Fiscal Crisis in the States
The Impact on Nonprofits and the People They Serve

Across the country, states are experiencing what has been called the worst fiscal crisis since World War II. The combined shortfall of state general funds grew from $10.1 billion in 2001, to $32.9 billion in 2002, to $34.6 billion — or more than 7 percent of state revenue — in 2003. This crisis is already having a negative impact on the nonprofit sector, since nonprofits rely on government contracts and grants for 31 percent of their income. And, while some indicators suggest that the economy is beginning to recover, nonprofits are likely to still feel economic pressure for the foreseeable future, according to two new studies funded by the Aspen Institute’s Nonprofit Sector Research Fund.

The studies’ authors see a troubling present and future for the sector, as nonprofits are vulnerable to cuts in funding even where they are providing important services with rising demand. Nonprofits that work in the health area in richer states have an advantage, say researchers, but those that work in other program areas or in low fiscal capacity states may be especially vulnerable.

In "Fiscal Crisis in the States: Its Impact on Nonprofit Organizations and the People They Serve," Woods Bowman (DePaul University) argues that while nonprofits have been struggling, they haven’t experienced a catastrophe, largely due to federal aid in the form of Medicaid, Temporary Assistance to Needy Families (TANF), and other programs. However, in the coming months and years, federal aid is likely to decrease and the nonprofit sector is likely to suffer further cuts in state funding, Bowman argues. The losses that the sector has already suffered have been difficult because it seems that there is no place to turn to make up for cuts: total giving from all sources dropped by 0.5 percent in 2002.

To make matters worse while resources are tightening, the demand for basic safety-net services is rising. More people need food assistance, emergency housing, and primary medical care, and the agencies that provide these services are overwhelmed. For example, a 2001 survey of 412 nonprofit safety-net organizations in California found that demand for emergency food rose 40 percent, emergency housing rose 20 percent, and the need for mental health care and primary medical care rose by 19 percent. There is no reason to think that demand will decrease, researchers say.

In "A Divided Community: The Effects of State Fiscal Crises on Nonprofits Providing Health and Social Assistance," Thomas Gais, Courtney Burke, and Rebecca Corso (Rockefeller Institute, State University of New York) argue that nonprofit social service providers are being severely squeezed, particularly if they work in areas outside of health or in states with a lower fiscal capacity. Nonprofits that can draw on Medicaid spending are in a stronger position than other nonprofits, while the hardest hit are those that serve constituents or activities that are not seen as crucial to achieving a mandated program goal (i.e., programs that serve youth or offer job training).

Gais, Burke, and Corso predict that nonprofits providing social services outside health are likely to feel pressure for years because of four contributing factors. First, many states have been able to avoid major cuts to social assistance because they have surpluses in their TANF funds, but these funds are being depleted quickly. Second, poor states tend to rely more on sales taxes, which will not recover immediately. Third, the elderly population is growing particularly in lower fiscal capacity states in the south and west like Mississippi, New Mexico, and Idaho. This will require more Medicaid spending. And finally, federal policy related to tax cuts and unfunded mandates will increase financial burdens on all states in the coming years.

Examples of general fund shortfalls in the states are presented on p. 3. For comparisons of the spending on social services in low and high fiscal capacity states, see the table on p. 4. A list of the programs one state can no longer afford to fund appears on p. 2.
Agencies at a Loss in Alabama: Examples from One State

Bowman provides a list of 29 organizations in Alabama that received at least $100,000 from the State in 2003 but will receive nothing in 2004. Here are the ten agencies experiencing the biggest losses:

<table>
<thead>
<tr>
<th>Agency</th>
<th>2003 Funding</th>
<th>2004 Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Educational grants for private college students</td>
<td>$5,305,944</td>
<td>$0</td>
</tr>
<tr>
<td>Tuskegee University</td>
<td>4,726,461</td>
<td>0</td>
</tr>
<tr>
<td>Network of Child Advocacy Centers</td>
<td>2,802,000</td>
<td>0</td>
</tr>
<tr>
<td>Rural volunteer fire department grants</td>
<td>2,483,875</td>
<td>0</td>
</tr>
<tr>
<td>Student assistant scholarships</td>
<td>1,326,933</td>
<td>0</td>
</tr>
<tr>
<td>East Alabama Child Development Center</td>
<td>1,051,673</td>
<td>0</td>
</tr>
<tr>
<td>Coalition Against Domestic Violence</td>
<td>814,332</td>
<td>0</td>
</tr>
<tr>
<td>Children’s &amp; Women’s Hospital, Mobile</td>
<td>608,437</td>
<td>0</td>
</tr>
<tr>
<td>Alabama Shakespeare Festival</td>
<td>563,086</td>
<td>0</td>
</tr>
<tr>
<td>Grants to historical sites not owned by the state</td>
<td>543,670</td>
<td>0</td>
</tr>
</tbody>
</table>

