

Solving Maine's Pandemic Revenue Crisis

How state policymakers can avoid painful cuts
and kick-start Maine's economic recovery

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Executive Summary



The Takeaway:

- Maine faces an \$883 million revenue shortfall because of the ongoing pandemic recession, in which tens of thousands of Mainers are unemployed and economic hardship is on the rise.
- Experience shows budget cuts will only pump the brakes on Maine's recovery, harming families and making the recession worse.
- A better solution exists: Policymakers can fuel a strong, swift recovery by raising the revenue necessary to keep money flowing to families, communities, and Maine's economy.

Because of the ongoing COVID-19 pandemic recession, Maine's next Legislature will face a dangerous revenue crisis. The choices legislators make in response will determine the speed and breadth of Maine's economic recovery.

The Legislature will stand at a crossroads, with two paths available:

Down one path, policymakers can attempt to resolve the \$883 million revenue shortfall with spending cuts and austerity that lead to more layoffs and a longer, more painful recession.

Down the other path, they can raise the revenue necessary to protect economy-boosting jobs and maintain public investments when they are needed most — keeping resources flowing to workers, families, schools, and communities and hastening Maine's recovery.

In this paper, the Maine Center for Economic Policy examines the effect of austerity during the Great Recession, when the state balanced budgets by cutting health care, education, funding for local infrastructure and services, and the safety net. The result was extreme child poverty, declining health coverage, and Maine experiencing one of the slowest economic recoveries in the nation, with the fourth-slowest job recovery between 2009 and 2015.

Maine's painful experience was mirrored by other states that pursued austerity in the fallout from the Great Recession. Meanwhile, states that chose to maintain public investments and protect public-sector jobs during the Great Recession outperformed states that did not.

Like most states, income and wealth inequality is on the rise in Maine. By 2015, Maine households in the top 1 percent had income 15 times larger than a household in the bottom 99 percent, on average.

During the pandemic recession, that inequality has revealed a stark truth about the underlying structure of our economy: Those with the most resources have been less likely to fall ill, less likely to lose work, and more likely to see their net worth increase even as low- and moderate-income families suffer the consequences of unparalleled job loss and a looming eviction cliff.

By avoiding the pitfalls of austerity-based budgeting, Maine can fund a strong, shared recovery that leaves no Mainer behind.

The evidence shows that Maine cannot cut its way to a strong recovery. But by raising revenue by increasing taxes on those with the most ability to pay and least likelihood to be suffering during this crisis, Maine can close its shortfall and use that money to maintain spending that supports jobs, families, communities, and our economy.

The stakes have never been as high as they are in the wake of COVID-19 and this unprecedented economic contraction. Decisions by Maine's policymakers will have real-world consequences on our state's near- and long-term future.

By learning from its own experience with the Great Recession, and evidence from other states that chose a better path, Maine can use smart tax policy to secure the revenue necessary to fund a strong, shared recovery that leaves no Mainer behind.

Budget cuts will stall Maine's recovery



The Takeaway:

- Public-sector jobs and spending slow the pace of job losses during a recession, and make for a speedier recovery.
- Every dollar of state spending cut during a recession takes \$1.41 out of the economy, with most of the loss occurring in the private sector.
- State spending prevents runaway inequality that can be worsened during a recession.
- Cuts would harm families who are already hurting from the pandemic recession.

In the face of the ongoing pandemic recession, Maine's lawmakers will face an \$883 million revenue shortfall in the next budget cycle.¹

Widespread unemployment and a reduction in economic activity caused by the public health crisis have effectively erased one-tenth of the state's revenue.

In the past, policymakers have responded to recessions with spending cuts, which reduced the state's ability to meet increased need for services, and tax cuts that made the revenue crisis worse. The austerity approach exacerbated economic harm to families and communities, delaying recovery and making inequality worse. It also led to a chronic underfunding of public education and state aid to municipalities, leaving schools and communities further behind.

State spending spurs economic activity and sets future generations up for success. By avoiding the pitfall of harmful budget cuts, policymakers can ensure the state is putting fuel in the tank to power the recovery for Maine families, communities, and businesses.

