F I S C A L   P O L I C Y   I N S T I T U T E
11 Park Place, Suite 701, New York, NY 10007
212-721-5624   www.fiscalpolicy.org

Testimony of
James A. Parrott
Deputy Director and Chief Economist
Fiscal Policy Institute

Before the

New York State Senate Finance Committee

Public Hearing on New York State Budget Oversight
Governor's Proposed Deficit Reduction Plan

New York City
October 26, 2009

My name is James Parrott, Deputy Director and Chief Economist of the Fiscal Policy Institute. Thank you for the opportunity to testify today.

In advancing his Deficit Reduction Plan (DRP) on October 15, Governor Paterson argued that $1.8 billion in state spending cuts between now and March 31, 2010, are needed to "prime" the state for economic recovery. However, such a belief defies economic logic. We indeed are in the midst of the "Great Recession"—the steepest and longest downturn in the U.S. since the 1930s. Nationally, eight million jobs have been lost since December 2007, and there are 30 million Americans unemployed, discouraged or under-employed.

In New York State, we have lost 253,000 jobs since August 2008, including over 23,000 in the government sector. There are nearly 850,000 New Yorkers unemployed, twice the number that were unemployed at the end of 2007.[1] Long-term unemployment is already at record levels and the consensus outlook among economists is that unemployment will stay high for at least the next two years.[2]

---

[1] For a detailed discussion of employment and unemployment trends in New York and the rising economic insecurity felt by New Yorkers, see Fiscal Policy Institute, *The State of Working New York 2009: Unemployment and Economic Insecurity in the Great Recession*, September 2009. http://www.fiscalpolicy.org/SOWNY2009.html.

[2] For example, in its August 25, 2009, economic forecast the Congressional Budget Office predicts that the unemployment rate will average 8.5 percent in the fourth quarter of 2011. http://www.cbo.gov/budget/econproj.shtml.

Midyear budget cuts will damage New York's economy

Against this bleak economic backdrop, the Governor's proposed spending cuts will only exacerbate our already high unemployment and worsen the prospects for an economic recovery. The U.S. economy can only recover if spending increases, including government spending. The federal government likely will increase counter-cyclical spending further in the months ahead, including through another round of state fiscal relief.

The governor has called for $1.8 billion in state spending cuts--$500 million in cuts in state agency budgets, $1.3 billion in local assistance cuts, including $480 million less in aid to school districts ($223 million of that in New York City), and $287 million less in Medicaid reimbursements to health care providers. However, reducing state spending on Medicaid by $287 million in just the next five months means that New York's health care providers will lose $747 million in reimbursements since the federal government, under the Obama stimulus package, is now funding nearly 62 percent of New York's Medicaid spending.

Thus, the governor's cuts mean that New York's economy will lose $2.26 billion in direct spending over the five months through the end of March 2010. Annualized, that's about $5.5 billion taken out of the economy. That translates into tens of thousands of jobs in public schools, colleges, hospitals, senior centers, youth programs, nursing homes, and home care agencies, among others, as well as jobs at private companies that sell goods and services that are either directly or indirectly paid for with state budget dollars. This magnitude of spending reduction and job losses would seriously hamper New York's economic recovery.

And this is not counting the additional $206 million by which state aid to school districts would be reduced during April, May and June of next year. Under the governor's proposal, school districts would lose a total of $686 million during the 2009-2010 school year already well underway.

The other $1.2 billion in budget balancing actions that the Governor is proposing for this year should be adopted. Those actions would not have the negative impacts on the economy of the $1.8 billion in real cuts in local assistance and state operations being proposed by the Governor.