From "Fiscal Crisis in the States: Its Impact on Nonprofit Organizations and the People They Serve"

The State Budget Picture

According to Bowman, state budgets are beset by structural imbalances as well as shortfalls aggravated by federal tax cuts and new unfunded federal mandates, like the Homeland Security Act and the No Child Left Behind Act. At least 42 states show shortfalls in the general fund that receives most of the state’s sales and income taxes and supports most of the programs that are of interest to the nonprofit sector. So far, states are coping with shortfalls through one-time strategies like using cash balances and rainy day funds and borrowing against tobacco settlement funds. But those strategies are largely exhausted now, and state legislators are predicting future cuts, especially in social services and healthcare.

Nonprofits are also changing the ways they work in order to deal with the fiscal crisis. Bowman cites a recent study by Martha Golensky of 100 nonprofits facing economic uncertainty which found that nonprofits use a range of strategies to cope with the changes: they plan to manage worst-case scenarios and better meet constituent needs by filling a niche; they manage expenses by strategically cutting budgets and tactically cutting costs; they raise revenue through innovation and aggressive diversification of revenue sources; they create strategic alliances and mergers; and they advocate for themselves with state and county legislators. Some of these ways of coping involve temporary change and some require structural change, but none of these strategies will totally solve the problem.

While the economy seems to show signs of improving — with growth in GDP, corporate profits, and business investment — state revenue growth will be slow because of tax cuts (those enacted in the 1990s as well as the most recent cuts, which will cause states to lose $3 billion). Gais, Burke, and Corso also point out that those states that have relied on income taxes have been especially hard hit. Their residents’ vulnerability to the rapid drop in capital gains has had an impact on available funds. The state budget picture for 2004 is likely to be grim: half the states expect that their 2004 general fund spending, adjusted for inflation, will be lower than actual 2002 spending. "Instead of being axed, programs of interest to the nonprofit sector will face death by a thousand cuts for years to come," says Bowman.

Bowman argues that "Overall, resources available to the nonprofit sector stopped growing in 2001, and fell by a modest amount in 2002. The drop is not catastrophic, but nonprofit organizations probably feel as if they are caught in a 'perfect storm' because there is no place to turn for replacement revenue when a cut does occur."

In addition, the improvement of the economy doesn’t necessarily spell the end of financial concerns in the sector. The sector tends to lag behind the economy, Bowman argues, citing an article by Jon Pratt in the Nonprofit Quarterly (Summer 2003): the sector continues to grow after the economy goes into recession and it stays down longer. In 2002, it was possible to still find job growth in the nonprofit sector in a number of states, but in 2003 layoffs and unemployment have become all too common in the sector. In Minnesota, for example, the 2nd quarter of 2003 brought a 20 percent increase in unemployment insurance claims for nonprofit workers.
Nonprofits Outside Health in Low Fiscal Capacity States Hardest Hit

Gais, Burke, and Corso focus their research on organizations that provide health and human services. Like Bowman, these researchers report the general expectation that the effect of the economy's downturn on the states would be negative for the human services sector. The researchers argue that there is a lot of variation, depending on which state and which sub-sector a nonprofit is in.

Historically, state and local expenditures for health and human services have continued to grow when the states have suffered economic declines. For example, in the years between 1987 and 1992 (spanning the U.S. recession of 1990-91), nonprofits delivering non-health social services grew in number by a third, from 49,180 to 65,756. Their revenues increased by more than 70 percent and their receipts from government grew by 97 percent. The researchers account for this trend: "Bad economic times typically pushed up spending on social programs by expanding the eligible populations, and if nonprofits were delivering the services, such organizations might do well."

But state funding for human services nonprofits has changed significantly since the early 1990s, and states have many more choices available to them. The states have gained greater flexibility with the enactment of Temporary Assistance for Needy Families (TANF) and other block grants. They also have won greater funding options in Medicaid, the largest of all social programs, and have more options regarding how they can work with nonprofit providers, including the basic functions that nonprofits may perform. "These choices mean that states may expand and contract programs in an accordion-like fashion as their governing coalitions choose, a capacity that not only allows states to adjust their programs to changing fiscal conditions but also creates a more intense and wide-ranging competition for resources in state budget offices, governor's staffs, administrative agencies, and legislatures," argue the researchers.

