The Perfect Fiscal Storm

By Fadhel Kaboub

More than 70 people attended “The Perfect Fiscal Storm” presentation sponsored by the A&S Dean’s Office and the Center for Full Employment and Price Stability (C-FEPS) at the administrative center on Wednesday October 23, 2002.

Mathew Forstater, C-FEPS Director and Assistant Professor at UMKC’s Economics Department, and Bryan Le Beau, Dean of the College of A&S, opened the roundtable discussion about the current fiscal crisis by expressing their concerns about the current economic situation at the state as well as the federal levels and its effect on higher education. Forstater also introduced the presenters and monitored the discussion with the audience, which included members of the Kansas City community in addition to UMKC students, faculty, and staff. Troy Nash, City Councilman (3rd District At-Large) and Fellow at C-FEPS, spoke to the audience about his own experience as a proponent of strengthening neighborhoods, creating jobs and helping youths. Nash acknowledged the role that both C-FEPS and UMKC’s Economics Department play in many Kansas City community development programs that he is engaged in especially the Prospect Corridor Renewal project, which focuses on one of the most crime-ridden corners in the United States, that of Prospect avenue and 39th street. Councilman Nash is currently working with neighborhood and community groups on the master plan for redeveloping the area.

L. Randall Wray, UMKC Economics Professor and Senior Research Associate at C-FEPS, was the main speaker on Wednesday. The title of his presentation was inspired by a statement made at a UMKC Board of Trustees meeting in June 2002, describing our current budget crisis as a ‘fiscal storm’. Wray argued that in fact it is a ‘perfect fiscal storm’, recalling the title of the book by Sebastian Junger, who described how the confluence of natural forces created the perfect storm in October 1991 that doomed the Andrea Gail in waves of over 100 feet. In our case, Wray explained that “a confluence of what we might call unnatural fiscal forces at the state, federal, and global levels have led our economy into a recession and will hinder recovery.”

Wray reminded the audience that since the Nixon era the growth of Federal spending has been decreasing and has led to a reduction in Federal support to state governments through what Wray called ‘devolution’. “Welfare programs were cut, payroll taxes increased, and fiscal stance was tightened,” said Wray, supporting his arguments with a number of statistical figures displayed before the audience. These tight fiscal policies make it very difficult for state governments to support social programs such as welfare and Medicaid, especially for the 49 states that are required by statutes or constitutions to run balanced budgets. Wray pointed out that the problem is that “state revenue is strongly pro-cyclical, increasing in a boom and falling in recession. And this is a big problem when the states are increasingly responsible for types of spending that need to rise in recession - like welfare and Medicaid.”

According to Wray, states governments typically cut taxes and increase spending in a boom (which helps to fuel the boom), and then raise taxes and cut spending in a recession
(thus adding to the depressionary forces that generate the recession). Replying to some of the comments and questions from the audience Wray said that “States are increasingly relying on regressive taxes, especially taxes on consumption, while like the Federal government they give tax credits and inducements to encourage saving.” This, he explained, depresses spending, especially in recession when the regressive taxes on consumption are increased at exactly the time that households are trying to cut back spending to increase rainy day funds.

How will we survive this ‘perfect fiscal storm’? The answer, according to Wray, is to reduce the payroll tax and make it more progressive, to increase government spending on public infrastructure, and to have the federal government bail out state governments. This will create jobs, boost income, consumption, and spending; thus bringing about an economic recovery.