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CHASE ECONOMETRIC SPEECH
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I. INTRODUCTION

Six weeks ago I was among the two dozen Republican governors who gathered in Philadelphia to celebrate our Party's victory in the November elections and to see what that victory would mean to the states. We Republicans had cause to celebrate. In four years our numbers had almost doubled in the statehouses. When I first took office in 1977, there were but 12 governors who called themselves Republicans. Now there are 23. We once could meet in a phone booth; now we're meeting in the Grand Ballroom.

But we had cause to celebrate beyond the increase in our numerical strength. The election of Ronald Reagan and the hope that he will return economic prosperity to this land is cause for jubilation itself. As governors, our states have suffered through the high inflation rates, the high interest rates and the high unemployment rates just like any business or individual. However, we as governors were forced to find an economic equilibrium for entire states; containing the full variety of our nation: cities and farms; wealth and poverty.

As governors -- both Democrat and Republican -- we've made great progress towards protecting our states from the vagaries of the national economy. For example, dozens of states, including my own Delaware, have straightened out our finances and enacted spending or taxing limitations in an attempt to hold down the cost of government. We realized long also that unbalanced budgets make poor economic and political sense. We have done other things as well.

We've sought a loosening of the strings on Federal grants so we can spend the monies more efficiently. We have become more sophisticated in our economic development activities. We are using our taxing authority less, to encourage more economic growth. We, as individual states, are initiating job training programs in the private sectors to lessen the load on the taxpayers. And we have become more aggressive in the areas of international trade.

The various States have become more aggressive on the financial and economic fronts for several reasons. First, we are on the front lines of the various battles being waged by taxpayers. The reaction over Proposition 13 and subsequent tax reduction proposals by taxpayers was spawned in part by the high tax policies of the federal government. We have been forced to deal with those types of cutbacks as government officials at the state level.

Second, the boom-bust cycles of the U.S. economy adversely affects State revenues and increases the demand of State services.

Thirdly, many of my Congressional colleagues are now governors or mayors and we now see the havoc Congress and the agencies are playing with our budgets. Witness the conversion of New York Mayor Ed Koch, one of the Congress' most prominent liberals, now as mayor sometimes is amazed by the cost, inefficiency and outlandishness of programs he supported in Congress. Consequently, we've resolved not to implement in our states, the type of programs the Congress, which we were members of, has imposed upon the nation. The growth of the federal government into areas such as law enforcement and education has resulted in 450 narrow categorical grants, creating an administrative nightmare for the states, not to mention the cost.

Finally, there is widespread agreement that this nation has become too diverse and the population centers have spread out so much that a highly centralized government no longer responds effectively to local needs. That is why we believe the individual states, acting singly or in concert, can achieve many of the social and economic goals sought by Washington, more quickly and less expensively. Consequently, the states have become more assertive in their relations with Washington over the cost and control of programs. We are no longer content to become the administrative agents for the federal government, rather we see a rebirth of federalism. And, we've become more assertive towards economic growth in our states, enacting various proposals to make the economic climate more attractive to businesses located in our states.

Given this preface, I'd like to outline for you today some of the action the states have made and project a bit of the present and future state roles.

At the same time, I'd also like to argue for a moment that some of the roles between the state and the federal government are confused and that we should consider a realignment of some of those policies. This is what we mean by federalism.

Finally, believing this will show that something new has happened. Statehouses have become economic planners, innovators, with as much impact on the economy as other broad sectors - defense, farms, etc.

II. RECENT TRENDS

A. Tax and Expenditure Limitations

Since the average American citizen feels that he has little control over the level and growth of the federal government, he has attacked government on the level where he can have some influence - the state and local level. Tax and expenditure limitations have often been explained as a response to the general public's dissatisfaction with the size and composition of all government. In the past ten years, total governments' consumption has increased from 30 to 42% of national income. The relative growth of the government sector implies a relative diminished purchasing power in the private sector.

States have responded to the specter of the tax revolt and many states have taken very appropriate actions in face of that threat. On net, state and local tax revenues fell last year after adjusting for inflation. In addition, the ratio of state and local taxes to GNP fell from 11% in 1977 to 10% in 1979. During 1978, 28 states enacted tax cuts, and in 1979, 24 states cut their taxes.

