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The Economic Crisis and the Crisis in Public Finance

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The Economic Crisis and the Crisis in Public Finance

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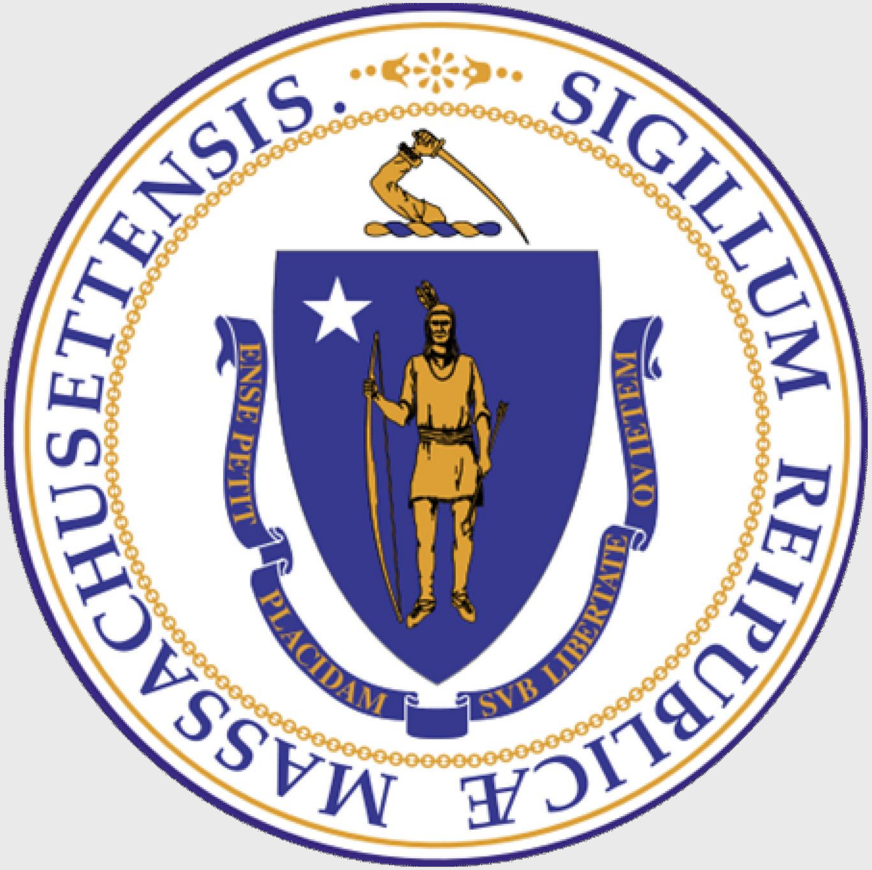
Crisis in Public Finance at the State Level



Crisis in Public Finance at the State Level: FY10 Budget Cycle

- Mid-year FY09 and FY10 deficit combined- $9 billion (Total state budget: about $32 billion)
- State balanced budget by:
  - Heavy reliance on "one-time revenues" (stimulus, reserves) in both FY09 and FY10
  - Raised sales tax from 5 to 6.25%, removed alcohol exemption (also introduced local option meals tax (.75%) and raised local option hotel tax from 4 to 6%)
- Cut local aid by 28% from FY09 levels

Crisis in Public Finance at the State Level: MA vs. Other States

Pew Center on the States' Survey of States' FY10 Budgets

State	Change in Revenue (1Q08 vs. 1Q09)	Size of FY10 Deficit	Change in Unemployment Rate (2Q08 vs. 2Q09)	Foreclosure Rate (1Q09)	Score (30=Worst)
California	-16.2%	49.3%	4.6	2.0%	30
Rhode Island	-12.5%	19.2%	4.5	1.5%	28
Nevada	-1.5%	37.8%	5.2	3.1%	26
Florida	-11.5%	22.8%	4.4	2.7%	25
New York	-17.0%	32.3%	3	0.8%	20
Massachusetts	-16.8%	17.9%	3.4	0.90%	19
Utah	-3.4%	19.8%	2.1	1.0%	11
Texas	-8.8%	9.5%	2.4	0.8%	9
Wyoming	19.7%	1.7%	2.1	1.0%	6
All States average	-11.7%	17.7%	4.4	1.4%	17

