PUBLIC POLICY INSTITUTE

# A taxpayer's guide to the (missing) 2001-02 New York State budget

## *What's behind Albany's inability to settle on a spending plan*

New York State will, once again, go through a significant part of a new fiscal year without a formal financial plan in place. The budget for the 2001-02 period, which began April 1, is still undecided after the end of the regularly scheduled legislative session in late June.

What, exactly, is all the fuss about? In a word: *Spending*.

That answer leads to further questions. Perhaps most importantly, how much can Albany afford, this year and in the future? What are the differences in the proposals made by our elected leaders?

> *So what's all the fuss about? In a word, it's spending.*

Then there are the questions that tend to be ignored in most of the debate over the state budget: What is the *existing* level of spending on which those proposals would build? And how do our current expenditures compare with those in other states?

### Where are we now?

Any attempt to decide how much more New York taxpayers should spend through their state government in the coming year should start with a look at what we're doing already.

In the fiscal year that ended March 31, state spending totaled $79.5 billion, an increase of $6.2

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### INSIDE

**The gridlock over the state budget is really a debate about spending more—a lot more. But there are good reasons to take a more cautious approach to state finance:**

- **State spending is already high in New York—third highest in the country, measured on a per-capita basis.**
- **Governor Pataki's budget proposed an ample spending increase of about 5 percent.**
- **Yet the Legislature wants to add at least $1 billion to that.**
- **The signs of a slowing economy ought to breed caution about the state's revenue picture, however.**
- **And New Yorkers remember the disastrous consequences of past budgets that sharply increased spending even in the face of economic downturns—consequences that included big tax increases, budget cutbacks and lost jobs.**

JULY 2001

billion, or 8.5 percent, from 1999-00. (The figures are preliminary calculations by the Office of the State Comptroller; a final tally will be issued in several months.)

This total includes revenues from the state's own taxes, other "own-source" revenues such as State University tuition and business fees, and federal aid. It works out to roughly $4,190 in spending for every resident of the state. According to U.S. Census Bureau data, per-capita state spending in New York was third-highest in the country in 1998, 39 percent above the national average.

***New York's state spending already ranks far ahead of almost all other states' — particularly in the two areas that get the lion's share of the state budget, education and health care.***

Two major spending categories—education and health—represent the lion's share of overall state spending. *(See graph, back page.)* The Office of the State Comptroller calculates that education was 38 percent, and health 20 percent, of state-funded expenditures in the 2000 fiscal year. The measurement does not include spending of federal aid. (Including those dollars would boost the proportion going to health care dramatically, because Washington pays half the cost of New York's Medicaid program.)

In both of these major categories, New York spends far more than most other states—particularly when *local* government spending, much of it required by the state, is added in. Public-school spending in the Empire State totaled $9,192 per pupil in 1999, 43 percent above the national average, according to the National Education Association. Census Bureau data show that New York's per-capita state and local government expenditures on health and hospitals were 39 percent above average, and seventh-highest in the nation, in 1997.

For more than three decades, the Empire State suffered economically because elected leaders in Albany spent too much. High spending required high taxes—the highest in the nation. And, when that revenue wasn't enough, excessive spending produced the nation's heaviest debt burdens as well.

New York *still* suffers from its history as a big-government state. Significant tax cuts, enacted in recent years by Governor Pataki and the Legislature, have improved our business climate and led to stronger job growth. But our taxes are still too high. In large part, that=s because the fundamental political culture in New York has not changed. Powerful interest groups demand more and more taxpayer spending. Many voters, too, assume that expanding government automatically means improving public services, despite little hard evidence to justify such a conclusion.

## Where do we go from here?

Governor Pataki has proposed an ample spending increase for the current fiscal year. His proposed Executive Budget would boost total spending by 5.3 percent, and state-funded expenditures (total spending minus federal funds) by 4.9 percent. Both figures are more than one-and-a-half times the projected inflation rate.

