Testimony to the Assembly Ways and Means Committee

2009-2010 Executive Deficit Reduction Plan

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We would like to thank the distinguished members of the Assembly Ways and Means Committee for the opportunity to testify here today.

We believe that Governor Paterson's Deficit Reduction Plan (DRP) to make $1.8 billion in spending cuts between now and March 31, 2010, is a poor policy recommendation that will have the opposite effect of his contention that it will "prime" the state for economic recovery.

First, Do No Harm!

Can you really take $2.26 billion of demand out of the state's economy in five months without having a significant negative economic impact?

At his October 15, 2009, press conference, Governor Paterson called for New York State, between now and March 31, 2010, to make $1.8 billion in real budget cuts - $500 million in cuts in state agency budgets and $1.3 billion in local assistance cuts, including $480 million less aid to school districts and $287 million less in Medicaid reimbursements to health care providers.

When the Governor was asked, at that press conference, if estimates had been prepared of the impact of his proposed cuts on employment levels in the state, his budget director pointed out that the $1.8 billion in cuts were designed to have the least possible negative economic impact and that their assumption was that the plan would not require significant layoffs. But the question regarding estimates of the impact of employment levels was never answered.

The Governor and the Budget Director did point out on several occasions that the school year impact of the proposed aid cuts would be greater than the $480 million in savings that the state government would realize during the current fiscal year. This is because the Governor's proposal for reducing school aid by $480 million between now and the end of the current (2009-10) state fiscal year, would also reduce state aid to school districts by an additional $206 million during April, May and June. This means that if the Governor's plan is adopted by the Legislature, school districts will have to figure out ways to operate with $686 million less in state aid than the levels on which they based their staffing levels for the 2009-10 school year which is now well under way. How can this be done without layoffs? The Governor responded to a question along these lines by saying that school districts could, if they wanted to, use their reserves (i.e., "fund balances") to make up for the lost state aid. But the New York City school district, with a majority of the state's poor school children, and the other four big city school districts, all with very high poverty rates, have no fund balances, because of their status as "dependent" school districts. And the Governor is averse to using the state government's own rainy day funds even though he is, in effect, urging such a course on the school districts that do have such reserves.

For New York State to save $287 million in state funds through cuts in Medicaid reimbursement rates, New York would have to cut its reimbursements to health care providers by about $747 billion. The magnitude of this differential is attributable to the fact that under the American Recovery and Reinvestment Act (the stimulus package signed into law by President Obama on February 17, 2009), the federal government is covering an increased share of each state's Medicaid cost (retroactive to October 1, 2008 and through December 31, 2010) with the amount of that increase varying from state to state based on changes in its unemployment rate. Under this arrangement, New York's FMAP increased from its pre-ARRA level of 50% to 58.78% for the period from October 1, 2008 through March 31, 2009; 60.19% for April, May and June of 2009; and 61.59% beginning on July 1, 2009.

Health care providers could not accommodate a reduction of revenue of that amount – by getting paid less for the healthcare services that they provide – without substantially reducing the size of their workforces. This would prolong the recession which has been driven in large part by substantial reductions in consumer spending due to high and rising unemployment and reductions in the confidence of many who are still employed but who are nervous about the current economic situation.

When the federal share of Medicaid costs are taken into consideration, the Governor's plan, if adopted by the Legislature, would reduce aggregate demand in the state economy by approximately two and a quarter billion dollars ($2.260 billion) between now and March 31, 2010. That's more than $5.5 billion on an annualized basis.

The Governor has argued that making these cuts will "prime" the state for the economic recovery. While there may be other arguments for the budget cuts that he is proposing, the Governor should acknowledge that his plan, if adopted and implemented as proposed, would definitely delay the recovery for which he is proposing to "prime" the state. **$2.26 billion of demand cannot be taken out of the state's economy on such a precipitous basis without disrupting and slowing down the recovery from the current recession.** Making such cuts is likely to prolong the downturn as similar budget policies did in the early 1990s, as opposed to the more rapid recovery that New York State experienced following the May 2003 state budget agreement (enacted over Governor Pataki's vetoes) and the May 2003 infusion of 15 months of state fiscal relief as part of a stimulus bill signed into law by President Bush.