- Total FY10 deficit for all states: $162 billion (at budget time-has grown since)
- States in worst position: CA, AZ, NV, MI, RI, and FL
- MA-slightly-worse-than-average fiscal position, according to Pew

Crisis in Public Finance at the State Level: Outlook for FY11

- MA-mid-year FY10 deficit of $300-500 million (must be closed by end of FY10)
- FY09 to 10-$870 million drop in revenues (less $890 million from sales tax increase)
- $3 billion shortfall for 2011
- Revenue drop recouped by raising taxes; imbalance remains for FY11 because of the reliance on stimulus and reserves.

Crisis in Public Finance at the Local Level: Worcester

Worcester's Finances: FY10 Budget

- Combined mid-year FY09 and FY10 deficit-$34 million (Total FY10 Budget=$491 million, $268.2 million=Worcester Public Schools)
- Causes of Deficit
  - $25M cut in local aid (W hugely dependent on local aid from the state-25% of City's budget and 75% of WPS budget)
  - Increased pension contributions
  - Adjusted revenue projection-decrease in property taxes, auto excise tax, etc.
  - Snow and ice removal costs
- Balancing W's FY10 budget required eliminating 300 municipal positions, reducing non-school workforce by about 18% (mainly attrition/not refilling empty positions; 90 employees laid off), leaving 1,380 employees (and 2,764 WPS employees)

Worcester's Finances: Outlook for FY11

- Local aid cuts likely
- Even assuming level-funded local aid, CM currently projects $13.3 million FY11 deficit (not including schools), result of:
  - increases in pension contributions
  - health insurance
  - debt service
  - required contribution to WPS
- $12 million excess levy capacity?

Biggest Problem: Worcester Public Schools' Finances

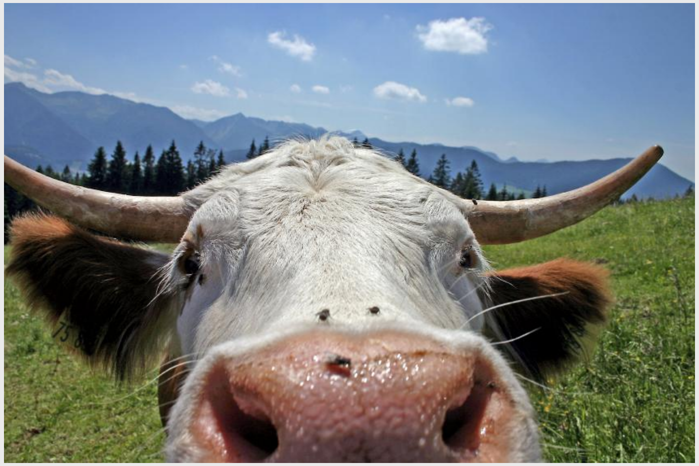
WPS' "Funding Cliff"			
Year	Total Budget	Estimated Increase	Deficit
FY08	$248.2 million	-	-
FY09	$256.6 million	3.4%	-
FY10	$268.2 million	4.5%	-
FY11	$277.8 million	3.5%	$25.9 million
FY12	$287.1 million	3.3%	$35.9 million

- Funding cliff-combination of unsustainable spending increases and one-time stimulus built into base budget
- WPS-recipient of over $50 million in ARRA (Federal stimulus) funds between FY09-11.
- No WPS layoffs in FY10; FY10 budget actually grew by 4.5% (all other city departments' budgets declined by over 10%)