Pro-spending groups are demanding hundreds of millions more. In response, both houses of the Legislature are pushing for additions to the Executive Budget. There are substantial differences between the two houses. The Senate Majority has proposed a budget that would add some $500 million to the Governor's budget; the Assembly Majority has proposed a $2.3 billion increase. The Senate and Assembly packages would result in overall spending increases of an estimated 6.2 percent and 8.1 percent, respectively, from the previous fiscal year.

Both legislative proposals include significant increases in education, in particular, and health care. When fully effective in several years, the Senate package would add $646 million, and the Assembly $3.5 billion, in education and higher education, according to a Senate Finance Committee comparison. Health / Medicaid spending would rise by an additional $419 million under the Senate proposal, and $441 million under the Assembly's, the Finance Committee staff calculated.

All told, the Senate's proposals add up to an eventual $1.1 billion, and the Assembly's, $4.6 billion, according to the Senate estimates—the only published comparison of spending proposed by the Governor and the two houses of the Legislature.

## How much can New York afford?

At first glance, it may seem hard to argue against more spending. After all, the state ended the last fiscal year on March 31 with a surplus of nearly $2.7 billion. Revenues for fiscal 2000-01 were significantly higher than projected, producing that dramatic surplus even while spending rose 8.5 percent over the previous year.

Still, history argues in favor of caution.

Just 10 years ago, New York State's budget was a disaster. The election-year budget of 1990 had sown the seeds for catastrophe by raising spending 9 percent, at a time when the state's private-sector economy was weakening. New Yorkers were losing jobs by the tens of thousands, but government was still growing by leaps and bounds.

After Election Day 1990 was behind them, Governor Cuomo and the Legislature faced the reality of revenues that could not keep pace with the demands for spending. They balanced the books for the 1990-91 fiscal year by cutting school aid $190 million in the middle of the school year, raising taxes and fees, and implementing fiscal gimmicks such as selling Attica state prison to a state-controlled public authority, the Urban Development Corp.

The 1990 spending binge had painful repercussions for years to come. That year's budget was balanced only through imposition of a $1 billion package of tax increases. Among them was a "temporary" surcharge on business taxes that lingered for seven years. It and other tax increases helped make the economic slowdown in New York the worst in the nation, with job losses that continued for more than a year after the rest of the country had resumed employment growth.

***The Legislature's budget proposals would add from $1.1 billion to $4.6 billion to the already ample budget proposed by Governor Pataki.***

The syndrome of damaging, election-year budgets reappeared in 1994. The financial plan enacted several months before that November's statewide elections produced a 12 percent jump in expenditures. Again, shortly after Election Day, the state Budget Division was warning of a huge shortfall projected for the ensuing year. Governor Pataki was confronted with a projected budget gap of nearly $5 billion as he entered office in January 1995.

***State aid to public schools is up $3.8 billion, or 36 percent, since the 1997 fiscal year — an increase nearly three times the rate of inflation.***

## No time for a spending binge

Since then, things have changed. Even including last year's more-than-twice-inflation increase, overall spending growth has been held to an average of 4.4 percent annually since 1995, according to the Budget Division. That level is significantly below the national average of 6.2 percent. (Spending in New York *should*

grow more slowly than in most other states, given our slower-than-average population growth.)

