

New York's Endangered Future:

Citizens
Budget
Commission



**Debt
Beyond
Our Means**

September 2005

CITIZENS

BUDGET

COMMISSION

Founded in 1932, the Citizens Budget Commission (CBC) is a nonpartisan, nonprofit civic organization committed to influencing constructive change in the finances and services of New York State and New York City governments.

This report presents policies approved by the CBC's Budget Policy Committee and its Competitiveness Committee. The Budget Policy Committee is co-chaired by Karen Daly and Heather L. Ruth; the Competitiveness Committee is co-chaired by Fred P. Hochberg and David A. Tanner.

New York's Endangered Future: Debt Beyond Our Means was written by Charles Brecher, Research Director, and Elizabeth Lynam, Deputy Research Director, with research assistance from Selma Mustovic and Shawn Rogers.

Overview

THE PROBLEM

New York State has too much debt. Its obligations will require current and future taxpayers to bear a burden that creates a competitive disadvantage with the other states. Not only is the absolute amount of New York's debt high, but the burden is excessive even after the State's relatively large tax base and other relevant factors are taken into account.

THE CAUSES

The core issue is that New York has no effective legal limits on the amount of debt it can assume. Constitutional provisions intended to limit debt are outdated and are circumvented regularly. Statutory limits – passed in 2000 – are also being circumvented. Simply put, it has become too easy for State leaders to borrow. In addition, they have misused debt, which should be restricted to paying for long-term capital projects, by financing annual operating expenses.

THE SOLUTIONS

Short-run and long-run measures are needed. In the near term, voters should reject bond referendums such as the Transportation Bond Act of 2005 until debt is brought under control. That act would authorize only \$2.9 billion of an additional \$13 billion in planned State borrowing, but it is the only opportunity that voters have to express their opposition to excessive borrowing.

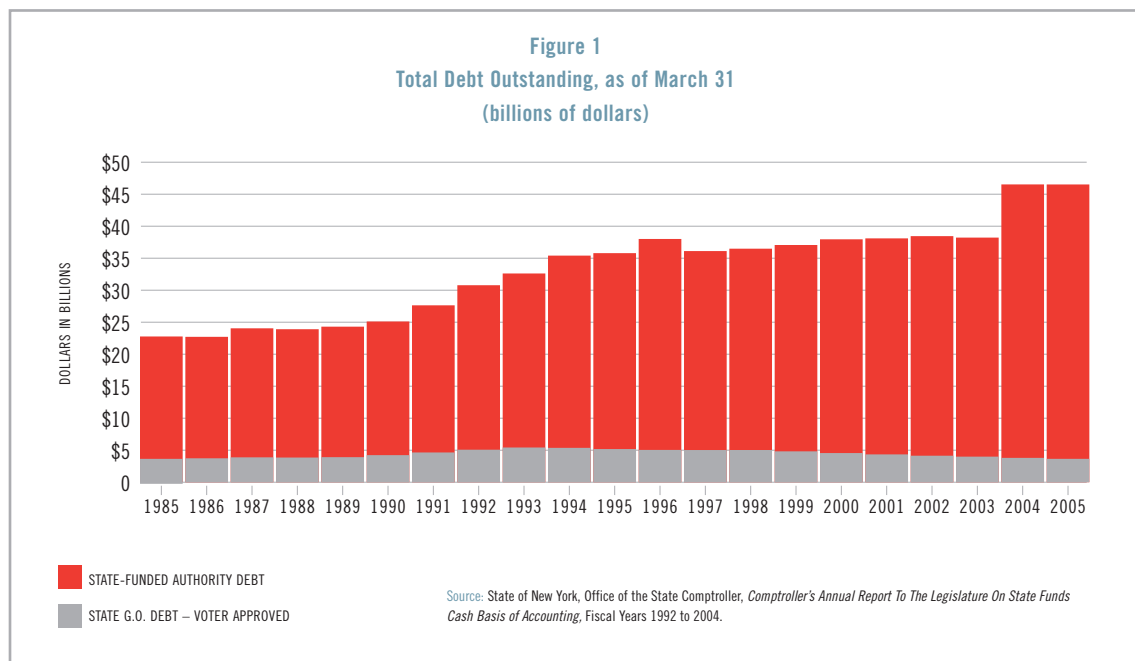
In the long-run the State must strike a balance between adequate infrastructure investment and a competitive debt burden. The State needs a new constitutional limit that does not require voter approval for every debt issuance, but does impose a binding limit that is linked to ability to pay.