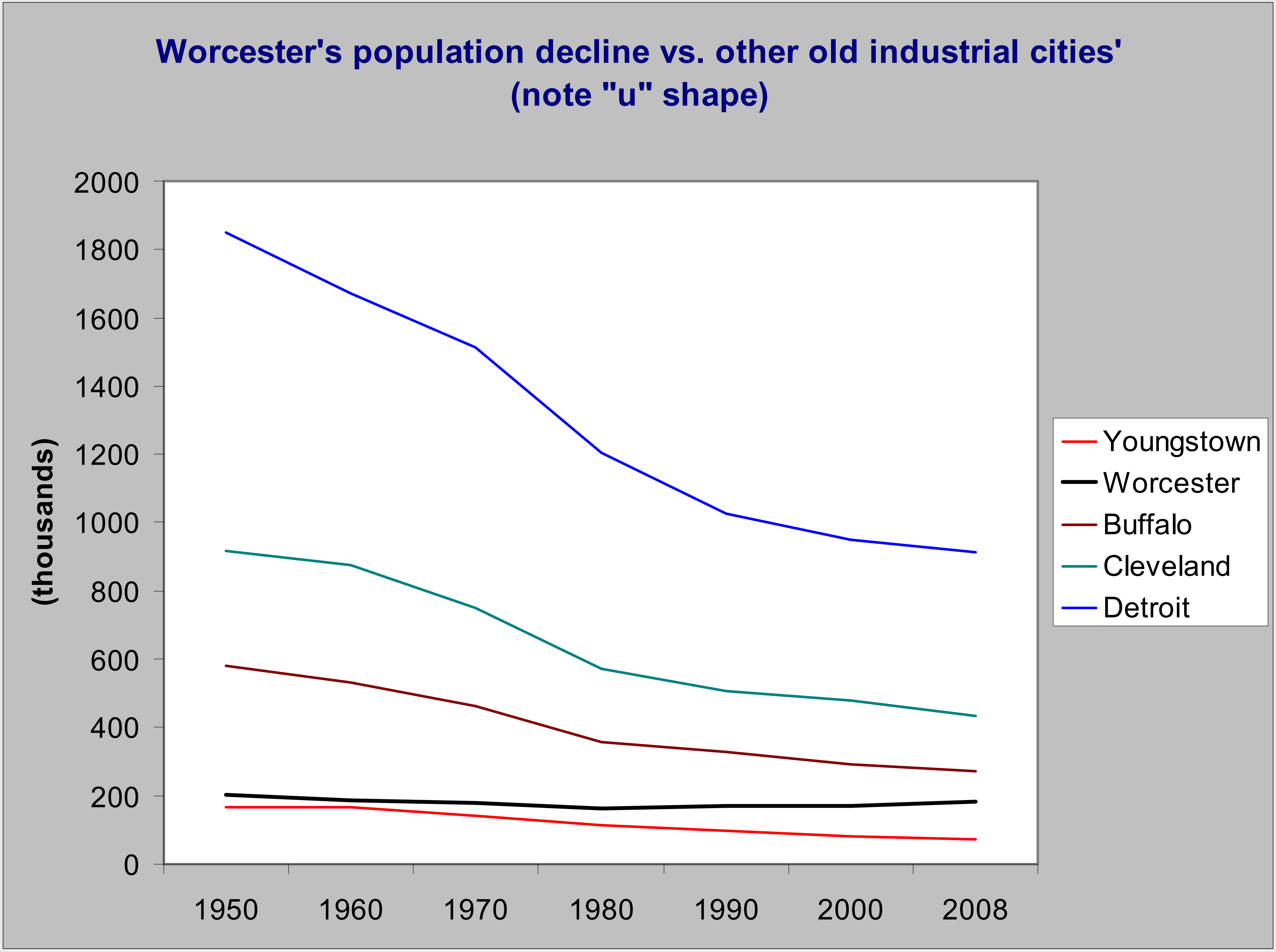
FY11 Budget Process Starts Soon…

Governor required to submit his proposed budget by January 27

Worcester: Bullish Perspective



- Unemployment: 9%-slightly above Commonwealth average (8.4%), but below national average (10%); metro unemployment-8.7%
- $1 billion in taxable and $1.2 billion in tax-exempt development currently underway
- Population has been steadily rising since 1980; now at 182,600-almost level of 1960 (contrast Detroit, Cleveland, etc.)