*Table 1*

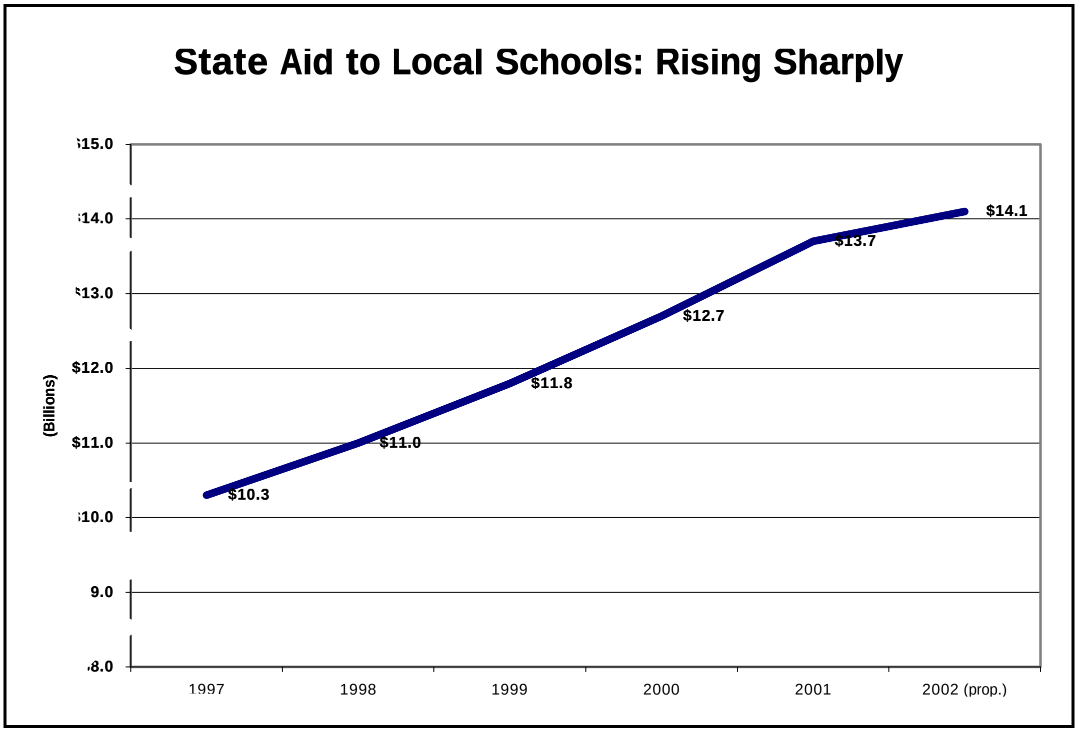
**Excelsior: Spending is 'Ever Upward'**

*Total Spending by New York State Government*

| *Fiscal year starting in ....* | *Spending (billions)* | *% increase from previous year* |
|---|---|---|
| **1982** | **$ 28.46** | **+ 11.6%** |
| 1983 | $ 29.62 | + 4.1% |
| 1984 | $ 32.85 | + 10.9% |
| 1985 | $35.41 | + 7.8% |
| **1986** | **$ 38.43** | **+ 8.5%** |
| 1987 | $ 39.78 | + 3.5% |
| 1988 | $ 43.51 | + 9.4% |
| 1989 | $ 46.71 | + 7.4% |
| **1990** | **$ 50.92** | **+ 9.0%** |
| 1991 | $49.55 | - 2.7% |
| 1992 | $ 51.03 | + 3.0% |
| 1993 | $ 54.35 | + 6.5% |
| **1994** | **$ 60.89** | **+ 12.0%** |
| 1995 | $ 61.78 | + 1.5% |
| 1996 | $ 62.68 | + 1.5% |
| 1997 | $ 64.11 | + 2.3% |
| **1998** | **$ 67.76** | **+ 5.7%** |
| 1999 | $ 72.57 | + 7.1% |

**Years in bold are statewide election years**

Source: *Comprehensive Annual Financial Reports*, Office of the State Comptroller




At the same time, taxpayer funding for priority areas has grown noticeably. For instance, state aid to public schools is up by $3.8 billion, or 36 percent, since the 1997 fiscal year. That increase is nearly three times the rate of inflation. And the Executive Budget envisions targeted investments in strategic areas, such as university-business research that will help build the thriving economy of tomorrow.

***Across the country, states are being forced to take a more cautious approach to their finances.***

Restraining spending has helped make it possible for Governor Pataki and the Legislature to cut taxes, thereby improving conditions for working families all across the state. Private-sector employment is up by more than 800,000 since January 1995. Most households seem to be enjoying a higher standard of living, as evidenced by things such as growth in new-home purchases, higher retail sales and more tourism activity.

