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James A. Parrott, Ph.D.  
Chief Economist and Deputy Director  
Fiscal Policy Institute  
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# Overview

- The expansion since mid-2003 was debt-fueled, characterized by a housing bubble and unsustainable.
- Wages failed to keep up with productivity and profit growth, or with the cost of living, forcing consumers to rely more heavily on debt.
- Unemployment insurance and Medicaid spending have helped cushion recent recessions in NYS, and in 2003 the State Legislature crafted a better approach to budget problems than the fiscal policy response to the recession of the early 1990s.
- The federal stimulus package is unlikely by itself to avert further decline; Washington should consider Stimulus II.
- Wall Street's current predicament could lead to regulatory and structural changes that will have significant implications for NYS.
- Revised DoB economic forecasts are reasonable.

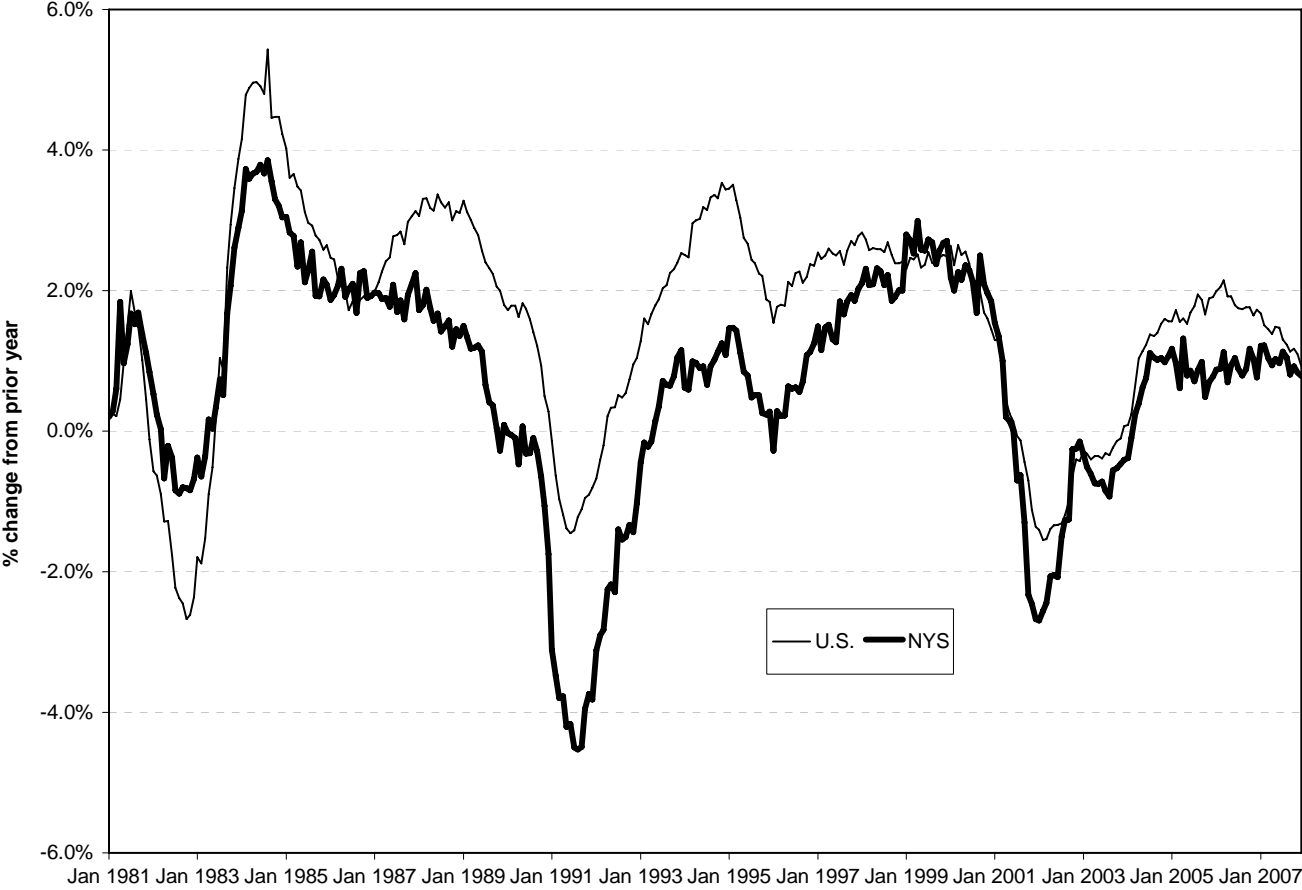
The U.S. expansion since mid-2003 was heavily fueled by debt, much of it related to an unsustainable housing bubble.

