Closing the Gap: Options for Deficit Mitigation: Session Summary

By Sujit CanagaRetna

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2010 ECONOMIC SUMMIT OF THE STATES

FINANCIAL SERVICES WORKING GROUP (FSWG)
Friday, May 21, 2010, 7:30 a.m. - 9:00 a.m.

MEETING SUMMARY

Presiding:

Nancy Kopp, State Treasurer, Maryland, Co-Chair FSWG

• Session Business

FSWG Co-Chair Nancy Kopp, Maryland, began the session by noting the presence of FSWG Vice-Chair Senator Tarryl Clark, Minnesota and by indicating that the session format would follow a conversational mode in an effort to encourage more discussion. In her opening remarks, Treasurer Kopp also commented on the fact that as states grapple with the worst economic downturn since the Great Depression, they faced many daunting challenges. She indicated that while the impact of the Great Recession on state budgets and state revenues had been staggering, it is expected that these impacts will linger long after both the national and state economies start ticking upwards again. In fact, according to Treasurer Kopp, at the state level, the sheer scope, depth and length of the Great Recession will ensure that a Great Transformation takes place in state government. She expanded on this by noting “[W]hat I mean by that is that state governments are being radically transformed given the steep drop-off in revenues and sharp expenditure cutbacks experienced in the last few years. These twin trends have already severely limited the kind of services provided by state governments, whether it is in the realm of education, healthcare, public pensions, transportation, infrastructure or a number of other fields.”

• Closing the Gap: Options for Deficit Mitigation

1. Scott D. Pattison, Executive Director, National Association of State Budget Officers (NASBO), Washington, D.C.

Mr. Pattison began by noting that for the first time in decades, state spending had declined in two consecutive years, fiscal years 2009 and 2010, signifying a trend that could be regarded as the onset of a “new normal.” As he indicated, this trend in the last two fiscal years stood in stark contrast to
the 32-year historical average growth rate of 5.6 percent in state spending. Not only has this resulted in record budget cuts, even after state budgets were enacted in fiscal year 2010, state revenues were also down 4.2 percent in the fourth quarter, resulting in the fifth straight quarter of declines. In addition, the end-of-year balances in states were also declining, another confirmation of the grim fiscal outlook sweeping over states.

According to Mr. Pattison, state revenues were extremely sensitive to national economic conditions and this was particularly evident with regard to the income tax. He cited several reasons for this increased volatility including an increasing reliance on upper income taxpayers, growing importance of capital gains and investment income and the general unwillingness in states to raise taxes.

Continuing his remarks, Mr. Pattison indicated that unlike in prior recessions and downturns, there had been fewer “rating agency downgrades of states so far.” As a point of comparison, he noted that in the 2001 to 2003 recessionary period, there were 14 state rating downgrades with four occurring in 2001, two in 2002 and eight in 2003. In contrast, he noted that between 2007 and 2010, there were only 7 state rating downgrades with one in 2007, none in 2008, six in 2009 and none so far in 2010. He commented that while the 2001 to 2003 recession represented a more sudden decline, the current recession was “slower but deeper.”

In closing, Mr. Pattison commented on the state fiscal outlook and forecasted “austere state budgets for at least the next several years.” While there would be tough competition for state general funds during this period, it would heighten and demand better performance, more transparency and stellar results and outcomes. He also speculated that these dire fiscal times provided incredible opportunities for meaningful and significant reforms.

2. Paul Priest, Assistant Director, Texas Legislative Budget Board, Austin, Texas

Mr. Priest began by noting that Texas did not have a legislative session in 2010 and that the state’s legislative session in January 2011 will decide on a biennial budget for fiscal years 2011 and 2012. He indicated that the total Texas 2011 biennial budget was $182.2 billion with general revenue funds providing $80.6 billion (44.2 percent), general revenue dedicated funds generating $6.4 billion (3.5 percent), federal funds providing $65.5 billion (36 percent) and other funds producing the remaining $29.7 billion (16.3 percent). In terms of breaking down the upcoming expenditure categories of the 2011 $182.2 billion biennial budget, Mr. Priest noted that the largest four categories were education ($75.5 billion or 41.3 percent), health and human services ($59.7 billion or 32.8 percent), economic development ($20.7 billion or 11.4 percent) and public safety and criminal justice ($10.8 billion or 5.9 percent).