## Clouds on the horizon

But there are clouds on the horizon. For months now, the nation's economic growth has been slowing, and some experts say an outright recession is likely. The Federal Reserve Board is so concerned about a downturn that Chairman Alan Greenspan and his colleagues have implemented five separate reductions in short-term interest rates over the last year, and have left open the possibility that further slowing of the economy may require further rate reductions.

Employers across the country cut 182,000 jobs in April, and another 19,000 in May. The April loss (on a seasonally adjusted basis) was the second consecutive monthly decline in payrolls, and the largest since the last recession a decade ago.

By restraining spending in recent years, Governor Pataki and the Legislature have been able to cut taxes significantly, and improve the state's credit rating.

Trends are somewhat more positive in New York, but there are trouble signs here, as well. For the first 14 weeks of this year, initial claims for unemployment benefits were nearly 20 percent higher than for the same period in 2000. Statewide, employment is still growing, but at a slower pace. Some upstate regions—the Buffalo, Utica, Rochester and Jamestown metro areas B all lost jobs over the year ending this May. The state's manufacturing sector has weakened noticeably during the same period, losing more than 26,000 jobs after several years of relative stability. Employment in construction, another high-wage sector which had averaged 7 percent growth for the last three years, has slowed to a 4.1 percent increase in the past year.

The downstate region, including its powerhouse financial sector, is showing a number of signs of economic weakness. The Securities Industries Association estimates first-quarter profits were down by more than half—$8.2 billion—for the first quarter of 2001 compared to a year earlier. Initial public offerings, mergers and acquisitions and other highly profitable activities on Wall Street are down sharply. As Comptroller McCall and others have pointed out, the securities industry is an especially important contributor to the fiscal stability of both the state and New York City government. When its revenues soften, so do those flowing to Albany.

In an April report, Comptroller McCall predicted the city's economy will slow in the second half of 2001: "The momentum created by record profits on Wall Street last year can carry the City's economy only so far. Later this year, the combined effect of the national slowdown and the reduction in wealth brought on by tumbling stock prices will slow things down."

Not surprisingly, the softening of the economy is already being reflected in state revenues. Withholding collections from personal income taxes showed no growth for the month of April compared to last year, after adjusting for the number of business days, according to the Budget Division. Growth in sales-tax receipts has slowed, as well. Tax collections were strong at the start of 2001, but much of that strength was related to capital gains in the previous year that will not be repeated this year.

## The Governor and the Comptroller call for caution

Both Governor Pataki and Comptroller McCall have called for fiscal prudence, given the potential of slowing revenues.

"With more than 20 states now facing major budget problems due to the national economic slowdown, it has become increasingly clear that we must avoid a spending binge," the Governor said in May.

Reporting in early April on a surplus carried over from the previous fiscal year, the Comptroller said: "The surplus must be used prudently. With the economy slowing down, now more than ever the state needs to put money in reserve."

