



DAVID HALE GLOBAL ECONOMICS

Chicago Will Feel Effects of Coming Fiscal Austerity

By David Hale

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Following three years of expansionary practices, fiscal policy could significantly retard the already slow growth rate of the U.S. economy next year.

Congressional Republicans and the White House are negotiating to raise the federal debt ceiling, with Republicans demanding large multiyear spending cuts in return.

But while much media attention has been focused on spending cuts that may be included in such a deal, the Obama administration's own proposed budget for fiscal 2011-12 includes significant "fiscal drag"—a combination of tax revenue increases and spending decreases. The projected fiscal drag for 2012 is 3.9% of GDP. That number represents the most restrictive fiscal policy in six decades. When the stimulus plan was originally enacted in 2009, the Obama administration was forecasting that unemployment would be close to 6% entering 2012; it now forecasts that rate at 8.6% in 2012. Personal tax increases will squeeze consumer income during early 2012 and could depress retail sales. Corporations could rush to buy capital goods during the final months of 2011, and then reduce spending next year.

The cuts in government spending also could reduce employment: State and local governments, which will receive only \$6 billion in federal aid this year after receiving an average of \$52.6 billion for each of the past three years, could be

forced to lay off several hundred thousand more employees. (Since August 2008, state and local governments have shed 577,000 jobs.)

In several states and cities, governors and mayors are negotiating tradeoffs between potential job cuts and reductions in their civil service wages or benefits. Illinois has been less aggressive than Wisconsin in pursuing such trade-offs, but any pay increases for state workers will require job cuts.

The Chicago area already has felt the effects of state and local government spending cuts. Since May 2008, state government employment in this area has fallen by 3.3%, compared with 1.1% nationally. Local governments have reduced employment by 1.3%, compared with 2.4% nationally. Washington has made \$19.3 billion of stimulus funds available to Illinois since 2009. The state has so far received \$15.3 billion of this assistance.

Illinois' budget shortfalls, of \$14.3 billion in fiscal 2010 and \$13.5 billion in fiscal 2011, forced the Legislature to enact large tax increases earlier this year. The shortfall is projected to fall to \$5.3 billion in fiscal 2012. But the persistence of the deficit and the large declines now occurring in federal aid will force the state to keep tight control on spending for another two years, restraining services and avoiding major new capital spending until the deficit is eliminated.

It has received nearly 100% of its allotment for the Department of Labor as well as 90% for the Departments of Education and Health and Human Services.

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