Delaware was among those states, enacting a 9% decrease in personal income taxes. This tax reduction was largely possible due to the careful cost confinement procedures that the State has followed for the past few years - eliminating the automatic cost of living adjustments for state employees, reducing debt service costs as a proportion of the budget, and reducing energy consumption in State facilities.

In addition, Delaware established a "rainy day" fund which provides monies for future tax reductions or unexpected revenue losses. This constitutionally mandated reserve consists of 5% of the revenue forecast for the next fiscal year. Delaware

also limits appropriations to 98% of available revenues, unless there is an extra-majority vote declaring an emergency by the General Assembly.

The theory behind such tax and expenditure limitations within our State has been to provide a stable and competitive financial climate for encouraging private business investment. Boom/Bust cycles are very disruptive to state economies. Often causing major tax increases which effect private sector and local economic development. As you may know, Delaware's reputation for handling State finances has not always been excellent - we had the lowest Moody's State rating (Baa-1) in March 1977, 3 drops in 1974-77; 4 increases in 1978-80 in Delaware. Our actions have changed the economic climate. In short, states have moved to protect against tax increases and to improve the economy.

B. Unemployment Compensation

Another example of impact of federal policies on state economies - and one where states have so far been unable to protect themselves - is unlawful compensation. The major cause of the high level of U.S. unemployment (7.6% - Nov.) is the lack of real growth in the productive sector of the economy. The federal government's destabilization policies - erratic money supply shifts, ballooning federal deficits, and regulations and restrictions on the actions of entrepreneurs, have successfully prevented a national business climate which would be conducive to steady real growth and greater employment. Seventeen states (including Delaware) now face large deficits to the federal government to cover borrowings for unemployment compensation payments. Every time an automobile assembly plant lays off a worker for 2 1/2 weeks in Delaware, that worker exhausts the total pay-in by his company to cover the benefits to which he's entitled. Extended periods of unemployment impose heavy costs on other firms within the State which maintain consistent employment levels, and on all firms in the long run as the federal government imposes penalty taxes on states with extended unemployment deficits. If total tax loads do influence business locational decisions, states with relatively high levels of unemployment will face increasingly heavy business tax burdens, which will further discourage employment opportunities within that state.

The analogy with social security and the welfare system seems clear - where the goals of assistance to the poor, to the elderly, and to the unemployed are national goals, at least a portion of the funding for those programs should come from the federal government.

C. Tax Exempt Financing.
A third example: an area where the state's role in economic development has grown because of failed federal economic policy is tax exempt financing. Because of the competitive nature of the states in the seeking of new economic development, the use of tax exempt financing for new industries and tax credits for expanding industries has grown in favor. Moreover, with the failure
of the federal government's stabilization policies, the use of revenue bonds for home mortgages is also growing as a way to help the housing and construction industry and strengthen a key segment of local communities.

Extraordinarily high interest rates, caused by excessive growth in the monetary base designed to cushion the impact of the federal deficits, generated tremendous pressure for assistance in particular industries. The home building and construction trades were among the "loudest" sufferers. The forms of relief designed to assist these groups provided them with a way to circumvent the full impact of the higher financing costs in their businesses. If tax exempt financing could be provided, the after tax interest costs would be approximately 60% that of the market rates. Thus the programs to fund housing through the single family mortgage bonds, and to fund business expansion through the industrial development revenue bonds, were expanded.

The states have stepped into this situation aggressively. We have responded to local economic pressures; and aided a key sector of our local economies yet we are causing some dislocation in the bond markets as a result. The failure of the federal government to keep its spending under control has shifted the burden of maintaining local housing economics to the states. A more effective way of maintaining a healthy housing industry so that we can supply adequate housing.
Public Employment The final area I'll discuss is in the realm of jobs programs. CETA programs are notorious for being poorly conceived, disrupting labor practices in existing private and public enterprises, encouraging waste and duplication of services, and costing billions of dollars.

An effective private sector jobs program is the only answer to unemployment. Federal destabilization policies discussed earlier have prevented this from being a reality. An effective substitute is not public sector jobs. Ultimately, the more public

sector jobs that are provided, the higher tax rates must become, resulting in lower levels of private sector activity which generate an ever diminishing base to finance the growing "need" for public sector jobs.