The Problem

New York State has \$46.7 billion in outstanding state-funded debt. It is important to note that while this figure includes all the relevant debt that must be repaid from the State's tax base, it excludes billions that the State's public authorities have borrowed and will repay with revenues such as highway and bridge tolls, and borrowing done on behalf of private organizations such as hospitals and universities. The \$46.7 billion is \$8 billion more than was outstanding in 2000 and nearly double the level in 1990. (See Figure 1.)

While this is a large amount even for a large state, the best way to assess the appropriate level of debt is to consider its affordability. To be judged affordable, the repayment of debt:

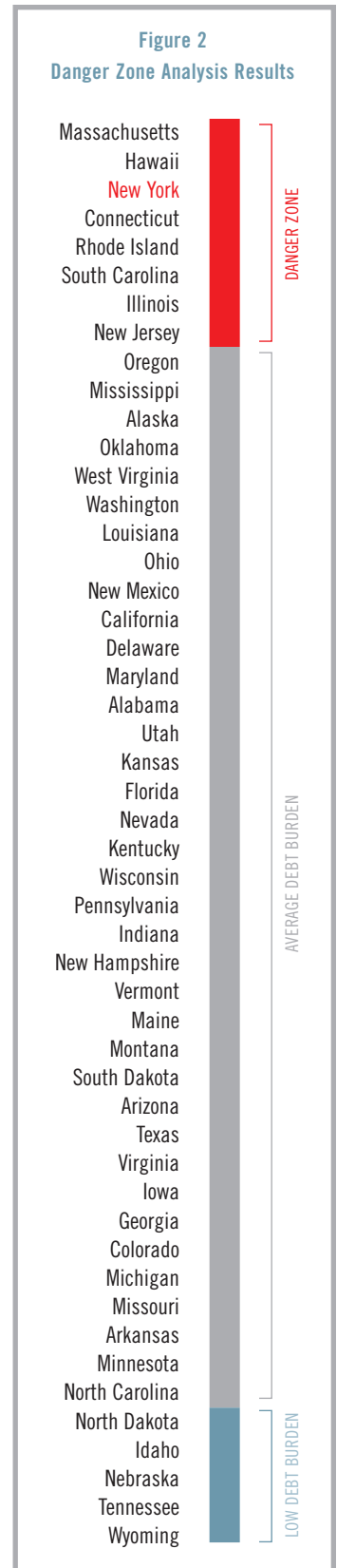
- ▶ Should not require tax increases or service cutbacks that make a place less attractive than its competitors;
- ▶ Should be gauged according to the level of resources available to repay it; wealthier places can afford to carry more debt than poorer ones.



To apply the standard, six analytic steps are necessary. The most recent data available to complete this analysis are from 2003.

STEP	RESULT
1. Identify relevant debt outstanding for New York and all states.	New York ranks 2 in gross numbers, well behind California and close to Illinois.
2. Account for pension obligations, another long-term liability for a state.	New York improves its ranking, because its pension funds are relatively well funded.
3. Determine resources available to repay debt.	New York is a high wealth state and ranks number 3 in resources available, behind California and Texas.
4. Adjust available resources to reflect the division of responsibility between a state and its local governments.	New York places a greater than average share of financial burden on local governments and should, therefore, have a lower State debt burden.
5. Include a safety margin for an economic downturn; a rapid downturn should not jeopardize debt repayment.	New York is more dependent on volatile taxes and needs a greater safety margin than other states.
6. Compute the ratio of debt to resources for each state; a state far above (more than one standard deviation above the average) its competitors is in the “danger zone.”	New York is in the “danger zone.”

New York’s debt – well into the danger zone – is nearly \$10 billion over affordable levels. Among 50 states only seven others are in the danger zone, and only two, Massachusetts and Hawaii, are in a riskier position than New York. (See Figure 2.)