This growing flexibility and competition will make some nonprofits in some states especially vulnerable to state fiscal crises. Gais, Burke,

---

<table>
<thead>
<tr>
<th>State</th>
<th>Est. Expend. as of Nov '02</th>
<th>Est. Rev. as of Jun '03</th>
<th>Budget Gap</th>
<th>Gap as % of Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Colorado</td>
<td>6,515</td>
<td>5,666</td>
<td>-849</td>
<td>-15.0</td>
</tr>
<tr>
<td>Georgia</td>
<td>16,178</td>
<td>14,650</td>
<td>-1,528</td>
<td>-10.4</td>
</tr>
<tr>
<td>Maine</td>
<td>2,710</td>
<td>2,371</td>
<td>-339</td>
<td>-14.3</td>
</tr>
<tr>
<td>Maryland</td>
<td>10,564</td>
<td>9,482</td>
<td>-1,082</td>
<td>-11.4</td>
</tr>
<tr>
<td>Michigan</td>
<td>9,185</td>
<td>8,299</td>
<td>-866</td>
<td>-10.7</td>
</tr>
<tr>
<td>Nevada</td>
<td>2,021</td>
<td>1,814</td>
<td>-207</td>
<td>-11.4</td>
</tr>
<tr>
<td>Texas</td>
<td>30,916</td>
<td>27,860</td>
<td>-3,056</td>
<td>-11.0</td>
</tr>
<tr>
<td>Wyoming</td>
<td>746</td>
<td>605</td>
<td>-141</td>
<td>-23.3</td>
</tr>
</tbody>
</table>

From "Fiscal Crisis in the States: Its Impact on Nonprofit Organizations and the People They Serve." Source: National Assn. of State Budget Officials and National Governors Assn.
and Corso make a distinction based on states' fiscal capacity. High fiscal capacity states — like Connecticut, New York, New Jersey, New Hampshire, Minnesota, Massachusetts, and California — have a stronger tax base and are better able to support efforts to increase revenues through future tax increases. They were hit hard by the economic downturn because they relied so heavily on income taxes. However, these states also have the greatest private resources to draw on, and they have offered the most generous benefits to low-income families. "These comparatively wealthy states have also suffered the largest revenue declines because they saw the biggest revenue increases in the 1990s, so it is possible that such states can cut back on programs or programs that are recent in origin without ripping the basic safety net in human service programs," argue the researchers.

In states with low fiscal capacity (like West Virginia, Idaho, Mississippi, Louisiana, North Dakota, New Mexico, Arkansas, and Montana), nonprofit service providers who are not in the health field may be severely squeezed for resources. "In poorer states, cuts in spending in some areas may be driven by demands for other program benefits as well as revenue slowdowns or reductions — and the nonprofit sector in these states may also confront growing needs that simply are not being met by government programs," say the researchers.

Since budgetary pressure is strong outside the public welfare area, it is unlikely in most states that the total social program budget will increase. Within the relatively fixed budget for social programs, both rich and poor states are seeing roughly equal and substantial increases in their Medicaid budgets — a boon for nonprofits serving Medicaid populations — even though

Panelists Linda Czipo, executive director of the Center for Non-profit Corporations and Researcher Woods Bowman

Participant Sheri Brady, Director of Public Policy, National Council of Nonprofit Associations

### Median State Expenditures on Social Programs, Per Poor Person, 1980-2000

**by State Fiscal Capacity (Per Capita Personal Income) (Spending in 2000 dollars)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash Assistance</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High Fiscal Capacity States</td>
<td>1,417</td>
<td>1,234</td>
<td>1,288</td>
<td>1,297</td>
<td>1,047</td>
<td>-250</td>
</tr>
<tr>
<td>Low Fiscal Capacity States</td>
<td>321</td>
<td>277</td>
<td>280</td>
<td>347</td>
<td>259</td>
<td>-88</td>
</tr>
<tr>
<td><strong>Medical Assistance</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High Fiscal Capacity States</td>
<td>2,024</td>
<td>2,699</td>
<td>3,426</td>
<td>5,911</td>
<td>7,173</td>
<td>1,262</td>
</tr>
<tr>
<td>Low Fiscal Capacity States</td>
<td>781</td>
<td>861</td>
<td>1,539</td>
<td>2,264</td>
<td>3,999</td>
<td>1,735</td>
</tr>
<tr>
<td><strong>Other Public Welfare</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High Fiscal Capacity States</td>
<td>1,114</td>
<td>1,401</td>
<td>1,662</td>
<td>1,938</td>
<td>2,530</td>
<td>592</td>
</tr>
<tr>
<td>Low Fiscal Capacity States</td>
<td>532</td>
<td>494</td>
<td>662</td>
<td>774</td>
<td>997</td>
<td>223</td>
</tr>
</tbody>
</table>

