

Statement of the Honorable David A. Paterson, Governor of the State of New York

Testimony before the Full Committee
of the House Committee on Ways and Means

October 29, 2008

Chairman Rangel, Ranking Member McCrery, and distinguished members of the committee, I appreciate the opportunity to testify before you today.

For the second time this decade, New York finds itself at the epicenter of a national emergency. Unprecedented turmoil on Wall Street has left our state in the throes of its most severe economic crisis since the Great Depression. The financial services industry has been shaken to its core, and with it, virtually every aspect of economic life in America.

In just the last month and a half we have seen the largest bank failure in U.S. history; the demise of the independent investment banking model; a credit freeze that is impacting the ability of municipalities to borrow funds needed for urgent infrastructure improvements; and declines in the stock market of over 40 percent—threatening the ability of average Americans to retire and send their children to college. In many ways, the economic consequences of the current financial crisis will likely be deeper and longer-lasting than those that followed the horrific terrorist attacks on Lower Manhattan.

The Failures of the Federal Government

Americans have watched the fabric of our economic system unravel and the values of their 401(K)'s evaporate, leaving them confused, angry, and wondering who is to blame for the near collapse of our financial system.

Certainly, an age of irresponsibility and greed on Wall Street was one of the most important factors behind this crisis. But there is another culprit that is equally culpable -- the lack of oversight and regulation by the federal government. In a moment of commendable candor, Treasury Secretary Henry Paulson recently admitted that he regrets the “failures of our regulatory system.” Former Federal Reserve Chairman Alan Greenspan also recently confessed he “made a mistake” by putting too much faith in the ability of the free market to police itself and protect shareholders.

Federal oversight bodies utterly failed in their duty to protect the life savings of millions of Americans and the financial system itself. And because of their failure, our government (federal, state and local) and individuals are left to pick up the pieces—as evidenced by the \$700 billion Wall Street rescue package that Congress was forced to pass.

How the Crisis is Impacting States

State governments, just like average Americans, have suffered as result of the failure of our national regulatory system. Tax revenues have plummeted and economic growth has stagnated. According to the Center on Budget and Policy Priorities, at least 39 states are currently experiencing fiscal distress. Twenty-nine states closed budget shortfalls of \$48 billion in enacting their 2009 budgets. Since, at least 27 states are experiencing mid-year budget shortfalls for FY09, totaling \$12.3 billion, and the projected shortfall for FY10 is \$100 billion.

New York State is no exception. In fact, the challenges we face are perhaps more acute than any other state given that Wall Street accounts for twenty percent of our state tax revenue. The New York securities industry has reported \$40.9 billion in losses in the last four quarters. Even in the four quarters following September 11, 2001, these firms posted a cumulative profit of \$8.4 billion. We are now projecting that Wall Street bonuses will decline by 43 percent, or \$20.7 billion, this year, and that capital gains on the sale of stocks and other assets will decline by 35 percent, or \$38 billion.

New York's broader economy, like those in states around the nation, is also struggling. Last month, unemployment in our state reached 5.8%, the highest level in more than four years. We project that over 160,000 New Yorkers will lose their jobs during the current downturn and unemployment will reach 6.5 percent in 2009.

There is no doubt we are currently in a statewide recession. And if history is any guide, the recession will be more severe and longer lasting in New York State than it is in the nation as a whole. Indeed, the last five US recessions lasted an average of 11 months compared to 25-months in New York.

Record Deficits and New York's Response

Yesterday, I announced that over the next four years New York State will have to close a staggering \$47 billion deficit – the largest in our history. Next year's \$12.5 billion budget gap alone represents more than 25 percent of our General Fund

The magnitude of this fiscal crisis will require state governments to make significant spending reductions. When I took office seven months ago, I immediately began this process. I have already worked with the New York State Legislature to make nearly \$2 billion in reductions to this year's state budget. I have also asked the State Legislature to partner with me and find \$2 billion in additional savings at a special session in November. And when I deliver next year's budget, I will propose the largest spending reductions in state history. Funding for many worthy programs, several of which I personally support, will have to be curtailed dramatically. This is not something I want to do, but it must be done.

But Governors can only cut so much before we begin to jeopardize our fundamental responsibilities to our constituents. The reductions necessary to close these massive deficits will impact the very core of what we do as states – protecting the public's safety, providing health

care for the most vulnerable, educating our children, caring for the needy, meeting the energy needs of our constituents, maintaining our infrastructure, and investing in our economy.

Unfortunately, the cruel irony is that at the time when citizens need their state governments the most, state governments are least equipped to help them because of plummeting revenues. History shows that during economic downturns, Medicaid and Human Services caseloads will increase dramatically. The current fiscal crisis will also impair our ability to make key investments in infrastructure and job creation that are needed to help us emerge from this recession and stimulate long-term economic growth.