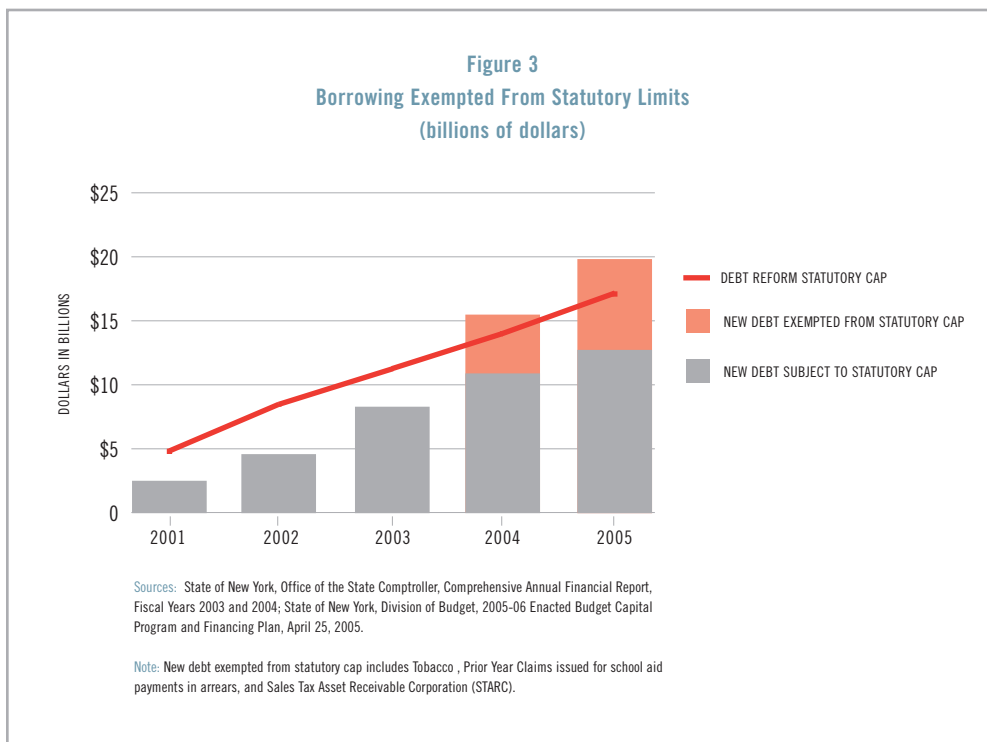


The Causes

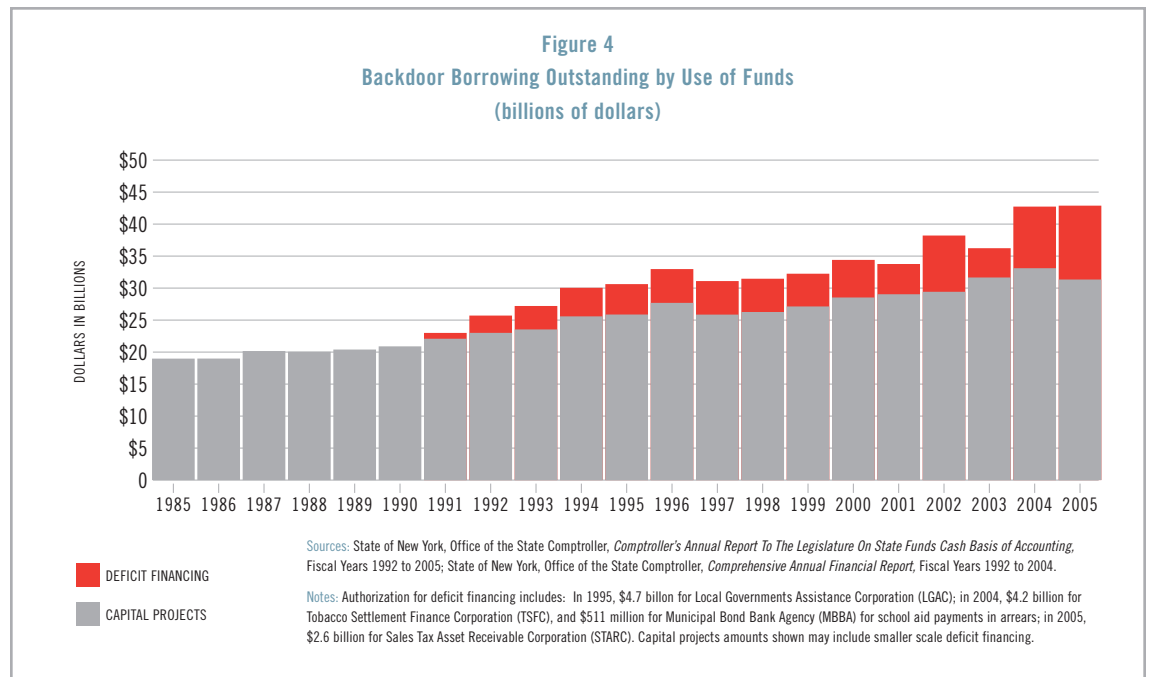
New York's dangerous debt levels have arisen because the State lacks an effective limit. The State Constitution, adopted in 1894 and revised in 1938, requires voter approval for any long-term debt backed by the State. Although this may have been appropriate 60 years ago, it has proved unworkable in modern times. It doesn't give State leaders the flexibility to fund all the infrastructure investments that are essential to the State's economic well being.

