U.S. states reflect federal budget crisis

by Andrew Rotstein

While the White House has confessed that the federal deficit for next year is running 50-100% over the estimates of four months ago, even the Bush administration's revised figures do not fully reflect the true magnitude of the ever-widening gap. The rapidly eroding fiscal position of the states, which has bred severe austerity moves and intense struggles around tax increases, is itself largely an extension of the national budget crisis.

The question, in part, is simply one of how the administration cares to look at it. For example, syndicated columnist George Will recently mocked the administration's claim that so long as Gramm-Rudman budget-balancing targets are satisfied, the challenge of deficit reduction has been met. Since modification of those very targets is emerging as a central element of the current budget negotiations between the administration and Congress, Will appropriately pointed out that such results are achieved "by semantic fiat—by redefining success."

Similarly, in the case of the federal budget, the extent of the problem has been understated by redefinition. This redefinition consists both of a shift to the states of functions formerly performed by the national government, and a host of new state programs mandated by additional federal regulations. To make matters worse, federal aid to states and localities has steadily declined since the late 1970s. If, in other words, standards of accounting are held constant, U.S. government finances are even worse than Washington has let on thus far.

Diminishing federal support

During the late 1960s and 1970s, additional programs required of states by federal law were matched by an increase in grants-in-aid by Washington and by revenue sharing. But revenue sharing, begun in the Nixon administration, was abolished in 1986.

And federal support to states and localities has fallen off sharply since the late 1970s. Measured in constant 1982 dollars, such grants have fallen from $109.77 billion in 1978 to $94.7 billion in 1989, according to a recent study by the Advisory Council on Intergovernmental Relations, a federal group. More significantly, relative to the size of the national economy, such aid has dropped from 3.7% of Gross National Product to 2.4% in 1989, a decline of 35%. In fact, figures for 1989 are themselves slightly bloated by $1.5 billion in extraordinary federal disaster relief grants in response to Hurricane Hugo and the San Francisco earthquake.

But even this does not tell the full story. The period witnessed a substantial growth in transfer payments, covering benefits to which citizens are entitled by law, but a precipitous drop in aid for infrastructure and other "discretionary" programs. Thus, federal aid for Medicaid, welfare, and other earmarked programs grew from $35 billion in 1978 to $50 billion in 1989 in constant dollars. Yet, from 1981 to 1990, support for employment and training fell from $8.4 billion to $3.5 billion, mass transit funds fell from $5.4 billion to $2.9 billion, and economic development aid plummeted from $5.7 billion to $2.9 billion. These last three sets of figures are all in current dollars, so the decline in inflation-corrected terms is even steeper than the numbers suggest.

Overall, "the fiscal position of state and local governments has declined steadily since 1984," reports the February 1990 Survey of Current Business of the U.S. Commerce Department. Such a trend, born largely of slumping sales tax and corporate income tax receipts, plus increasing expenditures for social services, hardly bespeaks the robust recovery which die-hard White House partisans advertised until Bush's recent about-face on the issue of new taxes.

Increasing federal demands

But concurrent with the withdrawal of its helping hand, Washington has enacted new legislation that supersedes state laws in areas from the environment to Medicare, necessitating additional budgetary outlays as a result.

The Advisory Council study found that of 354 such changes since 1789, when the First Congress convened in New York, 95 were enacted in the 1980s, and another 91 in the preceding dozen years.

Typical of these provisions, municipalities are required to test for pollution from thousands of storm sewers, to monitor city water supplies for 77 additional chemicals, and to control 83 new drinking water contaminants. States are now mandated to file reports on 152 new endangered species. They must also guarantee workplace compliance with new standards to protect hearing and to avoid exposure to a number of toxic chemicals.

In addition, many of the most nagging problems facing government—drugs, law enforcement, the prison system, AIDS, education, road repair, homelessness—have increasingly been left at the doorstep of the states, as federal budgets have been slashed.

Robbing the future

The states, however, are not entirely innocent victims of federal burden-dumping and accounting deceit. Many of the nation's 50 governors—leaders in innovation, as the now-shipwrecked Michael Dukakis of Massachusetts was fond of saying—have embarked on some outrageous shenanigans of their own. And in one of them, they are mimicking their counterparts on the Potomac.

