, *Employers and Welfare Recipients: The Effects of Welfare Reform in the Workplace*, can be found at www.ppic.org. The University of Oregon's report, *Oregon Families Who Left TANF or Food Stamps: A Study of Economic and Family Well-Being 1998 to 2000*, is available online at www.csws.uoregon.edu. The report from Washington State Institute for Public Policy, *Welfare Caseload Trends in Washington State, 1997-2000: Analysis of Long-Term Welfare Use and the Approaching Time Limits*, can be found at www.wa.gov/wsipp/main.html.

Fiscal Conditions. The Rockefeller Institute report can be found at www.rockinst.org.

State Policy Reports (ISSN #8750-6637) is published twice a month by Federal Funds Information for States (FFIS) at an annual subscription rate of \$445, \$405 without *State Fact Finder*. Editor: Marcia Howard, 444 N. Capitol Street, NW, Suite 642, Washington, DC 20001 (Phone: 202/624-5848, Fax: 202/624-7745, E-mail: mhoward@sso.org, Website: <http://www.ffis.org>). For ordering and subscription services contact the National Conference of State Legislatures (NCSL), Book Order Department, 1560 Broadway, Suite 700, Denver, CO 80202 (Phone: 303/830-2054, E-mail: books@ncsl.org).

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