State investments support jobs and economic growth

State spending is a significant share of Maine's economy. The roughly \$4.3 billion in General Fund and Highway Fund expenditures makes up more than 6 percent of the state's economy.²

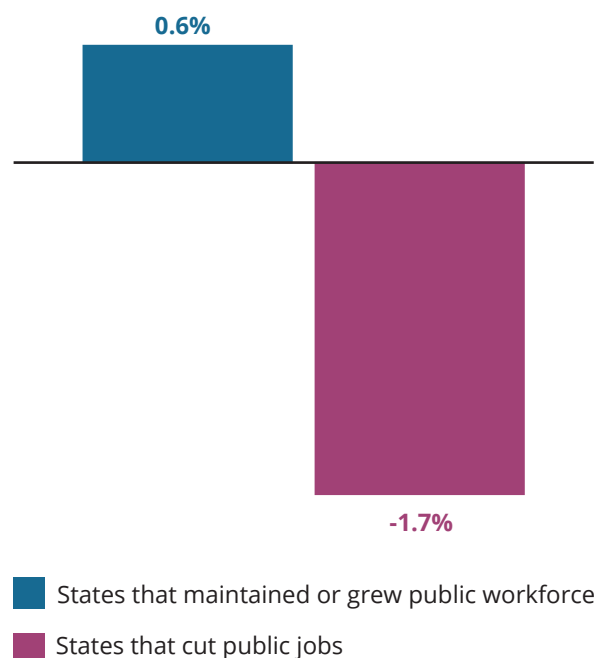
In addition to direct spending on jobs and purchases, state investments sustain private-sector jobs. State spending on goods and services and the income from state employees all help to bolster businesses throughout the state. Altogether, more than half of the economic benefit from state spending happens in the private sector.³

Public revenues support schools in every community in the state. They pay for roads and their upkeep, affordable health care for families — including children and seniors — and other essential infrastructure such as broadband and systems to maintain clean air and water. State spending also draws down billions of dollars in federal funding that support communities and Maine's economy.

Experience across the country shows that public spending on jobs and purchases slow the pace of job

losses during a recession and make for a speedier recovery: States that maintained or added state and local jobs after the Great Recession saw smaller jumps in unemployment rates and faster recoveries of jobs in both the overall workforce and the private-sector workforce. Between 2008 and 2013, states that maintained or grew their public workforce had fully recovered all jobs lost in the recession, whereas states that cut their public workforce still hadn't recovered their pre-recession jobs by 2013.⁴

Chart 1: States that kept their public workforce saw job growth during Great Recession



Change in total jobs, 2008-2013.

Source: Economic Policy Institute. May 27, 2020.

States that maintained or grew their workforces continued to outperform states that cut public-sector jobs during the recovery period of 2009 through 2015.⁵

Maine, unfortunately, was one of the states that cut public jobs after the Great Recession. The state cut one in twenty state and local jobs over this time and private-sector job growth seriously suffered. Maine's private-sector job growth was fourth worst in the country, growing only 4.4 percent over this period, less than half the 9.2 percent average growth rate of states nationwide.⁶

Spending can pump the brakes on inequality during a recession

Recessions often accelerate inequality along lines of race, gender, and class. Groups who face historic and systemic barriers to opportunity and prosperity tend to fall further behind, while those with longstanding access to wealth can leverage their resources to pull even further ahead.

Maintaining state investments during a recession can prevent this feedback loop of spiraling inequality. An analysis of state spending and income since 1987, spanning three recessions, found that “income inequality increases when states respond to economic crisis by relying on unexpected spending cuts.” The analysis finds that these inequalities persist through subsequent economic recoveries.⁷

Health and human services and public education are the state’s largest expenses, comprising 70 percent of general fund spending in 2019.⁸ These investments support the economy at large by providing the foundations for a healthy and well-educated workforce. While these investments benefit all Mainers, they have the highest impact on poor, minority, and female-headed households, all of which see larger-than-average gains in employment and health outcomes.⁹

- An analysis of state spending on social support programs found positive associations with health outcomes such as life expectancy and infant mortality rates.¹⁰
- A 2019 exhaustive review of several decades of rigorous academic research on K-12 schools finds definitively and quite simply that student achievement increases with higher spending per student. These outcomes of investments are particularly pronounced for students from low-income families and students of color.¹¹

When families with low incomes don’t have the resources to cover the basics and lack access to quality education that can help them get ahead, economic growth is held back.¹² Low- and moderate-income families are most likely to spend additional resources quickly, keeping money flowing through communities and powering the economy. As such, policies that get resources to those families combat inequality and fuel growth.