Like the federal government, now infamous for its diversion of the Social Security Trust Fund surplus, states are beginning to chisel public pension funds in order to ease their situation. In the last five years, two-thirds of the states have cut their annual retirement fund contributions by little more than accounting decisions. By changing the interest rate assumption—the projected rate of return on invested funds—states are able to lower their current payments into the retirement systems.

The temptation for the economically squeezed states is great. Social insurance fund assets (of which pension funds are the largest component) and general fund balances have been rapidly moving in opposite directions over recent years: the insurance funds steadily building, the administrative balances dropping like a stone. From 1985 to 1989, the pension and other funds grew from $51.3 billion to $78.0 billion, while the general funds sank from a surplus of $13.8 billion to a deficit of $33.8 billion.

The savings for these desperate states are enormous, and can be had for the stroke of a pen. In 1989, New York Governor Mario Cuomo and officers of the state's $45 billion pension funds agreed to increase the interest rate assumption from 8% to 8.75% per year. As a result, the state saved a tidy $325 million without cutting a single job or stopping even a foot of new paved roadway. Now, as the state faces a staggering $1.7 billion shortfall, Cuomo is pushing some additional adjustments, which will net another $200 million, with less political fallout than service reductions or tax increases.

But, like the paper charade with Social Security, such short-term measures imperil the future. Pension funds are heavily invested in the volatile stock market and other instruments, not all of them insured. Despite the record Dow Jones surge of late, good things don't always last forever—just ask the federal government overseers of the savings and loan bailout, who are now beginning to unload phenomenal amounts of sharply devalued real estate. A recent study by the federal Pension Benefit Guaranty Corporation found that some of America's largest and wealthiest corporations have tens of billions of dollars in unfunded liabilities.

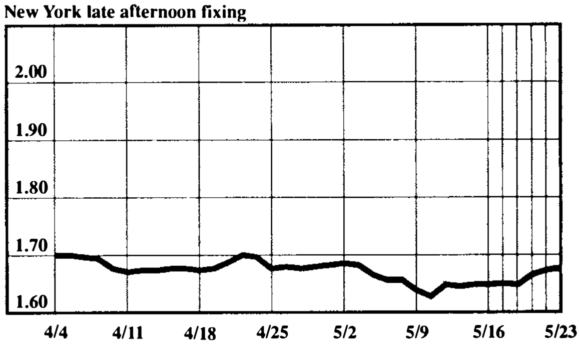
The likely immediate victims are beginning to squawk. "This is robbery, pure and simple," said Joe McDermott, head of the union representing 260,000 active and retired New York State employees, of the Cuomo move. "They're using the pension funds as a piggy bank that they can turn over when they get into a jam."

McDermott's members know what other Americans are rapidly learning: Bookkeeping tricks and other bureaucratic manipulations also have their costs.

Currency Rates

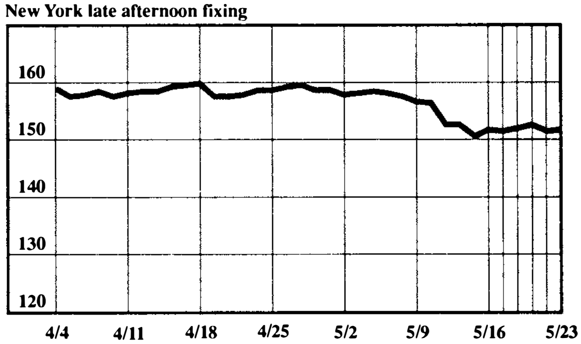
The dollar in deutschemarks

New York late afternoon fixing



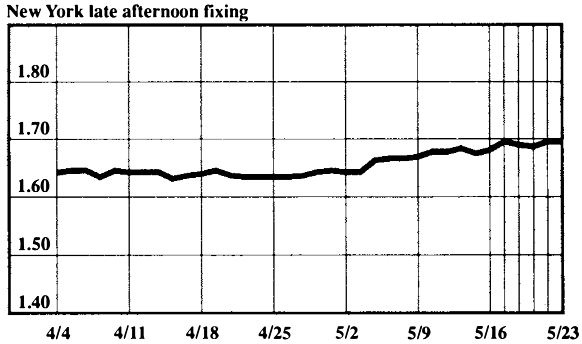
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss franks

New York late afternoon fixing