This is not to say that state governments have any easy choices during recessions. While the federal government can cut taxes and increase spending in an effort to stimulate the economy during recessions, New York and the other state governments have to balance their budgets in both bad times and good. That means that absent federal aid and/or the use of reserves, the states have to raise taxes and/or cut spending during recessions, thus canceling out some of the positive effects of the federal government's stimulus efforts. The Obama Administration and the Congress understand this dilemma, which is why the $787 billion stimulus package that

President Obama signed into law on February 17, 2009, included $135 billion that was explicitly for “state fiscal relief.”

The Governor’s overall Deficit Reduction proposal of $3 billion includes the use of some state reserves (and other actions that will not hurt the economy) in order to reduce the magnitude of the real state budget cuts to $1.8 billion. And, as pointed out earlier, the Governor says that school districts (and, presumably, other local governments and health care providers) can, if they want to, use some of their reserves to avoid having to lay off workers to accommodate the proposed cuts in state aid. But the Governor declines to tap additional state reserves, saying that he wants to keep that money in case of an even rainier day.

This may be because the Governor wants a Deficit Reduction Plan that includes budget cutting actions that will produce recurring savings that will reduce the budget gaps now being projected for future years. But the projected gaps that the state faces in future years are based, in large part, on the fact that the federal stimulus package’s “state fiscal relief” is currently scheduled to phase out before it is reasonable to expect that the states’ finances will have recovered from the current recession and the related meltdown of the financial services industry. Both the Governor and the Lieutenant Governor pointed out, correctly, that state governments’ fiscal recoveries lag the nation’s economic recoveries. The key to this dilemma, as the Lieutenant Governor pointed out at the end of the press conference, is for the 50 Governors and other state officials from around the country to work together to secure an extension of the federal government’s “state fiscal relief,” much of which is currently scheduled to expire on December 31, 2010, and the remainder of which is scheduled to expire on June 30, 2011. I would add that the key is to have the phase out of the federal government’s “state fiscal relief” dovetail with the recovery of the states’ finances. This is what happened in the spring of 2003 when the states were still facing substantial budget shortfalls for their 2003-04 fiscal years even though the recession had officially ended 18 months earlier, in late 2001. The 15 months of budget relief (for the period from April 1, 2003 through June 30, 2005), that President Bush signed into law in May 2003, allowed the states to get back on their feet with much less in budget cuts and tax increases than would have otherwise been necessary.

An extension of the federal government’s “state fiscal relief,” is also in the interest of the federal government since it is held accountable by the public for the overall performance of the national economy. It is clearly not in the interest of Congress or the Obama Administration to leave the states to fend for themselves, making budget cuts and/or tax increases that would endanger the emerging economic recovery.

Better Choices:

Use the Tax Stabilization Reserve Fund and State Rainy Day Fund to help solve our mid-year budget gap:

The Tax Stabilization Reserve Fund (TSRF) is for unplanned end of year deficits and totals $1.039 billion. The state rainy day fund has approximately $400 million reserved for economic downturns. These funds are an important backstop or cushion for getting through the current fiscal year without making $1.8 billion in cuts to vital services as the Governor has proposed.

These funds provide the state the time to have a well-informed debate over expenditures and revenues in the 2010-11 state budget. The Legislature cannot pass a law transferring money from the Tax Stabilization Reserve Fund to the General Fund, nor can it pass a law requiring the Governor to use the money from this fund. The Governor simply has to borrow the amount needed from it on March 31, 2010, if disbursements exceed receipts and money available to make those disbursements.

The relevance of the TSRF and rainy Day Fund to the current situation is that (1) NYS has a reserve fund of approximately $1.5 billion that it can borrow from if disbursements made during the 2009-10 SFY end up exceeding the receipts and money available for use during the SFY. The Governor and the Legislature should not make more cuts during the current fiscal year than are necessary given this $1.5 billion cushion.

Collect Taxes that are Due on Cigarettes: The impact of price on cigarette consumption is well documented. The more expensive tobacco products are the more people will want to quit smoking. The good news is the Empire State now has one of the highest cigarette taxes in the nation at $2.75 per pack. But there's a problem. Hundreds of millions of dollars in cigarette taxes aren't being collected.

New York has been unable or unwilling to collect taxes on tobacco products sold at Native American retail outlets. This torrent of tax free cigarettes is both a significant public health problem and economic burden to all New Yorkers. But a new law allows the state to collect all cigarette taxes before the products reach the reservation and put an end to this public health embarrassment. Native Americans would be provided coupons to purchase tax free cigarettes while sales to non-native Americans would be subject to the tax.