Austerity brings a big cost to Maine families, communities

Maine lawmakers made deep budget cuts in response to the Great Recession. In the aftermath of these cuts, Maine low-income families became poorer, health insurance rates fell, and Maine had one of the slowest recoveries in the nation. While those cuts were a response to revenue shortfalls, those shortfalls were made worse by expensive, lopsided tax cuts enacted under former Gov. Paul LePage.

Few areas of the budget were spared, but the most consequential cuts were those to health care, education, public employees, and state aid to municipalities.

Maine cut spending on health care and social support programs by making it harder for Mainers with low incomes to qualify for assistance. As a result, new caseloads dropped dramatically in Temporary Assistance for Needy Families (TANF), Medicaid, and food assistance between 2010 and 2015.¹³ For example:

- In 2012, a five-year lifetime limit on benefits was placed on TANF recipients. As a result, the share of families in poverty with children receiving benefits through TANF declined by 40 percent in 2013-2014 compared with 2005-2006. The share continued to decline through 2017-2018, when just one-fifth of families in poverty with children received benefits.¹⁴
- LePage successfully stripped Medicaid from 50,000 adults during 2013 and 2014. He also refused to expand access to Medicaid through the Affordable Care Act, despite approval for expansion from the Legislature and voters. His obstruction prevented 70,000 Mainers with low incomes from gaining access to health care.
- The LePage administration reinstated three-month limits for Supplemental Nutrition Assistance Program (SNAP) benefits to childless adults starting in 2015, and worst-in-the-country processing delays for applications and recertifications made families lose benefits.¹⁵

These barriers to health and economic security programs preceded stark increases in extreme child poverty and hunger and declining health insurance rates for Mainers, all of which make it harder for families to get ahead.¹⁶

State policymakers also turned to hiring freezes, furloughs, and job cuts to balance state budgets. Former Governors John Baldacci and Paul LePage both took a bite out of the state workforce in response to the Great Recession: In 2010, Baldacci instituted a hiring freeze and forced 7,000 state workers to take unpaid “shutdown days,” a move that cost families \$10 million.¹⁷ LePage in 2016 boasted that he had eliminated 467 jobs during his time in office.¹⁸ These pay cuts, furloughs, and job losses slowed Maine’s recovery.

Maine also balanced budgets after the Great Recession by shortchanging state funding requirements for education and local services. The state had never met its obligation to fund 55 percent of the essential programs and services at public schools, but nevertheless cut education funding between 2008 and 2015.¹⁹ Starting in 2009, lawmakers also slashed the Municipal Revenue Sharing program, which is supposed to send 5 percent of income and sales tax revenue to municipalities, with

communities receiving just 2 percent even as late as 2019. Underfunding has cost municipalities hundreds of millions of dollars over the last decade.

Proponents of austerity claimed it would support Maine’s economic comeback from the Great Recession. But despite all the belt-tightening and tax cuts, Maine’s recovery lagged far behind the nation. It took nine years to return to the pre-recession GDP.²⁰

Between 2006 and 2013, GDP outside the Portland region fell for seven consecutive years, representing a severe economic depression for rural Maine. Maine’s employment recovery was one of the slowest in the nation. After a decade, Maine’s total employment numbers were only 2 percent higher than they were at the start of recession. But even that growth was not all it seemed; As total jobs recovered, most of the middle-wage jobs lost in the recession were replaced with low-wage jobs.²¹

The Kansas Experiment reveals the cost of austerity

Proponents of tax cuts claim they promote economic growth, but that growth failed to materialize in states that cut taxes after the Great Recession.

A large body of economic research makes clear that a majority of economists agree tax cuts do little to boost economies.²² Of the five states that cut taxes in the wake of the Great Recession, four trailed the US in job growth. Tax-cutting states in the two prior recessions also trailed the US in job growth.

The biggest economic effect of tax cuts is the damage from the budget cuts used to pay for them. Kansas provides cautionary tales of the dangers tax and budget cutting policies can exact on a state’s economy.