<b>Gross Domestic Product and major components</b>	<b>First quarter 2001</b>	<b>First quarter 2007</b>	<b>Change</b>	<b>Percent Change</b>
Gross Domestic Product (GDP)	\$10,021.5	\$13,551.9	\$3,530.4	35.2%
Personal consumption expenditures	\$6,955.8	\$9,540.5	\$2,584.7	37.2%
Nonresidential fixed investment	\$1,229.6	\$1,431.4	\$201.8	16.4%
Residential investment	\$455.6	\$687.5	\$231.9	50.9%
Government expenditures	\$1,783.3	\$2,608.3	\$825.0	46.3%
Net exports, goods & services	-\$392.9	-\$714.2	-\$321.3	81.8%
<b>Growth in debt levels</b>	<b>First quarter 2001</b>	<b>First quarter 2007</b>	<b>Change</b>	<b>Percent Change</b>
Total domestic nonfinancial debt	\$18,339.1	\$29,255.0	\$10,915.9	59.5%
Home mortgage debt	\$4,921.7	\$9,854.2	\$4,932.5	100.2%
Consumer credit	\$1,794.0	\$2,459.1	\$665.1	37.1%
Federal government debt	\$3,383.0	\$4,966.4	\$1,583.4	46.8%
State/Local government debt	\$1,223.3	\$2,049.7	\$826.4	67.6%
Total business debt	\$6,567.3	\$9,229.2	\$2,661.9	40.5%
Domestic financial sectors	\$8,487.7	\$14,976.3	\$6,488.6	76.4%
<b>National income, wages and profits</b>	<b>First quarter 2001</b>	<b>First quarter 2007</b>	<b>Change</b>	<b>Percent Change</b>
National income	\$8,987.6	\$11,979.7	\$2,992.1	33.3%
Wages and salaries	\$4,961.1	\$6,261.4	\$1,300.3	26.2%
Corporate profits	\$778.7	\$1,547.7	\$769.0	98.8%

Note: Dollars are in billions, nominal.

Sources: U.S. Bureau of Economic Analysis, National Income and Product Accounts, and Federal Reserve System, Flow of Funds, First Quarter 2007

New York's job growth is starting to slow, but nationally it has been slowing for the past year.



The national economy is clearly slowing and could be in a recession; either way, NYS's economy will be adversely affected.

- Most indicators have turned sharply negative (e.g., consumer confidence, housing price declines, job growth)
- Every new survey of economic forecasters shows a greater number predicting a recession in the first half of this year.
- May not know officially about a recession for several months.
- The bursting of the housing bubble triggered a crisis in subprime mortgage lending, but risky lending practices went far beyond that.
- An unprecedented credit crunch has developed in financial markets and problems have spilled over to the municipal bond market.
- The foreclosure epidemic is headed for New York and the fallout for the broader real estate market will undermine consumer confidence.
- Initial unemployment claims in NYS are the highest in 5 years, with 25,000 New Yorkers a week filing initial unemployment claims.
- This is a highly unusual economic and financial situation and unprecedented counter-measures will be needed.

## Mortgage foreclosure problems will worsen in New York.

- While the real estate bubble was much worse in parts of Florida and California, real estate prices soared in New York City and its suburbs and questionable lending practices were widespread.
- With Wall Street opening the credit floodgates by “securitizing” home mortgages and re-selling them to investors, subprime mortgage companies aggressively sought out home buyers with easy credit terms and adjustable rate mortgages with low “teaser” rates that would “re-set” later at higher rates. This recipe could only work as long as real estate prices kept going up.
- A report on the mortgage crisis for the U.S. Conference of Mayors by the economics consulting firm, Global Insight, predicts that home price declines will average 7% across the U.S. in 2008, and there is a risk of greater declines. Job growth, incomes and consumption will all falter as a result, shaving a full percentage point from GDP in 2008.
- Even though the economic impact of the mortgage crisis will be slightly less than a 1% reduction across New York’s metropolitan areas, Global Insight predicts over 50,000 mortgage foreclosures in New York in 2008, the ninth highest among states (behind CA, FL, MI, TX, OH, AZ, IL, and GA).
- Global Insight projects that the value of housing in foreclosure in New York will reach \$14.2 billion in 2008, ranking the state 4<sup>th</sup>, behind CA, FL, and AZ. New York also ranks 4<sup>th</sup> in the 2008 projected decline in property values (\$63 billion).