Adapted from "A Divided Community: The Effects of State Fiscal Crises on Nonprofits Providing Health and Social Assistance"
many states are trying to slow the growth of health care spending. As Medicaid spending grows, however, "fund-streams serving nonprofits outside the health arena are highly constrained in poor states," say the researchers.

The researchers argue that programs at risk in all states are youth programs, after-school programs, job services for low-income people and programs to help low-income fathers or noncustodial parents. Also at risk are programs that provide childcare to low-income families not on TANF. In low fiscal capacity states, the impact on nonprofits providing these types of services is likely to be even more severe. In his broader study of the nonprofit sector, Bowman found that the arts, private higher education, and community development were also likely to suffer. Generally, programs that are not mandated by the federal government are likely candidates for cuts.

**Needed Research**

Bowman suggests a research agenda that would allow researchers to better understand the impact of the state fiscal crisis on the nonprofit sector. Among his suggestions are the following:

- Collect better data and do more research on linkages between the nonprofit sector and the economy. Unemployment data for nonprofit employees would be a good start, though technical issues in tracking the data would have to be worked out.
- Research linkages between the economy, demand for safety-net agencies, and federal spending.
- Study how programs of interest to the nonprofit sector are affected by the requirements that the federal government imposes on states.
- Develop current estimates of various state financial variables in order to better inform advocacy for the sector.
- Produce an annual report on overall state spending in program areas of interest to nonprofits—health, human services, community development, arts, and financial assistance for college students and grants to private universities—as well as state funding of nonprofits. A first step toward this goal would be developing a methodology and estimating the cost to implement it.

Gais, Burke, and Corso also suggest some potentially fruitful directions for further research in the area of social service provision:

- **Determine which characteristics of programs and their providers are critical when deciding what services to cut.**
- **Analyze how health and non-health nonprofits have dealt with the fiscal crisis.**
- **Track federal and state spending, by state and perhaps by major city, for human service nonprofits.**
- **Study whether and how private giving reinforces or helps to compensate for patterns of public spending: does private giving also favor nonprofits working in the health area?**
- **Explore the impact the fiscal crisis has had on privatization are states trying to save money by privatizing functions? Are privatization efforts being renewed, expanded, eliminated, or added?**

"Fiscal Crisis in the States: Its Impact on Nonprofit Organizations and the People They Serve" and "A Divided Community: The Effects of State Fiscal Crises on Nonprofits Providing Health and Social Assistance" are available from the Aspen Institute's Publications Office at (410) 820-5338.

---

**Contact the Authors:**
**Thomas Gais**
Phone: 518-443-5238
Email: gais@rockinst.org

**Woods Bowman**
Phone: 312-362-5718
Email: wbowman@depaul.edu
THE ASPEN INSTITUTE NONPROFIT SECTOR RESEARCH FUND

The Nonprofit Sector Research Fund awards research grants and disseminates research findings to expand knowledge of the nonprofit sector and philanthropy, improve nonprofit practices, and inform public policy related to nonprofits.

Council
Virginia A. Hodgkinson, Chair
Audrey R. Alvarado
Elizabeth T. Boris
Peggy Clark, ex officio
Stacey Daniels-Young
Julian Wolpert

Staff
Alan J. Abramson, Director
Cynthia H. Schuman, Associate Director
Winnifred Levy, Communications Manager
Rachel Mosher-Williams, Program Manager
Jill Blackford, Program Coordinator
Theresa Jenkyns, Program Coordinator

Funders
The Atlantic Philanthropies
The Ford Foundation
William Randolph Hearst Foundation
W.K. Kellogg Foundation
Charles Stewart Mott Foundation
The David and Lucile Packard Foundation

Findings presented in this publication reflect the opinions of the researchers and not those of the Nonprofit Sector Research Fund, the Aspen Institute, or their funders.