Table 2

## New York vs. Other 49 States, Selected Fiscal Comparisons

| | State & local taxes per capita, 2000 (est.) *Source: Tax Foundation* | State-only taxes per capita, 1999 *Source: Census Bureau* | State & local govt. jobs per 10,000 res., 1999 *Source: Census Bureau* |
|---|---|---|---|
| **New York** | **$4,905** | **$2,127** | **630** |
| Alabama | 2,229 | 1,380 | 599 |
| Alaska | 1,890 | 1,461 | 784 |
| Arizona | 2,564 | 1,579 | 495 |
| Arkansas | 2,295 | 1,806 | 574 |
| California | 3,523 | 2,184 | 480 |
| Colorado | 2,943 | 1,476 | 551 |
| Connecticut | 4,829 | 2,932 | 515 |
| Delaware | 3,299 | 2,695 | 569 |
| Florida | 2,931 | 1,574 | 485 |
| Georgia | 2,975 | 1,600 | 580 |
| Hawaii | 3,556 | 2,671 | 569 |
| Idaho | 2,535 | 1,735 | 587 |
| Illinois | 3,340 | 1,749 | 504 |
| Indiana | 2,875 | 1,638 | 521 |
| Iowa | 2,983 | 1,697 | 592 |
| Kansas | 3,007 | 1,729 | 637 |
| Kentucky | 2,347 | 1,857 | 539 |
| Louisiana | 2,412 | 1,379 | 638 |
| Maine | 3,559 | 2,028 | 555 |
| Maryland | 3,517 | 1,833 | 524 |
| Massachusetts | 3,953 | 2,386 | 509 |
| Michigan | 3,036 | 2,366 | 483 |
| Minnesota | 3,557 | 2,614 | 573 |
| Mississippi | 2,175 | 1,652 | 686 |
| Missouri | 2,727 | 1,566 | 552 |
| Montana | 2,132 | 1,547 | 571 |
| Nebraska | 3,218 | 1,598 | 626 |
| Nevada | 3,173 | 1,896 | 469 |
| New Hampshire | 2,863 | 891 | 512 |
| New Jersey | 4,319 | 2,079 | 545 |
| New Mexico | 2,377 | 2,003 | 663 |
| North Carolina | 2,835 | 1,887 | 571 |
| North Dakota | 2,364 | 1,746 | 593 |
| Ohio | 3,231 | 1,615 | 523 |
| Oklahoma | 2,386 | 1,613 | 608 |
| Oregon | 2,672 | 1,611 | 533 |
| Pennsylvania | 3,149 | 1,800 | 440 |
| Rhode Island | 3,580 | 1,913 | 549 |
| South Carolina | 2,422 | 1,499 | 599 |
| South Dakota | 2,292 | 1,184 | 553 |
| Tennessee | 2,288 | 1,311 | 543 |
| Texas | 2,643 | 1,281 | 570 |
| Utah | 2,916 | 1,711 | 570 |
| Vermont | 3,231 | 1,704 | 566 |
| Virginia | 3,192 | 1,682 | 542 |
| Washington | 3,482 | 2,143 | 513 |
| West Virginia | 2,326 | 1,742 | 522 |
| Wisconsin | 3,567 | 2,215 | 516 |
| Wyoming | 2,268 | 1,694 | 806 |
| **U.S. average** | **$3,210** | **$1,835** | **539** |
| NYS Rank | #1 | #10 | #7 |
| NYS vs. average | + 53% | + 16% | + 17% |

***New York still ranks high in state and local spending.***

*A gubernatorial veto of spending added by the Legislature in 1998 is one reason New York is fiscally healthy today.*

Numerous other states are already facing major financial problems. Officials in New Jersey, for instance, reported in mid-May that the state may face a $1.6 billion shortfall for the coming year. In Michigan, state agencies have been ordered to reduce spending; leaders are also considering canceling scheduled tax cuts and scaling back education spending as revenues weaken. "Free Spending in Flush Times Is Coming Back to Haunt States," *The New York Times* headlined a story outlining spending cuts and reserve-fund drawdowns being considered in nearly half the states.

Across the country, states are revising downward the economic assumptions they made when starting their budgetary deliberations several months ago. According to the Fiscal Studies Program at the Nelson A. Rockefeller Institute of Government, "State forecasts that were conservative when first prepared now appear very optimistic, due to the deteriorating economy." The Rockefeller Institute's *State Fiscal Brief* for May observed that the Blue Chip Consensus projection of this year's growth in gross domestic product has declined from a 2.6 percent estimate in December, when New York's Executive Budget was prepared, to
1.8 percent in April. Indeed, actual GDP growth for the first quarter of 2001 was even lower, at a 1.3% annualized rate, according to the U.S. Bureau of Economic Analysis.

"After five consecutive years of under-forecasting economic growth and state revenue, states now appear likely to overestimate economic growth and revenue," the Rockefeller Institute warned.

## Spending pressures are likely to increase

As economic trends appear to signal a weakening of revenues, there are significant spending pressures built into New York's existing programs.