Out of necessity State leaders have devised ways to circumvent the constitutional requirement. They have created and used authorities to issue debt that does not have to be approved by voters. This "backdoor" borrowing now represents \$43.0 billion of the \$46.7 billion in total State debt. (Refer to Figure 1.)

Recognizing this trend, State leaders passed the Debt Reform Act of 2000, in order to address statutorily the unworkable constitutional provisions. This statute set a limit on new debt at a fixed share of personal income. The legislation has not been effective. With other legislation State leaders have exempted borrowing from the limit. For example, in fiscal years 2003 and 2004 nearly \$7 billion in borrowing was exempted from the limit. (See Figure 3.)



Fully a quarter of the backdoor borrowing – about \$11.5 billion – has been used for the wrong purposes. Instead of being invested in long-term capital projects, it has underwritten annual operating deficits. (See Figure 4.)



The Solutions

The State should reduce its debt burden. This is not what is called for in the State's current plans, which would add about \$19 billion in new debt in the next five years – a stunning increase given that New York is already in the danger zone. (See Figure 5.)

SHORT RUN

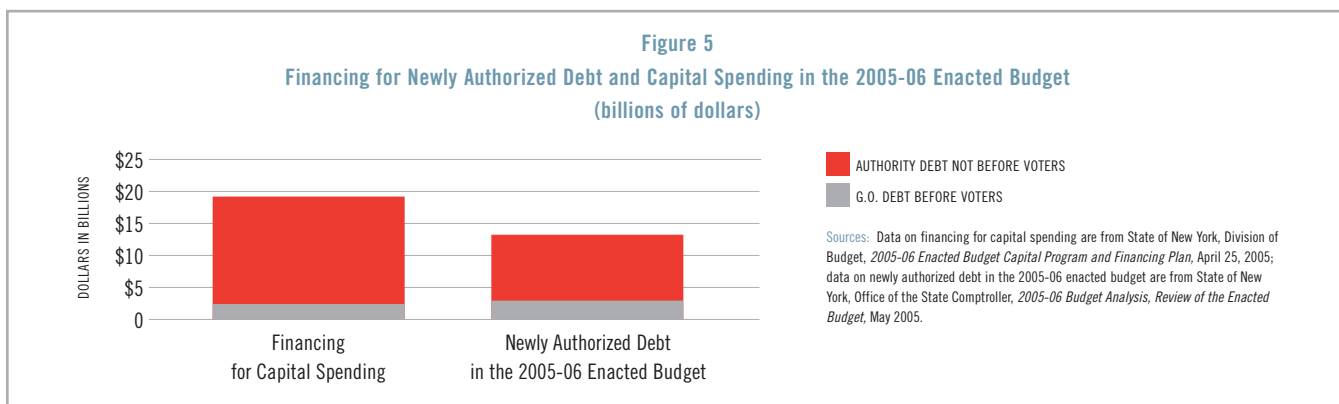
Voters are being asked to approve just \$2.9 billion of this total; the rest is backdoor borrowing. That is why the CBC has argued that voters should reject the overall growth in borrowing – in the only way they can – by voting “no” on the Transportation Bond Act of 2005.

LONG RUN

In the long run the solution is constitutional debt reform. Modern constitutional limits should:

- ▶ Establish a new debt limit based on the concept of affordability as determined by an independent Debt Policy Committee;
- ▶ Apply the limit to all forms of state-backed debt, including such bonds issued by authorities;
- ▶ Eliminate the need for voter approval within that limit;
- ▶ Restrict the use of borrowed funds to true capital investments.

A more detailed discussion of the CBC's recommendation for debt reform is presented in a previous report, *An Affordable Debt Policy for New York State and New York City*, available at <http://www.cbcny.org/debt1018.pdf>.