Worcester's population decline vs. other old industrial cities' (note "u" shape)
2000
1800
1600
1400
1200
1000
800
600
400
200
0
(thousands)
1950
1960
1970
1980
1990
2000
2008
Youngstown
Worcester
Buffalo
Cleveland
Detroit

Worcester's Strengths: "Eds and Meds"

Worcester's Top 10 Employers

	Employer	*# of Employees (2009)*	*% of Total City Employment (2009)*
1	UMass Memorial Health Care	14,738	19.1%
2	UMass Medical School	5,607	7.3%
3	City of Worcester	5,165	6.7%
4	St. Vincent's	2,210	2.9%
5	St. Gobain (formerly Norton)	2,162	2.8%
6	Hanover Insurance Group	1,951	2.5%
7	Fallon Clinic	1,820	2.4%
8	Clark University	1,496	1.9%
9	Polar Beverages	1,452	1.9%
10	Quinsigamond CC	890	1.2%

- UMass Memorial and UMass Medical together constitute over 25% of total employment in Worcester
- 9 colleges and universities enroll 30,000 students, provide 14,700 jobs, and spend $125 million in city annually (COWC).
- Student population-17% of city's total population
- "Education and Health Services"-provide 40K jobs in city (41% of total), 91K jobs in Worcester county (28%)
- Worcester's strengths benefit region

Worcester's Economy: Bearish Perspective

- W's total assessed valuation-dropped by unprecedented $1.2 billion (10%) between Jan 1, 2008 and Jan 1, 2009 (surely dropped further since). Biggest drop was residential.
- Hit hard by housing crisis: # of vacant and abandoned residential properties-up about 350% since 2005 (400 as of November 09)
- Foreclosure petitions-Up 25% between 08 and 09
- Charles River Labs (Shrewsbury)-closed-300 jobs

Obstacles to Economic Development: High Property Tax Burden

FY10 Commercial Tax Rates in Nearby Communities compared to Worcester	
Municipality	**Tax Rate**
Shrewsbury (FY09)	$9.68
Grafton	$12.43
Berlin	$13.37
Upton	$12.77
Harvard	$14.33
Holden	$14.80
Ashland	$15.10
Southborough	$14.06
Boxborough	$16.53
Hopkinton	$15.76
Westborough	$16.98
Bolton	$17.61
Milford	$24.40
Marlborough	$25.42
Worcester	**$33.28**

Commercial Tax Rate and "Mass Track" Rank in Nearby Communities		
Municipality	**2008 Mass Track Ranking**	**FY10 Commercial/ Industrial Tax Rate**
Shrewsbury	2	$9.68 (FY09)
Grafton	4	$12.43
Douglas	6	$11.77
Boylston	7	$12.82
Leominster	8	$13.82
Worcester	**240**	**$33.28**

- **2008-Mass High Tech Council Survey: ranking for locating high tech businesses; an important criterion=Is there a dual tax rate; what is the differential between the two rates?**

Obstacles to Economic Development: Image Issue

- MA regularly ranks in top 5 in "business-unfriendliness" surveys of CEOs, due to
  - Tax climate
  - High costs of labor, land, energy
  - Government regulations, politics, permitting
- "Taxachusetts" no longer quite deserved-DC-based Tax Foundation ranks MA 36th in its most recent "State Business Tax Climate Index" (#50 the worst-NJ)
- W in particular has a bad image (contrast Providence, Lowell)

Crisis in Public Finance & Impact on Business: Less Service, Higher Taxes, More Regulations (State and Local)

- Local-Reduced municipal service (police, fire, DPW, potentially education)
- State-Increased taxes: 22 states (and PR and DC) raised taxes in some form during 2009

Crisis in Public Finance & Impact on Business: Less Service, Higher Taxes, More Regulations (Federal)

- Recession compounding uncertainty about policies
- Federal policies
  - Cap and trade?
  - National health care legislation?
  - Increasing national debt-new taxes?