"Medicaid spending appears headed for a new growth era," *State Budget & Tax News*, a publication of the National Conference of State Legislatures, reported in April. Demographic pressures are one factor: The number of elderly Americans continues to grow, and many such individuals require tens of thousands of dollars in Medicaid funding for long-term care. In addition, enrollment of non-disabled adults and children is expected to increase as caseload reductions associated with welfare reform come to an end.

Health-care cost inflation will also play a role. "Assuming states maintain the current package of services available to Medicaid enrollees, which includes outpatient prescription drug coverage, they can expect costs per enrollee to increase," the NCSL newsletter reported.

Medicaid spending growth in New York outpaced that nationwide from 1995 through 1998. Spending in all states grew at an average annual rate of 3.9 percent; here, the figure was 4.7 percent. And the Family Health Plus program that Governor Pataki and the Legislature enacted in December 1999 may produce spending growth even further above that in other states, as new Medicaid beneficiaries enroll in the program.

## The progress we've made

Overall, as cited above, New York State's spending has been relatively restrained in recent years. That's one reason Wall Street's credit-rating agencies have upgraded their opinions of the state's creditworthiness.

Standard & Poor's cited "conservative revenue estimates and manageable spending increases," along with enhanced financial reserves and stronger economic growth, in upgrading the state's credit rating in December 2000. The upgrade brought New York State its best credit rating in 22 years and placed it in the middle of the pack among all states—23rd, a dramatic improvement from its former position of 42nd among the states. Another major rating agency, Fitch IBCA, also gave the state a two-level rating increase.

Higher credit ratings mean that investors in state bonds are willing to accept a lower interest rate. The recent upgradings will mean taxpayer savings in the tens of millions of dollars in coming years.

S&P's report included a discouraging analysis of the possibility for further credit upgrades, though. "New York State continues to be a high service provider, often at high costs to the state," the analysis stated. "Although efforts to control costs have been successful, it is unlikely that long-term measurable changes can be achieved."

## Will spending be 'ever upward'?

The state Constitution assigns the Senate and Assembly the responsibility of reviewing the Executive Budget and changing it as legislators see fit; the Governor retains the power to veto spending additions. Members of both houses, appropriately, take their Constitutional responsibility seriously—reallocating funds within the proposed budget, as well as adding to spending levels in priority areas.

Legislative additions can, however, go too far. In both 1990 and 1994, enacted budgets reflected the Legislature's addition of hundreds of millions of dollars to the fiscal plan proposed by the Governor. Trouble resulted, as described above. In 1998, Governor Pataki vetoed more than $1 billion in funding the Legislature added to an Executive Budget that already called for spending to rise 8 percent. Those vetoes, and the Legislature's decision not to override, helped produce the strong fiscal standing the state has enjoyed ever since.

Sometimes, spending ends up even higher than the level projected when the fiscal plan is enacted. In early fiscal 2000-01, for instance, when the Budget Division reported on the budget enacted by Governor Pataki and the Legislature, total spending was projected at $77.5 billion. Expenditures from the General Fund

***If the economy remains strong and New York continues to run a surplus, one logical course is to give the money back to the taxpayers — in the form of more tax cuts.***

(the account that receives most state tax revenue) were expected to be $38.9 billion. Actual spending figures turned out to be $79.7 billion and $39.7 billion, respectively. (State leaders took advantage of unexpectedly high revenues to pay down $500 million in debt on an expedited basis; that counted as "spending" and accounts for some, but not all, of the increase.)

This year, the Governor has made it clear that there is, as is traditional, some room for the Legislature to reallocate proposed funding from one area to another or even to make modest increases in overall spending. But adding multiple hundreds of millions of dollars, as pro-spending lobbyists desire, would return New York to the days when budget policy seemed based on the state motto: *Excelsior*, or "ever upward." That, in turn, would leave open the real possibility of another fiscal crisis next year.

Indeed, traditional election-year pressures will threaten another round of over-spending in 2002, and resulting fiscal problems that year or the following year. Restraining spending now to keep reserves as large as possible will make it easier for fiscal stability to last beyond whatever levels of expenditures the Governor and Legislature decide on next year.

