THE COUNCIL OF STATE GOVERNMENTS

FISCAL FORUM SUMMARY

DECEMBER 3, 2012, 8:00 A.M. TO 11:00 A.M.

DELL HEADQUARTERS, ROUND ROCK, TEXAS

Moderator/Presiding: Representative Maxine T. Bell, Idaho House of Representatives

Presenters:

- Mr. Scott D. Pattison, Executive Director, National Association of State Budget Officers (NASBO)
- Mr. Rick Mattoon, Senior Economist and Economic Adviser, Federal Reserve Bank of Chicago
- Mr. Keith Brainard, Research Director, National Association of State Retirement Administrators (NASRA)

Mr. Pattison began his remarks by noting that the current state fiscal situation was stabilizing from the rigors of the Great Recession and the clearest demonstration of this trend was that only eight states were forced to make mid-year budget cuts in fiscal year 2012, a sharp contrast to the 43 states that were forced to do so in fiscal year 2009. In fact, state general fund spending ($683 billion in fiscal year 2013) had crawled almost up to where it was in fiscal year 2008 ($687 billion). State revenues also continue to grow and in fiscal year 2013 will reach $690 billion, barely surpassing the level reached in fiscal year 2008 ($680 billion). Mr. Pattison indicated that states had learned a number of lessons from the Great Recession, including the need to plan for contingencies, prudently use debt, replenish rainy day funds, limit reliance on one-time revenue sources, extensively use performance information and assiduously avoid creating expensive programs during plentiful fiscal times.

Mr. Mattoon's presentation dealt with an extremely significant development: volatility levels of state revenue inflows, a development that has been marked in the 2001 recession and the Great Recession. While state tax revenues have always been volatile in responding to the business cycle, the experience of these past two recessions indicates that there appears to be a structural change in process. In the past, revenue volatility levels have largely matched the severity of the downturn or recession. However, in these two most recent recessions, the 2001 recession, a brief and shallow recession led to a far larger fiscal crisis while the Great Recession, resulted in a major fiscal crisis in the states. According to Mr. Mattoon's research, the role played by individual income revenue had shifted drastically in the last decade or so, particularly the role played by investment income, i.e., dividends, interest, realized capital gains. An important corollary to understanding the role played by investment income required further explorations of stock market dynamics and capital gains tax rates.

Mr. Brainard indicated that public pensions remain one of the major challenges confronting almost every state in the country, a statement reinforced by the fact that since 2009, 45 states have enacted reforms to bolster their plans. States continue to struggle to improve the funding position of their plans and on aggregate, public pension plans had a 76 percent funding level. He noted that there had been an unprecedented number of legislative changes made to public pensions and a record number of legal challenges in response to these legislative changes. In addition, there had been an unparalleled degree of attention devoted to public pensions and public employee compensation in the last few years alongside a reduction in state and local government employment that had not been seen in prior years. In an effort to improve their funding positions, states continue to require higher employee contributions; lower benefits to retirees (higher retirement age, more required years of service, longer vesting period and reduced or eliminated cost of living allowances (COLAs); risk-shifting to employees; and, the increased use of hybrid retirement plans.