Crisis in Public Finance & Impact on Business: Question of Sustainability

Sustainability of Public Spending: K-12

- About $600 billion annually on K-12 (90% state and local), exceeding all areas of government spending except health care
- Nationally, per-pupil spending has doubled over the last 35 years (inflation-adjusted)
  - We've tripled the number of teachers
  - Cities w/the worst schools (Newark, DC, Hartford) spend the most
- Achievement in the aggregate has been flat, in terms of both NAEP and SAT scores
- We outspend all other countries, but get less bang for our buck (mediocre on tests, graduation rate and college completion rates)
- Without additional stimulus funding, school districts nationwide will either have to make big cuts or raise taxes

Sustainability of Public Spending: Salaries and Benefits

- Public salaries-on average higher than private sector; average Federal salary is now $71,206 (private sector average salary-$40,331)
- During Great Recession (since 12-07):
  - # of Federal salaries over $100,000 has increased by 46% during recession
  - Fed employment grown by about 10% (192,700); private sector declined by 6.3% (7.3 million), (state and local- declined by .2%)
  - Average pay raise-Fed 6.6%, State and Local 3.9%, Private Sector 3.9%
- MA state workforce has increased from 80,000 to 83,000 since 2006
- If we keep expanding number of public sector workers and compensation, will there be enough private sector workers to support public sector?

Benefits-Even Bigger Private vs. Public Sector Gap

- **Retirement benefits-not only do state and local workers have greater <u>access</u> to retirement benefits (99%), character of those benefits is more generous**
- **Nationwide, the % of *all* workers who receive a traditional defined benefit pension as their exclusive form of retirement benefit is <u>8%</u>**
- **<u>Over 90%</u> of state and local government workers still receive traditional DB pensions**
- **<u>Health Insurance</u>: Private sector employer contribution rate: 80% and 70% (family) vs. state and local 90% and 73% (family)**

Sustainability of Public Spending: Pension Funding

Pension Assets and Liabilities: Worcester and MA

	Total Liability	***Assets***	***Unfunded Liability***	***Funded Ratio***
Massachusetts (state retirees and teachers)	\$56.2 billion	\$35.9 billion	\$20.3 billion	64%
Worcester	\$950 million	\$650 million	\$300 million	68%

- Prior to 2008, average funded ratio for state and local pension systems nationally was around 85%
- Average loss in 2008-25 to 30%; average funded ratio declined to about 65%
- Big rebound in 2009, but most municipalities will have to increase pension appropriations 30 to 50% by FY11 or 12 in order to return to prior funding schedule

Sustainability of Public Spending: Retiree Health Care (OPEB)

State and Local Govt Retiree Health Care Obligations	
Nationwide	$600-1.6 trillion
Massachusetts	$15.3 billion
Worcester	$1.1 billion

1. All public employees in MA qualify for retiree health benefits after 10 years of service
2. Very few states and municipalities have begun to fund OPEB=huge opportunity cost
3. Govt must regularly estimate liabilities (GASB 43 and 45, effective in FY08), but these estimates can vary widely based on investment assumptions
4. But having to estimate and acknowledge (if not fund) these liabilities has had positive effects (For ex. adoption of MGL ch. 32B s. 18 (“section 18”) yielded over $100 million in savings in W)

What's the Outlook?

- Conference Board's "Index of CEO Confidence"-up 1.5% between 4Q and 3Q 2009, and up 24% from 4Q 2008.
- "Consensus of economists at state revenue hearing"-we've hit bottom; it's not getting worse in MA
- Signs of Responsible Leadership-Worcester city manager and city council:
  - adopted Section 18
  - changed Quinn Bill going forward
  - increased employee contributions to health insurance
  - restructured police and fire departments to reduce authorized personnel complement
- State pension reform legislation of 2009-marginal changes
  - Baker proposal-$90,000 cap, base pensions on whole career, not highest three years
  - See Research Bureau reports "Public Employee Pensions: Is it time to Retire the System?" and "Massachusetts Pension Reform: What was accomplished? What remains to be done?"
- Will crisis begin to change people's spending and saving habits? ("new normal" question)
- Are young people's employment expectations changing?
  - Research Bureau's survey of employers (forthcoming)

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