According to Mr. Priest, federal funds are an important component of Texas budget and for the upcoming 2011 biennial budget the state will receive $65.5 billion in funds from the federal government. Most of these federal funds, he noted, will be allocated towards health and human services and education. He added that the funds Texas received under the 2009 American Recovery and Reinvestment Act (ARRA) were an important boost to waning state revenues and ensured that essential programs continued in many areas of Texas state government. Under the ARRA, Mr. Priest noted, in 2008-09, Texas has either expended or budgeted $2.4 billion with a bulk of these funds going towards health and human services. For 2010-2011, Texas has been appropriated $12.1 billion in ARRA funds with a majority of these funds going towards education ($6.2 billion), health and human services ($2.7 billion) and business and economic development ($2.6 billion).

On the revenue side, Mr. Priest noted that the estimated revenue collections for the 2011 biennium revolved around three major revenue categories: federal funds (27.3 percent), sales taxes (24.3 percent) and other taxes (16.1 percent). The chair of the Texas House Appropriations Committee
recently announced that Texas faces an $18 billion shortfall in its 2011 biennial budget, a scenario that will place considerable challenges on state policymakers.

3. Robert B. Ward, Deputy Director, The Rockefeller Institute, Albany, New York

According to Mr. Ward, the national downturn that began gathering intensity in 2007 has been “a perfect storm of fiscal calamities” for almost every state but particularly New York. He indicated that in New York, as in so many other states, the dramatic decline in state revenues has been coupled with sharply increased state costs in Medicaid, education, unemployment insurance and many other areas. He added that New York as a result of the strong fiscal headwinds faces “a generational challenge that will test the durability and flexibility of its government.” He was quick to note that the current crisis did not cause New York’s enormous fiscal challenges but only further “exposed them.” Mr. Ward indicated that for many years now, New York has been on “a long-term, unsustainable divergence between state revenues and expenditures” that “has led directly to a large and growing structural budget deficit that is masked, year after year, through accounting techniques, borrowing, and one-time actions.” Unfortunately, Mr. Ward indicated, “many people in the state do not yet understand the severity of the structural deficit problem.”

In devising strategies to begin dealing with this rapidly escalating fiscal conundrum, Mr. Ward noted that a team of officials working with Lieutenant Governor Richard Ravitch have come up with a series of specific recommendations. Mr. Ward indicated that the sooner policymakers at every level of state government pursue implementing these recommendations, working in tandem and cooperation with the other stakeholders, the sooner the state’s fiscal situation will stabilize.

By implementing these measures, Mr. Ward noted, New York will be able reach the following objectives:

- Ensure that the state pays down its existing structural budget gap within five years;
- Enforce a quarterly assessment by an independent review board of the state's progress towards balancing its budget permanently;
- Authorize the Governor, if the independent review board finds that the budget is not projected to be in balance at year's end under current budget rules or has not made adequate progress toward balance, to implement across the board, proportional reductions;
- Ameliorate the dispute between the executive and legislative branches over the inclusion of statutory language in executive budget appropriations bills; and
- Allow the state to borrow within stringent limits to close existing budget gaps, but only if the independent review board finds that strict new financial controls have been met and only on the condition that debt service be repaid within a limited amount of time.

**Conclusion**

Treasurer Kopp fielded a number of questions directed to the presenters and the ensuing discussion provided additional information on the dire fiscal situation challenging states. She then encouraged FSWG members and others interested in issues impacting state finances to contact either her or CSG staff regarding future topics for discussion, thanked the panelists for participating and sharing their expertise and finally, with no more business up for discussion, Treasurer Kopp adjourned the meeting.

**Meeting Materials:**

State Fiscal Outlook Background [2]
Scott Pattison, Executive Director, National Association of State Budget Officers