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Panel Discussion:
THE RECESSION'S IMPACT ON THE STATE BUDGETS OF NY AND NJ
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[JAMES ORR]:
Hello, I'm Jim Orr an economist with the Federal Reserve Bank of New York The recession that began in 2007 has taken a significant toll on state government finances. With the decline in business activity and employment, tax revenues have dropped placing significant stress on state government budgets. Earlier this year when lawmakers in both New York and New Jersey were preparing their budgets for fiscal 2011, projected tax revenues were falling short of projected expenditures by billions of dollars in both states.

I'm here today with Richard Deitz, Andrew Haughwout and Charles Steindel, research economists at the Federal Reserve Bank of New York, who have written an article exploring the recession's impact on the state budgets of New York and New Jersey.

Rich, Andy, Charlie thanks for joining us to discuss your findings. I want to start with you Rich. Why do state government budgets deteriorate so sharply during a recession?

[RICHARD DEITZ]:
Well first, revenues are under downward pressure as taxes decline. So income taxes decline as more households are out of work. As incomes are reduced, there is also declining revenue from business taxes as business activity may decline and as households are under increasing pressure there may be less spending so sales taxes may also decline. At the same time that revenues are under downward pressure, expenditures are under upward pressure. There is increasing needs for funding income support; for example unemployment compensation and Medicaid benefits. So the combination of downward pressure on revenues and upward pressure on expenditures place a significant pressure on state budgets and that is exactly the situation in New York and New Jersey.

[JAMES ORR]:
Clearly, other states are experiencing fiscal stress. Charlie, how do the problems of New York State and New Jersey stack up against other states?

[CHARLES STEINDEL]:
New York and New Jersey have large problems both in terms of dollars and its share of state budgets. However, we are not unique in this. The problems of California and Illinois are even larger than those in NY and New Jersey. Other states, Arizona, Nevada have big problems and small states as well, including Rhode Island and Hawaii. All these problems in state budgets ultimately stem from the recession. The extent of them however. are unique to every state. They depend on the particulars of the state's economies, what industries suffered during the recession. They depend on the particulars of the state's tax structure, the particulars of the state's expenditures and indeed the particulars of the state's rules and budget institutions to determine how things go. You have to take each state on a case by case basis.

[JAMES ORR]:
O.K. so let's talk about some of the distinct features of New York and New Jersey. Andy, what sets the two states apart?

[ANDREW HAUGHWOUT]:
There are really a couple of things that make budgeting in New York and New Jersey especially challenging. First of all, both states rely really heavily on income taxes as their major source of tax revenue. And that means that because income is so much more volatile than say retail sales, there's going to be wide swings in tax revenues in both states. Put that on top of that the fact that economies of the two states are heavily dependent on the finance sector, that means that because finance itself is quite volatile, they're going to have even more volatility in their overall tax revenues. At the same time as Charlie pointed out, the expenditure side matters here too. So, both states have relatively generous social welfare programs like Medicaid as Rich mentioned and those tend to rise as the recession occurs, putting further pressure on New York and New Jersey relative to other states. And, finally each state has sort of unique budgetary institutions. One example is the Property Tax Relief Fund in New Jersey which really can strain the ability of policymakers to devote revenue where it's needed when the downturn occurs.

[JAMES ORR]:
Clearly some hard choices have to be made. Let's talk a little bit about some of the steps that have been taken in New York and New Jersey to help balance the budget. Charlie, what has New Jersey done?

[CHARLES STEINDEL]:
New Jersey adopted its 2011 budget a couple of weeks ago and budget balance was achieved primarily through cutting spending. The state reduced grants to local governments and school boards. The state eliminated all funding of employee pension plans and the state

eliminated its property tax rebate for the year. This is a little different than what happened in 2010 where the state increased some taxes and also furloughed state workers for a spell but it's not out of the ordinary for how New Jersey has dealt with budget problems in the past.

[JAMES ORR]:
Rich, what has New York State done?

[RICHARD DEITZ]:
Well, New York State has not yet adopted its 2011 budget so many options are still under consideration. But during last year's budget, New York used many tools it has in the past. So first, it increased taxes on high income households; a temporary tax increase, it also eliminated its property tax rebate, the STAR property tax relief and also increased tuition at SUNY and followed and made a number of other increases in fees. At the same time made some cuts in spending. Primarily for example, cutting expenditures at state agencies.

[JAMES ORR]:
Let's look ahead. What is the outlook for the state finances in New York and New Jersey?

[ANDREW HAUGHWOUT]:
Well Jim, I think the answer to that question has two parts. First, in short run our index of coincident economic indicators shows that growth is resuming in both New York and New Jersey and that's very important because sustainable economic growth is important for supporting revenues of both the states. Unfortunately, there's some bad news in the short run as well because federal aid, which increased dramatically in the Stimulus Bill that was passed last year, is going to start to decline as this fiscal year goes on. Now, on the longer run it is important for the listeners to realize that really, state budgeting is a very difficult business and both states are always going to face stresses when the economy declines particularly, when it declines as sharply as it did this time. So, a key question then is how do we prepare for these cyclical swings in economic growth and their effects on state budgets. So, one thing some states have done is create substantial rainy day funds that can be filled with revenues when times are good and then drawn down to cushion the blow when the economy starts to contract. Still, in the long run both states and all states have to face the difficult choices that come with a declining economy and deciding whose taxes to raise or whose favorite program to cut is a very difficult kind of decision to make and it will also, can have important consequences for state economic growth. So these are very difficult choices.

[JAMES ORR]:
Clearly officials in both Albany and Trenton have their work cut out for them. Rich, Andy, Charlie thank you very much. You can find the article that we've been discussing "The Recession's Impact on the State Budgets of New York and New Jersey" as well as other research on our region at the Federal Reserve Bank of New York website *newyorkfed.org* .

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