State and city deficits running out of control

by Stephen Parsons

Federal Reserve Chairman Paul Volcker's depression is creating a fiscal crisis for U.S. state and city governments of such proportions that severe austerity measures and tax increases enacted through 1981-82 have proven of no avail, and governments around the nation are resorting to across-the-board budget cuts of 10 to 15 percent to meet deficits. The accelerating fall-off in tax revenues due to economic collapse, a situation unforeseen by state and city financial planners, has precipitated the crisis.

The two most populous states in the nation—New York and California—are now enacting the most serious cuts, but according to preliminary data from the National Conference of State Legislators, at least 25 states have cut their 1983 fiscal year budgets, and could not even wait until after the November elections to do so. Ohio cut its state budget by 10 percent, after a series of tax increases and budget cuts throughout the year; Arizona still expects an $81 million deficit despite the governor making cuts of $70 million to state agencies. Nevada cut its budget by 15 percent, and Oregon, whose legislature cut the budget by 10 percent in a special session in January-March to rectify a $131 million deficit, made a second round of cuts in June due to a continuing $101 million shortfall. The deficit continued at $91 million in September, when further cuts were put through.

The state of California is currently unable to meet its November bills, and is seeking a $400 million 90-day loan on the New York money markets. News of a massive deficit began to leak out before the Nov. 2 elections, and one week later, the state director of finance issued a report forecasting a budget deficit of at least $666 million, which could reach $1.1 billion by June 1983; the state comptroller's office warned that revenue shortfalls may instead bring the deficit up to $3 billion. Official unemployment in California is now at 10.7 percent, well above the national average. Only a $5 billion surplus left over from the Reagan administration carried the state through eight years of the Brown administration, and the local budget cuts necessitated by Proposition 13's property tax reductions.

The short-term surge in revenue due to speculative real-estate and office-building spirals and expansion of the "service industries" in the 1970s, has now collapsed. This was the only basis on which states such as California, New York or Texas were able to sustain any kind of budgets when industrial states such as Ohio and Michigan went into financial collapse.

Inflation threw personal income into higher tax brackets, and office and hotel expansion in the city increased New York City's local revenues by 10 percent in 1980-81. But the real-estate market in New York and Houston has collapsed.

In addition, the bond markets, to which a number of states have resorted for emergency funds, could soon cut off lending to state and city governments. Despite their tax-free advantage, Treasury bills in particular have been the investment preferred to municipal bonds in the recent period. The huge federal deficit and corporate cash needs will absorb that market, leaving states and cities dependent on funds from foreign investors. If the inflow of funds from the Eurodollar market and other sources dry up, states and cities will be unable to meet even minimal costs of government.

The current crisis is far more serious even than the municipal bankruptcies of the 1930s, as the New York situation demonstrates. In 1975, the New York City fiscal crisis nearly precipitated a money market panic—but at that time, the state and federal governments were able to bail out the city. That is no longer the case.

In an unprecedented move, Gov. Hugh Carey, as head of the city's Financial Control Board, announced Nov. 23 that he was rejecting New York City Mayor Ed Koch's announced plans to meet the city's current deficit, because that plan was dependent on state funds. The New York City crisis has been snowballing since the beginning of November. The city faces a deficit of at least $340 million in this fiscal year, and $1.3 billion in the next. The Gross City Product has declined for three consecutive quarters, and employment has fallen for the first time since 1977. General corporate tax receipts have declined by 3 percent.

Mayor Koch announced 6 percent across-the-board cuts the first week in November, as well as a hiring freeze. Two weeks later, he proposed a $222 million tax increase and a $200 million increase in state aid, with dire warnings of thousands of municipal layoffs if the state were not forthcoming. By the third week in November, an additional 1.5 percent budget cut for city agencies was announced.

The state will not be able to pay. Governor Carey has already proposed a five-day unpaid furlough for state workers, in addition to massive cuts of state aid, merely to maintain already-contracted bailout programs. The 1981 plan to save the Metropolitan Transportation Authority from collapse was based on new state taxes that were to raise $793 million in new funds. To date, there is a $250 million shortfall in these revenues. The state now proposes to cut aid to education by $100 million, to social services by $80 million, and to cities by $79 million—to sustain the MTA.

Such a choice will mean 1,500 new policemen will not be hired by the city, and 4,000 teachers will lose their jobs immediately. New York has cut its workforce by 40 percent since 1975, and such cuts can only accelerate the fiscal collapse.