NYS should implement this law as soon as possible to help eliminate the need for cuts in vital state services.

Eliminate Empire Zone Program: This failed program sunsets in 2010 and should be eliminated in its current form. Eliminating it would save the state approximately $600 million per year. This program has proven to be ineffective and fraught with abuse. Many have advocated its elimination for years, now is the time to scrap it.

End the Contracting Out of State services to Pricey Private Consultants: In SFY 2007-08, NYS spent $2.78 billion on consultants and paid them an average annual rate of $126,503. Consultants charge 54% more than state employees who do the same work (including the cost of state employee benefits). Consultant spending for the first half of this year is at the same rate as last year. The state should reduce the use of these high priced consultants before eliminating jobs and/or services from the current years' budget. Replacing half of these consultants with state employees will save the state over $730 million over the next three years.

Bulk Purchase of Pharmaceuticals: Language inserted into last year's budget allows the Department of Health to negotiate directly with drug companies for lower cost drugs. According to recent studies, New Yorkers spend over $20 billion a year on prescription drugs. Approximately $4 billion (or more) of this spending is in the Medicaid program. We should use our purchasing power to force drug companies to provide us with lower cost drugs. We could save hundreds of millions or more if we were able to get drugs for what the federal government currently pays.

State Spending CAPS: A Bad Choice for NYS

The Governor is also calling for the enactment of a state spending cap. We believe this to be a bad choice for NYS. Colorado is the birthplace of the State Spending Cap. In 1992, Colorado enacted a Taxpayers Bill of Rights (TABOR), a constitutional amendment that limits the annual growth in state revenues and expenditures. In recent years, anti-government groups have pushed spending cap proposals like Colorado's in numerous other states. These proposals have gone under a variety of names, such as "Tax and Spending Control" (Nevada) or "Stop Over Spending" (Michigan) and now the "State Spending Cap" in New York. Unfortunately these types of caps can have very negative consequences.

Spending Caps Negatively Impact Colorado

Colorado's State Spending Cap contributed to a significant decline in public services in Colorado. It resulted in:

- Colorado declined from 35th to 49th in the nation in K-12 spending;
- higher education funding dropped by 31 percent;
- Colorado fell to near the bottom of national rankings in providing children with full, on-time vaccinations; and
- the share of low-income children in the state who lacked health insurance doubled, making Colorado the worst in the nation by this measure.

In 2005, these problems led Colorado voters to approve a statewide measure to suspend TABOR's for five years in order to allow the state to rebuild its public services.

Spending Cap Proposals in Other States

In recent years, several national anti-government groups have led campaigns in numerous other states to enact Spending Caps. Since 2004, serious efforts have occurred in 20 states: Arizona, Colorado, Florida, Georgia, Kansas, Maine, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, and Wisconsin. Most of these proposals failed to make the ballot. In the three states where proposals did make the ballot — Maine, Nebraska, and Oregon — voters rejected them. Colorado thus remains the only state with a TABOR.

Unintended Consequences:

Despite the Governor Paterson's assertions to the contrary, a state spending cap will inevitably drive up local property taxes. As evidenced in Colorado, the state spending cap did not decrease the cost of healthcare or education it simply resulted in less state spending on these critical needs. In New York we have seen that when the state shirks its funding responsibilities, local property taxes rise to make up for the shortfall.

What do Colorado's Business Leaders Say about the Spending Cap:

"Coloradoans were told in 1992 . . . that the Spending Cap guaranteed them a right to vote on any and all tax increases. . . . What the public didn't realize was that it would contain the strictest tax and spending limitation of any state in the country, and long-term would hobble us economically." — Tom Clark, Executive Vice President, Metro Denver Economic Development Corporation

"The Spending Cap formula . . . has an insidious effect where it shrinks government every year, year after year after year after year; it's never small enough. …That is not the best way to form public policy." — Brad Young, former Colorado state representative (R) and Chair of the Joint Budget Committee

"[Business leaders] have figured out that no business would survive if it were run like the Spending Cap faithful say Colorado should be run -- with withering tax support for college and universities, underfunded public schools and a future of crumbling roads and bridges." — Neil Westergaard, Editor of the Denver Business Journal