In 2012 and 2013, Kansas slashed its top income tax rate and made large portions of business income tax-exempt. The Kansas experiment caused per capita state spending to fall 5.5 percent between 2012 and 2016.²³

The effect on school budgets was devastating. Kansas schools saw major cuts to their budgets and even closed early for summer break in the 2014-2015 school year because state funding had dried up.²⁴ Rather than addressing revenue shortfalls, lawmakers responded to budget pressures by canceling dozens of scheduled road projects and raiding their Highway Fund of more than \$1.4 billion between 2011 and 2017.²⁵

The tax changes also did nothing to improve economic outcomes in Kansas. One study found that decline in state spending necessitated by tax cuts made Kansas perform worse economically than similar states on jobs, poverty, home values, and per capita income.²⁶

New Revenue will power Maine's economic comeback



The Takeaway:

- Raising the revenue necessary to protect jobs and maintain spending will put gas in the tank to power Maine's economic recovery.
- Raising taxes on the highest incomes and profitable corporations — who have been less affected by the pandemic recession and have even seen wealth grow — can provide the revenue Maine needs to keep money flowing through the economy.
- Experience across the country shows that raising taxes on high incomes does not harm incomes, jobs, or economic growth.

The experience of Maine and other states, along with decades of research, prove that cutting spending during a recession will only delay Maine's recovery. The alternative to using spending cuts to balance the state budget is to raise the revenue necessary to protect the economy-boosting jobs and investments that keep money flowing to workers, families, and communities.

The core of the budget challenge policymakers face is not spending. It is an unprecedented crisis in revenue, in which roughly \$450 million per year in state revenue has been erased by the pandemic. And a revenue crisis demands a revenue solution.

State officials and advocates ranging from the bipartisan National Governors Association²⁷ to the US Chamber of Commerce²⁸ have urged Congress to increase federal aid to states to make up for lost

revenue. While the federal government has the borrowing power to help states backfill lost revenues, federal lawmakers have yet to approve funding states need. Even if Congress acts, history indicates federal aid will fall far short of what's needed.²⁹

As Maine lawmakers build the next state budget, they must do what they can – with or without Congressional support – to protect and even expand economy-boosting investments in education, health care, social support programs, and jobs.

At the state level, Maine can raise revenue by eliminating tax loopholes and raising taxes on those most able to pay and least affected by the crisis. The revenue generated will prevent damaging cuts and additional layoffs, both of which will hasten Maine's economic recovery.

States that raised taxes on high incomes outperformed neighbors

Several states have had success growing their economies after increasing taxes on households with the highest incomes. For example, Minnesota raised income taxes on high incomes and used the revenue to pay down a budget deficit, increase investment in public education, establish full-day kindergarten for Minnesota children, and expand health coverage through Medicaid.³⁰ Paired with a minimum wage increase, these policies led to more job growth and higher wages for Minnesotans compared to their counterparts in neighboring states.

Between 2013, when implementation of the new taxes began, and 2018:

- The number of jobs in Minnesota increased 8.1 percent, compared to neighboring state's at 6.9 percent.
- Minnesota's per capita income increased 14 percent, while neighboring state's increased only 8 percent.³¹
- Minnesota's economy grew 11 percent, compared to neighboring states at 10.5 percent.

Twelve states have passed similar laws since 2000. Eight of them have neighboring states similar enough to allow for comparison.³² Of these eight, six states outperformed or equaled their neighbors in GDP growth following implementation of the new tax, according to the Center on Budget and Policy Priorities. Two states — Connecticut and New Jersey — underperformed their neighbors. However, these states' economies are both heavily dependent on the financial sector and were hit hard by the 2008 financial crisis, which occurred during the research period. Similarly, seven of the eight states — all but Connecticut — outperformed their neighbors in per-capita personal income growth. Five of the eight states matched or outperformed their neighbors in job growth.³³

Another state comparison found the nine states with the highest top marginal tax rates outperformed the economies of states without any income taxes between 2007 and 2016.³⁴

Raising revenue will put gas in the tank to fuel the economy

Instead of cutting jobs and essential services and scaling back economy-boosting public investments, Maine could secure the resources necessary to fund its recovery by raising revenues. In doing so, the state could avoid the recovery-delaying mistakes made during prior downturns and instead make investments that support Maine's economic comeback.

The Congressional Budget Office estimates that each dollar spent on direct government purchases of goods and services generates an average of \$1.50 in economic activity, while direct income assistance to low-income families and unemployed workers — such as policies Congress enacted to send stimulus checks and increase unemployment benefits during the pandemic — generate an average of \$1.25 in economic activity.³⁵

These investments provide a net gain because the money continues to move through the economy after it is initially spent. State spending and assistance to cash-strapped households support demand for goods and services and supports public and private employment across the state.