# Capital gains and Wall Street wages accounted for half of the growth in NYS's personal income tax base from 2003 to 2007.

	NYS Adjusted Gross Income (NYSAGI) (\$ millions)	Net Capital Gains (\$ millions)	Total Wall Street Wages (\$ millions)	Capital Gains and Wall Street Wages as a share of	
				the level of AGI	AGI change from prior year
<b>1996</b>	347,981	22,441	24,534	13%	47%
<b>1997</b>	383,179	31,563	28,790	16%	38%
<b>1998</b>	417,996	38,929	33,602	17%	35%
<b>1999</b>	448,531	48,330	35,116	19%	36%
<b>2000</b>	508,934	62,302	48,777	22%	46%
<b>2001</b>	481,001	29,450	49,813	16%	114%
<b>2002</b>	459,919	20,398	40,278	13%	88%
<b>2003</b>	473,778	28,455	38,025	14%	42%
<b>2004</b>	525,964	51,196	46,203	19%	59%
<b>2005</b>	571,916	64,411	51,616	20%	41%
<b>2006</b>	631,683	81,071	63,590	23%	48%
<b>2007</b>	686,008	93,151	76,308	25%	46%
<b>1996-2000</b>	46%	178%	99%	18%	39%
<b>2003-2007</b>	45%	227%	101%	22%	48%

Sources: NYSAGI and Capital Gains, New York State Division of the Budget; 2005-2008 are DoB projections (2007 from 21-day amendments). Wall Street Wages from NYS DoL: 1991-1999 on SIC basis; 2000-2008 on NAICS basis. 2006-2008 Wall Street wages are FPI projections.

There was broad improvement in New York's job growth in 2007, with Western and Northern New York improving the most.

	Non-agricultural Employment	Annual Average Absolute Change				Annual Average Percent Change			
	Jan.-Nov. 2007	2003-04	2004-05	2005-06	2006-07	2003-04	2004-05	2005-06	2006-07
<b>United States</b>	<b>137,853,545</b>	<b>1,436,000</b>	<b>2,268,000</b>	<b>2,471,000</b>	<b>1,841,600</b>	<b>1.1%</b>	<b>1.7%</b>	<b>1.8%</b>	<b>1.4%</b>
<b>New York State</b>	<b>8,684,400</b>	<b>55,000</b>	<b>72,200</b>	<b>78,800</b>	<b>86,800</b>	<b>0.7%</b>	<b>0.9%</b>	<b>0.9%</b>	<b>1.0%</b>
<b>New York City</b>	<b>3,711,327</b>	<b>18,200</b>	<b>52,900</b>	<b>62,200</b>	<b>54,200</b>	<b>0.5%</b>	<b>1.5%</b>	<b>1.7%</b>	<b>1.5%</b>
<b>Eastern New York</b>	<b>2,718,300</b>	<b>29,258</b>	<b>12,783</b>	<b>14,842</b>	<b>21,600</b>	<b>1.1%</b>	<b>0.5%</b>	<b>0.6%</b>	<b>0.8%</b>
Nassau-Suffolk, NY Metropolitan Division	1,255,409	11,200	5,700	8,300	9,400	0.9%	0.5%	0.7%	0.8%
Putnam-Rockland-Westchester	573,255	8,500	2,500	2,000	6,200	1.5%	0.4%	0.4%	1.1%
Albany-Schenectady-Troy, NY MSA	447,882	4,400	2,000	1,600	1,200	1.0%	0.5%	0.4%	0.3%
Glen Falls, NY MSA	55,100	1,400	200	500	500	2.7%	0.4%	0.9%	0.9%
Kingston, NY MSA	65,882	-700	-100	700	1,200	-1.1%	-0.2%	1.1%	1.9%
Poughkeepsie-Newburgh-Middletown, NY MSA	257,518	4,000	2,200	1,700	2,400	1.6%	0.9%	0.7%	0.9%
Columbia County	21,527	500	0	0	100	2.4%	0.0%	0.0%	0.5%
Greene County	15,027	-500	300	200	300	-3.4%	2.1%	1.4%	2.0%
Sullivan County	26,700	400	100	-100	300	1.5%	0.4%	-0.4%	1.1%
<b>Western and Northern New York</b>	<b>2,772,336</b>	<b>12,000</b>	<b>7,267</b>	<b>5,783</b>	<b>14,900</b>	<b>0.4%</b>	<b>0.3%</b>	<b>0.2%</b>	<b>0.5%</b>
<b>W&amp;N NY Metropolitan Areas</b>	<b>2,253,145</b>	<b>8,900</b>	<b>5,992</b>	<b>2,367</b>	<b>11,100</b>	<b>0.4%</b>	<b>0.3%</b>	<b>0.1%</b>	<b>0.5%</b>
Binghamton, NY MSA	113,782	-100	-300	1,100	500	-0.1%	-0.3%	1.0%	0.4%
Buffalo-Niagara Falls, NY MSA	548,518	2,600	-1,300	-1,000	3,300	0.5%	-0.2%	-0.2%	0.6%
Elmira, NY MSA	40,336	-600	0	300	0	-1.5%	0.0%	0.8%	0.0%
Ithaca, NY MSA	62,427	900	500	400	200	1.5%	0.8%	0.6%	0.3%
Rochester, NY MSA	514,109	1,700	3,600	-1,600	1,300	0.3%	0.7%	-0.3%	0.3%
Syracuse, NY MSA	321,982	1,000	1,900	200	1,800	0.3%	0.6%	0.1%	0.6%
Utica-Rome, NY MSA	132,800	400	200	-400	200	0.3%	0.2%	-0.3%	0.2%