The worse-than-expected economy and rising state budget pressures likely will mean another round of "state fiscal relief" by the federal government

Unemployment is higher now and the national economy is in worse shape than what had been anticipated at the start of 2009, even with the $787 billion American Recovery and Reinvestment Act (ARRA). New York is far from alone in facing midyear budget shortfalls. In a report released last week, the Center on Budget and Policy Priorities (CBPP) stated:

> The worst recession since the 1930s has caused the steepest decline in state tax receipts on record. … New shortfalls have opened up in the budgets of over half the states for the current fiscal year … States will continue to struggle to find the revenue needed to support critical public services for a number of years.[3]

To lessen state budget cuts and/or tax increases and to maintain state/local government spending, the single largest spending component of ARRA was $135-$140 billion for state/local fiscal relief. These funds could be used over a 33-month period from October 2008 through June 2011.[4] The recent CBPP report projects that after exhausting the remaining ARRA state fiscal relief funds, states will still have to close budget shortfalls of an estimated $260 billion for state fiscal years 2011 and 2012. [5] Thus, given the worsened economic picture, federal fiscal relief will end before state revenues and budgets recover.

Unless there is another round of substantial federal assistance to help state governments deal with their budget pressures, states would be forced to begin making severe cuts to their budgets in the spring of 2010, cuts that will certainly exacerbate the recession and the unemployment situation. I do not think that Congress and the administration will allow that to happen. There is a lot of pressure building in Washington for further measures to jump-start a recovery that brings with it a resurgence of hiring and reductions in unemployment.

New York's alternative to midyear budget cuts

The Governor's other $1.2 billion in gap-closing recommendations together with end of the year loans from the state's Tax Stabilization Reserve Fund and its Rainy Day Fund would allow the state to close out the current fiscal year in balance without doing damage to the state's economy. As the state's Annual Information Statement indicates, the Tax Stabilization Reserve "can be used to finance an unanticipated deficit at the end of the fiscal year."

State tax collections for the first six months of the fiscal year have been weak, but the current economy is exceptionally hard to predict. In recent months, job losses have been less than expected, particularly in the finance sector. While the functioning of financial markets certainly cannot be considered back to "normal," Wall Street's profit outlook is much better than anyone predicted and it looks like bonus payments will be much higher than thought just a few months ago.

---

[3] Elizabeth McNichol and Nicholas Johnson, "Recession Continues to Batter State Budgets; State Responses Could Slow Recovery," Center on Budget and Policy Priorities, Oct. 20, 2009. http://www.cbpp.org/files/9-8-08sfp.pdf.
[4] Under ARRA, the increased federal share of Medicaid (FMAP) is in effect from October 2008 to December 2010, and the State Fiscal Stabilization Fund provides aid from January 2009 through June 2011.
[5] Most states operate on a July-June fiscal year; the exceptions are New York (April-March), Texas (September-August), and Alabama and Michigan (October-September).

Should the state have a cash flow problem in December 2009 when substantial local aid payments are due, the state should seriously consider short-term borrowing that would be re-paid before the end of the fiscal year. Short-term interest rates are extremely low and many states have been using short-term borrowing to meet cash flow needs.[6] According to Bloomberg News, it appears that the state General Fund lost money by not borrowing short-term in September to take advantage of a discount it would have received by making a $1 billion pension payment early.[7]

New York's 2009-2010 tax increases and the state's economic outlook

The $17.9 billion 2009-2010 state budget gap was closed last spring through a combination of federal stimulus funds, budget cuts, and increases in taxes and fees, with each type of action accounting for roughly a third of the gap. Some have argued that the tax increases damaged the state's economic climate and failed to produce the projected revenues. It is important to address the inference that the imposition of temporarily higher personal income tax rates on high-income taxpayers produced less revenue than projected because some taxpayers moved out of the state. There is absolutely no evidence that we know of to support this contention. Personal income tax collections have been weaker than forecast for the six months from April through September because the downturn has been more severe than anticipated in early 2009. Tax revenues have been weak because of the recession's effects on wage earnings and the financial market's effects in reducing capital gains.

New York was not alone in raising taxes and fees. According to the Center on Budget and Policy Priorities, over 30 states raised taxes during the past year.[8] There is no doubt that most New Yorkers have been adversely affected by the severity of the recession. As noted earlier, nearly 850,000 New Yorkers are officially unemployed, several thousand more have seen their hours and pay reduced, and foreclosures and personal bankruptcies are both running at about 50,000 a year in New York. The recession is taking a heavy human toll. Nonetheless, in terms of job losses, most states appear to be worse off than New York. Forty states have experienced steeper job losses than New York since the beginning of the national recession. New York's job loss has been less than half the national rate during the recession.[9] Moreover, in the months since March when New

---

[6] Michael Quint, "New York Delays $959 Million Payment to Pension Fund," Bloomberg.com, October 24, 2009. http://www.bloomberg.com/apps/news?pid=20601103&sid=aTXLmNLxluZs.