When states are hurting, our national economy suffers. State governments are engines of both economic and social progress. They are a key source of job creation in this country, through aid for small businesses, incentives for economic investment, and workforce development programs.

Likewise, investments at the state level both expand our national tax base and lower entitlement pressures on the federal budget. For example, the innovative Federal State Health Reform Partnership (F-SHRP) program provides federal assistance to reform our health care industry and to deliver more cost effective services, which saves money for both levels of government.

An investment in state governments is an investment in the health of both our overall economy and the federal budget. And, while I acknowledge that the federal government is facing fiscal difficulties of its own right now, I submit that avoiding the long-term adverse consequences of failing to aid state governments greatly outweighs any short-term financial costs.

Direct Fiscal Relief to States

In dealing with the current fiscal crisis, New York and other states are holding up their end of the bargain by reducing spending in a proactive and responsible manner. But we also need a partner in the federal government. No single action could re-establish that partnership more quickly than for Congress to pass an economic stimulus bill before it adjourns for the year.

There are a number of important initiatives that should be included in any final negotiated package, such as money for infrastructure improvements, greater unemployment benefits, and a temporary increase in food stamp subsidies. But there is an essential item that rises to the top of the priority list ahead of all others.

As part of a comprehensive second economic stimulus package, *states need direct and immediate fiscal relief* to help close their massive budget deficits. The failure of our federal regulatory system has caused too many innocent bystanders to suffer. And now, Washington needs to step up and help states address a problem that was not of their own making. Just like the financial services industry, we need a partner in the federal government in order to help stave off an impending calamity and stabilize our fiscal condition.

Much of the good that would be done through proposals like expanding unemployment or food stamp benefits would be undone if states do not receive necessary federal budget relief. State governments like New York are on the front lines of service delivery for our citizens for

programs like Medicaid, TANF, and other social services. The results of federal inaction could be devastating in every corner of our nation. We would be giving with one hand and taking with the other.

Furthermore, most state budgets dedicate a substantial amount of resources to local assistance payments to municipalities. In New York, seventy percent of our budget goes to local assistance. Massive sudden reductions in state budgets will reverberate across all levels of government from the largest cities to the smallest school districts.

While all states are hurting and deserve support from the federal government, I think it is incumbent on me to note that New York faces unique circumstances with respect to this crisis. First, we are at the epicenter of the crisis on Wall Street, and the failure of financial institutions impacts our revenues and unemployment situation more than any other state. Just as after 9/11, we are asking the federal government to come to our assistance in a time of emergency. Second, New York has been shortchanged for years when it comes to aid from Washington. In 2007 alone, New York sent \$86.9 billion more to the federal government in taxes than it received in return – again, more than any other state.

State fiscal relief is most effectively and efficiently provided through a temporary increase in the Federal Medicaid Assistance Percentage (FMAP) and emergency block grant funding. To help support escalating Medicaid costs, a temporary FMAP federal reimbursement rate increase of at least 5 percent should be provided through federal fiscal year 2011 to states hardest hit by the current economic crisis. Next, we ask that Congress again provide emergency block grant funding to states as it did in 2003, which will allow us to preserve a broad array of essential services.

I firmly believe that if it took only two weeks for the federal government to find \$700 billion dollars to bail out Wall Street and bank executives that brought our financial system to the brink of collapse, then we ought to be able to find a fraction of that amount to help preserve essential services at the state level that will help lift up Americans out of poverty, expand opportunity for the middle class, and protect our economic future.

States didn't cause this crisis and we shouldn't be left to deal with it alone. I have no choice but to close the massive deficits I inherited. It is simply a question of how. A rescue package from the federal government will help soften the blow for average Americans. It could make the difference between targeted, surgical spending reductions that will help heal our fiscal condition and massive and wide-ranging cuts that will cause irreparable damage to millions of families.

Other Vital Initiatives to Stimulate the Economy

While stabilizing the fiscal condition of state governments is of immediate importance, you have rightly recognized that there are other critical components that must be included in any new stimulus or recovery package. We must also rebuild our aging infrastructure and provide direct relief to citizens who have been hardest hit by this economic downturn.

- Infrastructure funding for ready-to-go transportation and water improvement projects. Infrastructure spending is one of the most important investments the federal government can make during an economic downturn as it has the dual benefit of modernizing our nation's deteriorating infrastructure while also stimulating the economy through job creation. In fact, analysts estimate that for every \$1 billion invested in transportation projects, approximately 35,000 jobs are created.

The American Association of State Highway and Transportation Officials (AASHTO) estimates that there are over 3,000 transportation projects in over forty states worth more than \$18 million 'on the shelf,' waiting to be funded. In New York, with an additional \$410 million in funding, we could put people to work immediately on over 40 highway, transit and rail projects that are shovel-ready.