	Non-agricultural Employment Jan.-Nov. 2007	Annual Average Absolute Change				Annual Average Percent Change			
		2003-04	2004-05	2005-06	2006-07	2003-04	2004-05	2005-06	2006-07
<b><i>W &amp; N NY Non-metropolitan areas</i></b>	519,191	3,100	1,375	3,317	3,800	0.6%	0.3%	0.6%	0.7%
Allegany County	17,164	300	0	0	100	1.8%	0.0%	0.0%	0.6%
Cattaraugus County	34,127	100	-400	-200	100	0.3%	-1.2%	-0.6%	0.3%
Cayuga County	27,182	500	-300	200	200	1.9%	-1.1%	0.7%	0.7%
Chautauqua County	56,536	500	0	-400	-100	0.9%	0.0%	-0.7%	-0.2%
Chenango County	17,018	0	100	200	0	0.0%	0.6%	1.2%	0.0%
Clinton County	36,073	0	100	0	100	0.0%	0.3%	0.0%	0.3%
Cortland County	18,364	-400	-300	-200	0	-2.1%	-1.6%	-1.1%	0.0%
Delaware County	18,364	300	100	0	0	1.7%	0.5%	0.0%	0.0%
Essex County	15,600	300	0	-200	300	2.0%	0.0%	-1.3%	2.0%
Franklin County	19,636	100	100	100	300	0.5%	0.5%	0.5%	1.6%
Fulton County	18,536	100	-100	200	-100	0.5%	-0.5%	1.1%	-0.5%
Genesee County	23,755	-100	-100	100	700	-0.4%	-0.4%	0.4%	3.0%
Jefferson County	43,309	300	700	1,600	600	0.7%	1.7%	3.9%	1.4%
Lewis County	7,136	100	100	300	200	1.5%	1.5%	4.5%	2.9%
Montgomery County	20,036	400	500	100	0	2.1%	2.6%	0.5%	0.0%
Otsego County	26,945	500	200	300	0	1.9%	0.8%	1.1%	0.0%
St. Lawrence County	41,955	-100	100	300	400	-0.2%	0.2%	0.7%	1.0%
Schuyler County	4,955	100	0	100	0	2.1%	0.0%	2.0%	0.0%
Seneca County	11,936	100	0	0	200	0.9%	0.0%	0.0%	1.7%
Steuben County	38,645	-200	400	200	300	-0.5%	1.1%	0.5%	0.8%
Wyoming County	14,700	0	200	500	400	0.0%	1.5%	3.6%	2.8%
Yates County	7,218	300	-100	-100	100	4.3%	-1.4%	-1.4%	1.4%

