



## **A Better Choice for Addressing New York State's Projected Budget Gaps**

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### **I. First, Do No Harm!**

Governor Paterson's proposal to make \$1.8 billion in real budget cuts between now and March 31, 2010, is a poor policy recommendation that would, if actually implemented, have a significant negative effect on the state economy - the opposite effect of his contention that his plan will "prime" the state for economic recovery.

When the federal share of Medicaid costs are taken into consideration, the Governor's plan, if implemented as proposed, would reduce economic activity in the state 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.

It is simply not possible to take \$2.26 billion of demand out of the state's economy in five months without having a significant negative effect on the economy.

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. That

question should be answered and the Governor's estimates should be carefully reviewed by independent outside economic experts.

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 \$223 million of the \$686 million in proposed cuts), 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 million. The magnitude of this differential is attributable to the fact that under the American Recovery and Reinvestment Act (ARRA), 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 costs (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 Federal Medicaid Assistance Percentage (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 current 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.

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.**

## **II. Understanding the Role of Federal Aid and State Reserves During Economic Downturns**

Making such cuts is likely to prolong the current economic 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 2009-10 Deficit Reduction Plan (DRP) 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.

At the Governor's October 15th press conference, both the Governor and the Lieutenant Governor pointed out, correctly, that the states' fiscal recoveries lag their 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.

The key is to have the phase out of the federal government's "state fiscal relief" dovetail, as closely as possible, 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. A similar policy response by the federal government is needed now.

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.

Rather than risking an interruption of the economic recovery, the state should balance this year's budget with as little damage to the economy as possible. Budget decisions that affect multiple years should be made as part of the regular budget process with a thorough vetting of all the options.

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 Fund "can be used to finance an unanticipated deficit at the end of the fiscal year."

These funds are an important backstop or cushion for getting through the current fiscal year without making the \$2.26 billion in cuts to vital services that the Governor's plan entails. The use of these reserve funds would provide the state the time to have a well-informed debate, with all the expenditure and revenue options on the table, as the Legislature and the public consider the Governor's 2010-11 Executive Budget which must be submitted to the legislature in just over two months from now. This does not mean that the Legislature and the Governor should not address the state's immediate budget needs now; but that it should address them in ways that does not do harm to the state's economy and interrupt the emerging recovery.

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 this fund on March 31, 2010, to ensure that the state's general Fund closes out the 2009-10 fiscal year in balance.

According to the State Budget Director, New York State has reserves of approximately \$1.5 billion that it does not currently plan on using to help close out the current state fiscal year in balance. Given this \$1.5 billion cushion, the Governor and the Legislature should avoid precipitous, "seat of the pants" budget cuts and revenue increases that would hit the state economy hard during the next five months.

### **iii. Making Better Budget Choices for 2010-11**

Among the budget balancing options that the Governor and the Legislature should consider in proposing and evaluating the 2010-11 Executive Budget are the following.

#### **1. 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.

#### **2. 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.

#### **3. 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.

#### **4. 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.