If business climate could be improved, by, for example, just using the CETA equivalent funding to state governments for use in economic stimulation, the growth of jobs might far exceed those generated by the CETA funding itself. In Delaware we have successfully demonstrated private sector employment programs in tackling youth unemployment.

These four examples -- financial stability, unemployment compensation, the financing of local industries and job training -- are some of the ways the States have responded to the instability of the nation's economy. We are attempting to protect our finances, provide aid to the needy, and encourage growth in locally-based economies. In the last 1/4 century states have become as involved in economics as the national government was a century ago. We have become economic innovators and planners on our own.

However, the state's efforts can be undermined by existing federal policies. The best example is the difficulties each state has in coping with the 450 specific categorical grants provided by the federal government. These grants often bypass the plans and policies of the states. A better system would be to provide block grants to each of the states. We could better combine those funds with our own and meet more directly the needs of our constituents.

For example, in Wilmington, Delaware, we sought to build a bridge, costing $7 million.

The federal highway trust fund would provide us with the bulk of the funds -- but only if the bridge cost $10 million or more. Even though we promised to pave the bridge in gold, the federal government refused to give us the funds. Ultimately a change in the federal law was enacted by the Congress so we could rebuild this vital bridge. While this is an extreme example, it indicates the frustration felt by governors, mayors and townspeople in dealing with the maze of government regulations over the use of federal dollars.

I believe the climate is ripe for the reordering of governmental roles, and I think the new administration will be receptive to it. Scarce resources and limited tax dollars will make consolidation of aid programs inevitable. Successful programs will require a new harmony and understanding between the states and the federal government.

III. STATE INFLUENCE ON THE ECONOMY

In our new role, there is much we can do to help ourselves in the future.

A. Macro

The maintenance of a sound national economy is a federal mandate. States can do little to stop the inflationary spiral, or to wipe out recessions. But, in the face of oil price rises, states can try to relax regulatory and land use barriers to the development of alternative energy sources, and direct development financing toward new energy conservation products and services. And we can try to cut cost and reduce spending to soften the blow of each economic shock. State budget deliberations must go beyond the traditional year-to-year considerations in order to anticipate fiscal requirements of the full economic cycle, to conserve during economic booms when transfer demands are low and revenues optimal, for the lean economic times of high transfer demands and diminished revenues. From the perspective of a full economic cycle, the boom period surpluses are not "real" ones. They are hostage to the slack period deficits, which inevitably follow. The establishment of budgetary reserve accounts, fed during the boom years, can provide a stabilization fund on which to draw, when necessary, to offset unexpected revenue declines as well as to provide a resource to fund counter cyclical programs Capital expenditures also could be timed with more attention to the economic cycles, to afford maximum benefits to the state's economic activity at periods in which economic stimulus is required.

B. Micro

Similarly, on micro basis - states can help local economies. Economic development today encompasses a good deal more than the industrial development programs of yesterday. It is commonly understood, now, that there is more to development than luring the large manufacturing plant and its hundreds of jobs from a present location to your own state. Most states now place increased emphasis on the jobs which are gained by the retention and expansion of existing firms; hence, their

attentiveness to local economic concerns and their receptivity to business recommendations.

Two-thirds of the 6.7 million jobs generated between 1969-76 came from firms of 20 or fewer employees. They tend to be young firms. Eighty percent of the job generating firms were less than 4 years old. And they are volatile, expanding and contracting with some frequency. They tend to be in the service and trade sectors. Assistance to these economic units - job training, road repairs, sewer service, may be the most effective economic development tools we have.

IV. CONCLUSION

State and local government is today eyeball deep in economic planning stimulation, economic innovation. Through the vacuum created by the federal economic policy failure, we have been drawn into an area formerly reserved to the federal government.

And we like it here. We are positively impacting our states; helping citizens, creating economy opportunities but not without problems. In short, new federalism is already here.

We look with enthusiasm to the Reagan Administration. For an opportunity to be a part of a creative effort to restore prosperity, to redirect use of resources towards more productive patterns of activity.

We will be involved. The message to you, as you consider economic impact of monetary defense, tax, agriculture policy, is that there is state and local government policy which equally impacts national economic policy.