The conservative cost estimate of repairing, replacing and updating New York's municipal wastewater infrastructure is \$36.2 billion over the next 20 years. There are 390 separate projects, with costs exceeding \$4 billion waiting for funding. With an additional \$715 million in Clean Water State Revolving Funds, New York's share of the proposed \$6.5 billion stimulus investment in Clean Water State Revolving Funds we can protect and improve the water quality of New York State and put people to work on 58 wastewater projects this year.

It is important to note that state budget conditions have deteriorated to the point where any federal dollars received for infrastructure projects must be free from state matching fund requirements. States have already reprogrammed and reprioritized to a point where there is simply nothing left in the budget for the current fiscal year.

The financial crisis has also forced governors and legislatures to explore new ways to finance and deliver infrastructure projects and effectively make long-term capital investments. Some states have already made hard decisions to increase tolls and implement congestion pricing. In New York, I recently signed an executive order to establish a State Commission on Asset Maximization to study potential public-private partnerships. The Commission will examine the role of PPPs and consider whether this model can benefit New York State. It will also examine whether any specific state assets, such as the multi-billion dollar replacement for the Tappan Zee Bridge, are suitable candidates for such partnerships.

I would also like to take a moment to remind the members of this committee and Congress about the only portion of the post-9/11 recovery package which the federal government promised New York but has not yet received – the proposal to sunset the existing \$2 billion New York Liberty Zone tax provisions, and instead provide tax credits which the State and City of New York will use to fund infrastructure projects with a connection to Lower Manhattan. This provision has been included in the President's budget year after year, and it has been included in multiple pieces of legislation that have passed both the House and Senate more than once. Somehow, though, it has not yet found its way into a bill that has ultimately been signed into law. This is not only a tremendously high priority for me, but also for Mayor Bloomberg and all New Yorkers. I ask you to follow through on this promise to New York.

- An extension of Emergency Unemployment Compensation (EUC) benefits and modernization of the unemployment insurance system. The current EUC program, which took effect on July 6, 2008, provides 13 weeks of benefits to laid-off workers after they exhaust 26 weeks of regular Unemployment Insurance benefits. In New York State, we project that 90,000 laid-off workers will exhaust 13 weeks of EUC benefits by the end of this calendar year.

Congress should provide for an additional 7 weeks of emergency benefits after the 13 weeks of EUC benefits. Studies reveal that for each dollar in cost, an extension of unemployment benefits generates \$1.64 to \$1.73 in increased activity. The Congressional Budget Office agrees: its report on short-term economic stimuli found that extending unemployment benefits is among the most cost-effective, potent, yet temporary steps that Congress can take to jump-start our economy.

Additionally, as Congress gets set to consider a broader economic recovery package it must take action to close the gaps in the unemployment insurance system. Mr. Chairman, I commend you for your Unemployment Insurance Modernization Act proposal, which would help close this gap by making an estimated half-million more low-wage and part-time workers eligible for unemployment benefits. It ties distribution of funds to various changes in state laws to broaden eligibility for unemployment insurance benefits. This could result in over \$400 million to New York State over the next five years. This is of critical importance to my state and many others.

- Temporary boost in funding for the Food Stamp program. As the economy declines, more and more Americans are struggling to feed their families. In New York, demand for food assistance New York has increased by 30 percent statewide over the last year. Through our Working Families Food Stamp Initiative, we have enrolled over 100,000 new families in the Food Stamp program. In these difficult economic times, the federal government must act swiftly to help our most vulnerable families by providing a temporary increase in food stamp benefits.
- Moratorium on federal regulations that harm state budgets. At a time when states are so desperately in need of fiscal relief, the last thing we can afford is onerous federal regulations that curtail existing avenues of federal support for critical services. One such regulation is the Outpatient Hospital Clinic regulation that was inappropriately promulgated by the Center for Medicare and Medicaid Services (CMS). This regulation would restrict over \$450 million in federal funding to outpatient services to New York State alone. This regulation should be placed under moratorium in the stimulus package.

Conclusion

Last week, Federal Reserve Chairman Ben Bernanke expressed his support for a second federal stimulus package. Chairman Bernanke noted that this congressional effort should be aimed at “redressing specific factors that have the potential to extend or deepen the economic slowdown.” I can tell you, most assuredly, that the large budget gaps facing New York and other states, and

their impact on vital services, are just such a factor. Unless states receive fiscal relief, I believe the goal of stabilizing the economy cannot be achieved.

I know that we can partner together to help ensure that, despite the challenges that lie ahead, states like New York can help preserve essential functions of government, grow our economy, create jobs for average Americans, and emerge from this crisis even stronger than before.

Once again, I thank you for the opportunity to provide a state perspective on these important issues, and I welcome your questions.