[7] Ibid. Apparently, the state would have received a discount equal to $36 million if it had paid the state retirement fund $959 million this September instead of in March of next year. If the state were able to borrow at a 1 percent annual rate for six months (which seems reasonable since Illinois, with a slightly lower credit rating than New York, borrowed $1.25 billion in August at costs ranging from 0.77 percent for a seven-month issue to 1.14 percent for 10-month notes), it would have cost the state about $5 million to borrow the $959 million needed to make the pension payment.

[8] Nicholas Johnson, Andrew C. Nicholas, and Steven Pennington, "Tax Measures Help Balance State Budgets. A Common and Reasonable Response to Shortfalls," Center on Budget and Policy Priorities, updated July 9, 2009. http://www.cbpp.org/files/5-13-09sfp.pdf

[9] Fiscal Policy Institute, *The State of Working New York 2009: Unemployment and Economic Insecurity in the Great Recession*, September 2009, p. 27. http://www.fiscalpolicy.org/SOWNY2009.html.

York raised its income tax rate, the rate of private sector job loss was less in New York than at the national level.[10]

Once the national economy moves onto a path toward sustainable recovery, the outlook for New York's economy relative to other states is promising. Federal government data indicate that New York's workers are among the most productive in the United States. New York's value added per private sector worker was 37 percent greater than the national average in 2007, and the highest among the 10 largest states. The state's productivity edge is broad-based across many sectors. Among the 10 largest states, New York ranks first in worker productivity in 11 out of the 18 major non-agricultural sectors, and second in two other sectors.[11]

Some have also argued that reducing state government spending would enhance New York State's long-term competitiveness. However, this is an argument based more on ideology than on sound economic reasoning. The logic behind such a perspective is always one-sided, seeing government spending as only a cost to business in the form of taxes while ignoring the value of investments made by state and local governments in contributing to New York's high productivity—investments such as in mass transit, public higher education, and primary and secondary education.

Governor Paterson's proposal for a state spending cap

The Governor is also calling for the enactment of a state spending cap. Colorado is the only state where voters have approved a spending cap, and its experience suggests it may be the last. In 1992, Colorado enacted a constitutional amendment to limit the annual growth in state revenues and expenditures to a highly restrictive formula—the rate of inflation plus the annual change in population. In Colorado, the spending cap contributed to a significant decline in public services, with these results:

- Colorado's ranking in K-12 spending as a percent of personal income dropped from 35th to 49th in the nation;
- Higher education funding dropped by 31 percent after adjusting for inflation;
- The share of low-income children in the state without health insurance doubled, making Colorado the worst in the nation by this measure;
- Colorado fell from 23rd to 48th in the nation in the percentage of pregnant women receiving adequate access to prenatal care; and
- The state fell from 20th to 48th for the percentage of low-income non-elderly adults covered by health insurance.

In 2005, these problems led Colorado voters to approve a statewide measure to suspend the spending cap for five years in order to allow the state to rebuild its public services.[12]

[10] Between March and September 2009, the decline in private sector employment was 1.1 percent in New York State and 1.7 percent in the U.S. Bureau of Labor Statistics, seasonally adjusted payroll employment.
[11] Ibid, p.41.
[12] Iris J. Lav, "A Formula for Decline: Lessons from Colorado for States Considering TABOR," Center on Budget and Policy Priorities, October 9, 2009. http://www.cbpp.org/cms/index.cfm?fa=view&id=753.

Governor Paterson's proposed state spending cap would be even more restrictive than Colorado's—he is proposing to cap spending at the average inflation rate for the three previous years.

In addition to seriously eroding the quality of public services and quality of life in New York, a state spending cap likely would put even greater pressure on local property taxes since the state would have less to spend on education or healthcare.

Thank you for the opportunity to testify today.