These investments have an immediate positive economic impact on the economy and protect public- and private-sector jobs alike.³⁶

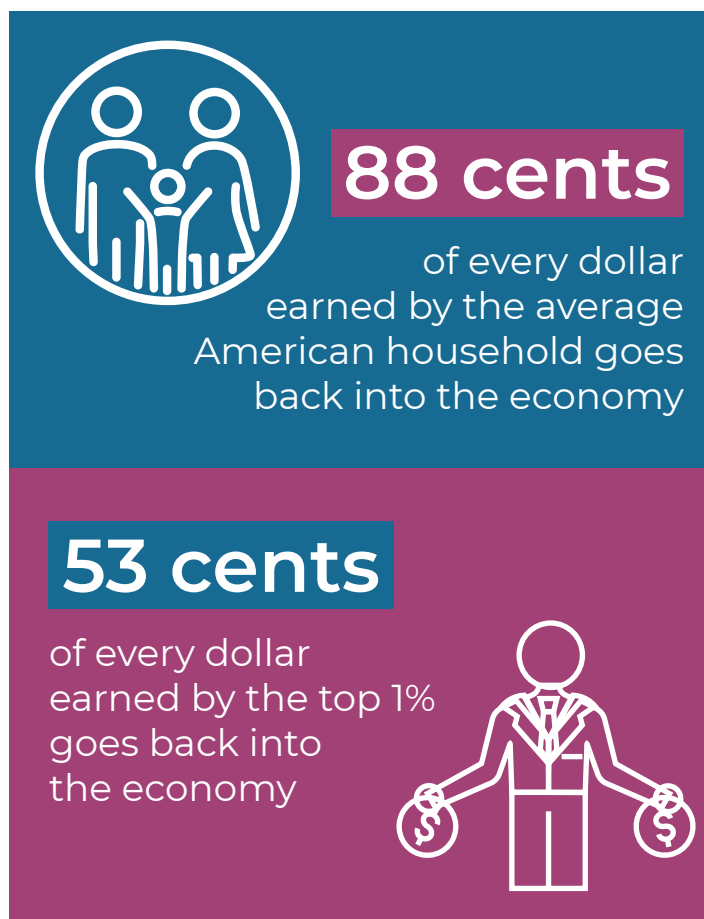
Raising revenue to protect or even increase state spending and jobs would stabilize the workforce and prevent a second wave of layoffs and lost income. It would also prevent worsening inequality through budget cuts that harm low-income families most.

Given all that is known about the stimulative effect of public investment, the question is not whether new revenue would support Maine's economic comeback, but where those revenues should come from.

There are several reasons that policymakers should prioritize taxes on high-income households, rather than broad increases across the income spectrum:

Increased savings mean the wealthy are doing less to power the recovery

Low- and moderate-income households spend most or all of their income, which keeps money flowing through the economy and supports jobs. In contrast, the highest-income households save nearly half their income, keeping that money from circulating in communities and the economy.



From 1989 to 2013, the average saving rate was 11.6 percent, while the top 1 percent saved 47.4 percent of their income. In other words: The average household put about 88 cents of every dollar they earned back into the economy, while the wealthiest households spent just 53 cents of every dollar they earned.³⁷

During the pandemic recession these saving rates have likely gone up, as Mainers with low incomes have maintained or even increased spending since January while wealthy Mainers are spending less.³⁸

Higher savings and lower spending mean that wealthy households are putting less of their income back into a stalled economy. Increasing taxes on the highest-incomes would put that money to use funding schools, health care, jobs, and direct support for families struggling during the pandemic recession — all of which will stimulate the economy and boost the recovery.

And, because wealthier families are less likely to spend their income in the economy right away, taxing this income has little effect on their spending even as it spurs economic activity through direct assistance to low-income families and state and local jobs.

Inequality hurts the economy. Raising taxes on high incomes will help.

Raising taxes on the highest incomes would slow widening inequality by putting more money into communities and investments such as education and infrastructure, which promote shared prosperity and a more resilient economy.