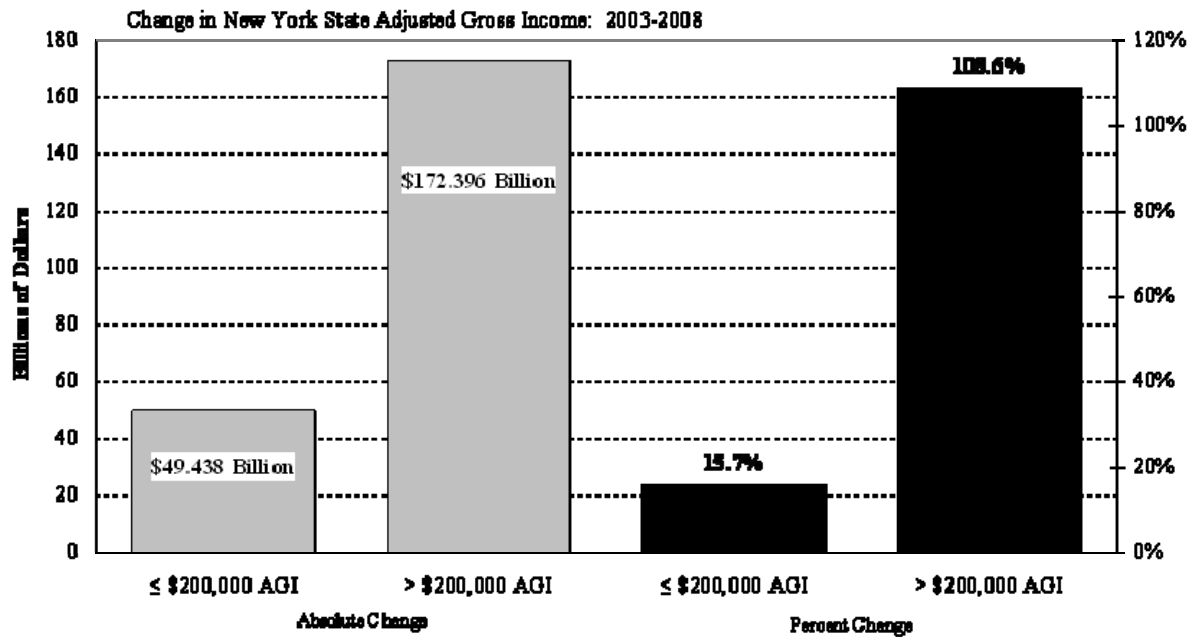
Source: New York State Department of Labor. 2007 data projected based on 11 months.

While the economic slowdown takes center stage, New York also needs to understand and address four “troubling trends.”

- The deterioration in job quality—less economic security, fewer benefits.
- Wage-productivity gap—New York’s productivity grows but outstrips wage growth.
- The reality that just getting a job isn’t enough to lift families out of poverty—the increase in the working poor.
- The widest income gap among states between rich and poor, and between rich and the middle class.

[these trends discussed in detail in FPI’s *The State of Working New York 2007*]

New York's income growth since 2003 has been concentrated among the top 5%.



Source: New York State Division of the Budget.

The right policy actions can help counter recessionary pressures.

- New York's experience in the last two recessions underscores the importance of unemployment insurance and Medicaid spending in cushioning the downturn.
- In 2003, the State Legislature crafted a better and more balanced budget response than proposed by the Governor or that had been pursued during the early 1990s recession.
- The recently enacted Federal stimulus package is a step in the right direction to boost spending, but it is far less targeted (and ultimately will be less effective) than extending unemployment benefits, providing state fiscal relief, or funding needed infrastructure spending.

# State unemployment insurance benefits served a critical safety net function during the 2000-2002 downturn.

	Increase in state unemployment insurance (in millions)	Percent increase in state unemployment insurance	Change in unemployment insurance as a share of the change in personal income
<b>United States</b>	\$32,838	164.9%	3.6%
<b>New York State</b>	\$2,620	158.7%	17.9%
<b>New York City</b>	\$1,407	168.4%	36.1%
<b>Eastern New York</b>	\$588	159.0%	8.8%
Capital District	\$81	111.3%	6.8%
Long Island	\$295	179.0%	7.9%
Hudson Valley	\$212	160.2%	12.1%
<b>Western and Northern New York</b>	\$626	140.3%	15.6%
Central New York	\$85	150.5%	6.6%
Finger Lakes	\$180	175.2%	14.0%
Mohawk Valley	\$54	126.3%	25.6%
North Country	\$180	175.2%	46.7%
Southern Tier	\$100	186.3%	88.1%
Western New York	\$167	120.8%	12.3%

Note: Nominal dollars, not adjusted for inflation

Source: Bureau of Economic Analysis data analyzed by Fiscal Policy Institute.

Medicaid spending in New York (with half coming from Washington) has grown fastest during and coming out of the last two recessions.