***Traditional election-year pressures will threaten another round of over-spending in 2002 — with fiscal problems resulting that year, or the following one.***

## But suppose the good times keep rolling?

There is, of course, the possibility that the national economy, and that of New York State, will return to boom times. It is conceivable that the stock market will return to double-digit annual growth, and that profits on Wall Street and elsewhere will once again produce the extraordinary bounty of tax revenues Albany has enjoyed for the past three years.

If those things happen, and this year's state spending is kept to around the level proposed by Governor Pataki, pro-spending forces will argue that restraint was a mistake. We *could* have spent more, they'll say.

An unexpected tide of tax revenue should be the fondest hope of anyone concerned about New York State=s financial strength and the public services it makes possible. But, *if* such a windfall should occur—and, according to experts from Alan Greenspan on down, the economic forces that would be needed do not appear to be at hand—the results would only be good for New Yorkers.

Think what the Governor and the Legislature could do with a big surplus next year. They could reduce New York State's debt, which has more than doubled since 1990 and is greater than that of any other state. They could make more capital spending on a pay-as-you-go basis, to avoid incurring new debt and reducing interest costs further. They could build on recent success in expanding reserve funds, against the possibility of any future downturns in the economy.

## And how about just giving the money back?

Perhaps most important, if restraining spending today were to produce a big surplus next year, Albany could *give money back to the taxpayers.*

As mentioned above, Governor Pataki and the Legislature have built an impressive record of tax cuts over the last seven years. But there's certainly room for more to be done.

One worthwhile step would be to speed implementation of tax reductions that are already enacted, or that are awaiting action as part of this year's budget. Proposals to eliminate the alternative minimum tax on businesses could be changed to take effect immediately, or over two years, rather than the contemplated five years. Ditto for the proposed change in New York's corporate tax structure to a single sales factor that would have businesses pay income tax based on their sales in the state, rather than taxing employment and plant investment here. Reductions in energy taxes for both businesses and residential customers could be expanded and accelerated.

***A huge spending increase this year is either unnecessary — or simply irresponsible.***

The property-tax burden on employers in the Empire State continues to grow. As fiscal conditions allow, the Governor and the Legislature should consider ways to reduce that burden, as the state already does for homeowners through the STAR school-tax reduction program.

Then again, it's quite possible that tougher times are, indeed, ahead. A huge increase in spending this year is either unnecessary—or simply irresponsible.

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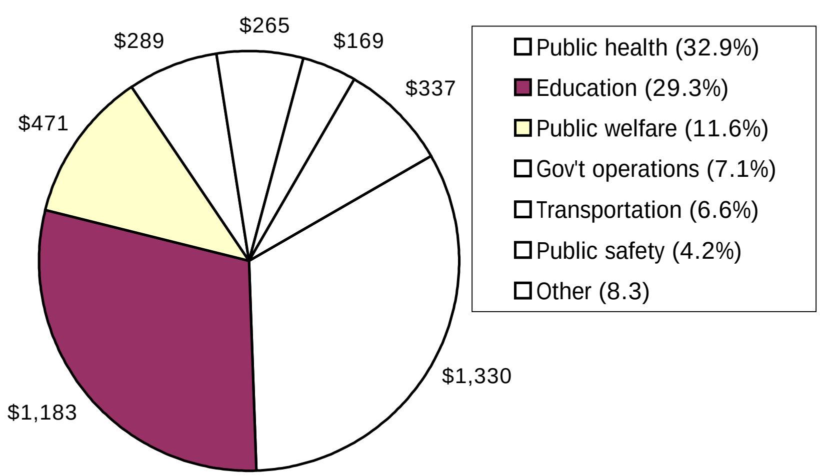
PUBLIC POLICY INSTITUTE



*A Special Report:*

# A taxpayer's guide to the (missing) budget

**Where Your State Tax Dollars Go**




Dollars per state resident, devoted to major purposes in the 1999-2000 state budget.
Source: Office of the State Comptroller