The wealthiest Americans are accumulating greater shares of income and wealth, making the US the most unequal of all large advanced economies.³⁹ The US Census estimates that the top 5 percent of households controlled 23.1 percent of income compared to the bottom twenty percent of households that controlled only 3.1 percent of income in 2018.⁴⁰ A more recent estimate from the Federal Reserve shows the wealth divide is even more stark than the income divide. In the first quarter of this year, the top 1 percent of households controlled 31.2 percent of wealth compared to the bottom half of Americans who owned only 1.4 percent of the country's wealth.⁴¹

Maine is not immune to growing inequality. According to analysis by the Economic Policy Institute, the average income of Maine's top 1 percent was more than 15 times the average income of the bottom 99 percent in 2015. Inequality was worst in Cumberland County where the top 1 percent took home nearly 19 times more income on average than the bottom 99 percent.⁴²

Stark inequality is creating barriers to educational and advancement opportunities for children from low-income households and weakening our ability to de-



Taxing the highest incomes would protect jobs for teachers, social workers, and public health nurses — as well as the services necessary to help families recover from the pandemic recession.

velop a skilled labor force, according to a paper published by the Organization for Economic Cooperation and Development.⁴³ It is also suppressing the buying power of the low-income families who would spend additional income in the economy if they had it.⁴⁴

As a result, the US economy grew 20 percent slower between 1990 and 2010 than it would have if inequality hadn't increased in that time.⁴⁵ Additional research demonstrates that rising shares of income for the top 1 percent of households has a net negative effect on GDP over the following 5 years, compared to a 1 percent increase in the bottom 20 percent of households' income which returns a net positive gain in GDP over the following 5 years.⁴⁶

Raising taxes on wealthier households makes it possible to enact policies that can decrease inequality and improve the economy, such as boosting incomes for poor families, improving access to

high-quality education and job training, and helping families afford health care.⁴⁷

Wealthy families can afford to pay more, even during the pandemic recession

While recessions seem like shared experiences, history and recent evidence of the pandemic recession show that wealthy households are harmed much less by recessions.

Low- and moderate-income families suffer the brunt of recession, with lagging wealth, income, and employment levels long after wealthy families have recovered. In the last three recessions, the average income of the poorest households fell deeper than the wealthiest 5 percent of households and low-income households took longer to recover their income.

In the wake of the Great Recession, the lowest-income families took a pay cut for 11 years, compared to just four years for the wealthiest. The wealthiest 5 percent of households recovered their 2007 level of income by 2011, while the bottom 20 percent did not recover until 2018. The lowest-income quintile also lost a share of income roughly twice as large as the top 5 percent.⁴⁸

The pandemic recession is noteworthy for the vastly different experiences for wealthy and working-class families:

- **Working-class families** are experiencing high levels of hardship nationally. Here in Maine, joblessness remains at record-smashing levels, with more than 68,000 Mainers collecting unemployment in the week ending August 29. That's five times higher than in the week ending March 21, even after adjusting for increased eligibility for small business owners and others, and greater than the worst week of the Great Recession.⁴⁹ Demand for food assistance, cash assistance, and housing assistance are all up during the pandemic recession.⁵⁰ One in four small businesses are closed.⁵¹
- **Wealthier families** are less likely to have lost their jobs than households with lower incomes. For example, two Maine industries with low wages — food preparation and restaurants and per-

sonal care and service workers — experienced the highest rates of layoffs at 19 and 21 percent in July 2020, respectively. A whopping 35 percent of middle-income employees in Maine's farming, fishery, and forestry industry were unemployed in the same period. Meanwhile, Maine's high-wage management workers have a layoff rate of just 14 percent.⁵² The country's largest corporations are turning record profits⁵³ and the stock market is experiencing record growth. The wealthiest 10 percent of households own 87.2 percent of all stocks and mutual funds,⁵⁴ so have likely seen their wealth grow during the pandemic.

Conclusion

Investment, not austerity, will put Maine on path to recovery



Mainers need a state budget that funds essential investments, keeping state dollars flowing to communities and mitigating economic harm to vulnerable families.

The state and the country are still far from recovered from the economic damage of the coronavirus and maintaining or increasing resources for state and local investments plays a crucial role in stabilizing the state's workforce of public and private employees and keeping up economy-wide spending.

Budget cuts, on the other hand, would further

weaken the jobs market and take money out of communities across the state.

Wealthy households are faring better during the pandemic recession than households with lower incomes. And while they have more resources to contribute to a strong recovery than families with low incomes, they are spending less of each dollar they earn to power Maine's economic comeback.

Taxing high-income households is a good strategy to prevent budget cuts that would further harm families who are already struggling, while promoting a faster, more inclusive recovery.

About MECEP

The Maine Center for Economic Policy is a nonprofit research and policy organization dedicated to economic justice and shared prosperity by improving the well-being of low- and moderate-income Mainers. Since its founding in 1994, MECEP has provided policymakers, advocates, media organizations, and the public with credible, rigorous research and analysis. MECEP is an independent, nonpartisan organization.

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