- While total Medicaid spending grew 8.1% annually from 1996-2006, it grew by 15% a year from 1988-93, and by 10.7% annually 2001-04. (Bureau of Economic Analysis personal income data)
- During the last recession, Medicaid spending accounted for nearly 20% of the increase in total NYS personal income (2001-04), while it was 12.3% during the 1988-93 downturn.

Enacted Federal stimulus package with tax rebates will help but it is unlikely to prevent the economy from worsening.

- While the House and the Senate improved upon the President's approach, the bulk of the tax rebates still go to higher income households less likely to spend their tax rebates and stimulate consumption spending.
- The bonus depreciation component is unlikely to stimulate business investment.

## It's not too early for Congress to be considering Stimulus II.

- Most economists agree that the quickest way to boost consumption spending is to have the federal government extend unemployment benefits and increase food stamp allotments.
- With more and more states facing severe budget pressures, balanced budget imperatives are likely to force spending cuts or tax increases, both of which will hinder recovery. In the last recession, federal fiscal relief to the states took the form of increasing the federal share of Medicaid and by providing unrestricted aid. This would ease mounting budget gaps in NY and elsewhere.
- Also, many governors are pressing for federal infrastructure assistance for repair and other projects that can be gotten underway quickly as an intermediate-term stimulus measure that also helps states address critical infrastructure needs.



Wall Street's current turmoil may lead to structural and regulatory changes that could have profound economic and revenue implications for NYS.

- Broad agreement that Wall Street's innovative financing practices have compounded market risks rather than hedging them.
- Institutions have already written down nearly \$200 billion in bad loans with one estimate putting the ultimate total as high as \$800 billion.
- This has produced an unprecedented credit crunch not seen since the Great Depression ... and forced some banks to seek infusions of foreign capital.
- Increasing calls for a re-regulation of the finance sector to restore a better balance between the "real economy" and the "financial sector".
- Some finance experts, including a Federal Reserve governor, also calling for changing the basis of individual compensation to better reflect longer-term risks undertaken by investment bankers and traders.
- These changes could reduce securities profits and bonus payouts, with implications for NYS tax revenues.

## Division of the Budget revisions to U.S. economic forecasts in the Governor's 21-day amendments.

<i>calendar year</i>	<b>2007</b>	<b>2008</b>	<b>2009</b>
<b>Real GDP</b>			
21-day amendments	2.2	1.9	2.5
Executive Budget	2.2	2.2	2.9
<b>Corporate Profits</b>			
21-day amendments	3.2	0.5	5.5
Executive Budget	3.7	3.1	5.5
<b>Personal Income</b>			
21-day amendments	6.2	4.4	5.4
Executive Budget	6.2	5.3	6.0
<b>Nonag. Employment</b>			
21-day amendments	1.1	0.6	1.1
Executive Budget	1.3	1.0	1.2
<b>Federal Funds Rate</b>			
21-day amendments	5.0	2.7	2.9
Executive Budget	5.0	4.0	4.3
<b>Consumer Price Index</b>			
21-day amendments	2.9	3.0	2.2
Executive Budget	2.8	2.7	2.2

## Division of the Budget revisions to NYS economic forecasts

<i>calendar year</i>	<b>2007</b>	<b>2008</b>	<b>2009</b>
<b>NYS Personal Income</b>			
21-day amendments	7.8	4.3	4.1
Executive Budget	7.4	4.3	4.8
<b>Finance and Insurance Bonus</b>			
21-day amendments	28.8	-3.7	0.8
Executive Budget	28.5	-3.2	9.8
<b>Nonag. Employment</b>			
21-day amendments	1.2	0.5	0.5
Executive Budget	1.1	0.6	0.6
<b>Composite CPI of NY</b>			
21-day amendments	2.8	3.0	2.5
Executive Budget	2.8	2.7	2.5
<b>Capital Gains</b>			
21-day amendments	14.9	-9.4	6.4
Executive Budget	13.8	1.8	5.6
<b>NYSAGI</b>			
21-day amendments	8.6	1.4	4.1
Executive Budget	8.0	3.2	4.8

## Conclusions

- In basic agreement with DoB revised economic forecasts; reflects radically changed financial and economic environment.
- Tax revenue forecasts also seem appropriate given the changed economic outlook.
- Important to consider how budget and policy actions will affect the state economy in the short run. 2003 budget actions more balanced and far better than in early 1990s recession.
- Given economic weakness, a second federal stimulus package will probably be necessary. Important to make this one more targeted and in a way that will help NYS and other states.
- Also important for State to address the four “troubling trends” identified in the State of Working New York.