Appendix: Affordability Analysis by State, 2003 (dollars in thousands)

STATE	NET STATE DEBT OUTSTANDING	UNFUNDED STATE PENSION LIABILITY	TOTAL STATE OBLIGATION	REVENUE CAPACITY	INDEX OF STATE/LOCAL RESPONSIBILITY	ADJUSTED REVENUE CAPACITY	RECESSION FACTOR	RECESSION ADJUSTED REVENUE CAPACITY	RATIO OF STATE OBLIGATION TO REVENUE CAPACITY
Massachusetts	\$23,619,457	\$3,470,203	\$27,089,660	\$19,516,859	1.045	\$20,396,357	-1.42%	\$20,106,789	1.347
Hawaii	4,540,474	807,856	5,348,330	3,053,113	1.359	4,150,182	2.11%	4,237,751	1.262
New York	49,731,579	(623,356)	49,108,223	49,155,179	0.820	40,310,291	-2.23%	39,409,770	1.246
Connecticut	11,975,757	1,306,705	13,282,462	11,068,602	1.006	11,136,654	-1.94%	10,921,033	1.216
Rhode Island	2,142,440	538,054	2,680,494	2,469,114	0.990	2,443,367	0.41%	2,453,423	1.093
South Carolina	8,996,348	480,653	9,477,001	8,479,846	1.052	8,918,687	1.37%	9,041,027	1.048
Illinois	23,682,192	4,554,396	28,236,588	30,840,321	0.911	28,091,316	-1.29%	27,729,738	1.018
New Jersey	21,035,005	124,470	21,159,475	24,775,847	0.892	22,093,213	-1.34%	21,798,023	0.971
Oregon	4,493,720	2,358,184	6,851,904	8,972,452	0.966	8,669,736	-0.47%	8,628,817	0.794
Mississippi	3,213,137	1,133,660	4,346,797	5,150,364	1.221	6,289,796	1.14%	6,361,503	0.683
Alaska	1,861,576	22,505	1,884,081	3,100,072	0.887	2,749,052	2.39%	2,814,770	0.669
Oklahoma	3,611,866	1,970,196	5,582,062	7,296,073	1.161	8,471,931	-1.32%	8,359,902	0.668
West Virginia	1,846,011	1,270,377	3,116,388	3,586,271	1.289	4,623,549	0.96%	4,667,948	0.668
Washington	9,384,329	1,660,701	11,045,030	15,470,084	1.090	16,867,278	0.77%	16,996,803	0.650
Louisiana	4,368,022	1,988,359	6,356,381	10,267,968	1.017	10,447,060	2.06%	10,662,270	0.596
Ohio	12,010,200	2,901,774	14,911,974	27,116,408	0.938	25,428,904	0.68%	25,601,208	0.582
New Mexico	2,267,663	778,987	3,046,650	4,255,331	1.253	5,332,529	0.08%	5,336,729	0.571
California	52,762,077	(573,336)	52,188,741	85,588,460	1.088	93,103,466	-0.53%	92,611,948	0.564
Delaware	1,788,996	62,143	1,851,139	2,488,432	1.363	3,391,215	2.69%	3,482,290	0.532
Maryland	5,315,137	1,923,352	7,238,489	15,408,306	0.917	14,134,337	2.04%	14,423,016	0.502
Alabama	4,295,404	883,614	5,179,018	9,312,430	1.128	10,508,675	2.12%	10,731,284	0.483
Utah	2,365,987	229,022	2,595,009	4,859,966	1.097	5,333,463	0.89%	5,381,084	0.482
Kansas	2,374,791	357,701	2,732,492	6,125,585	1.016	6,222,269	-0.84%	6,169,834	0.443
Florida	17,675,404	(414,834)	17,260,570	41,122,803	0.953	39,170,809	1.23%	39,653,347	0.435
Nevada	2,406,283	761,929	3,168,212	7,063,988	1.033	7,299,322	2.19%	7,459,192	0.425
Kentucky	3,641,722	984,492	4,626,214	8,845,379	1.246	11,023,373	2.28%	11,274,448	0.410
Wisconsin	7,100,337	(1,520,808)	5,579,529	12,927,584	1.069	13,826,020	0.75%	13,930,153	0.401
Pennsylvania	10,951,824	(144,959)	10,806,865	29,181,799	0.991	28,922,805	1.01%	29,213,803	0.370

New York's Endangered Future

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Indiana	4,113,425	1,229,563	5,342,988	14,308,592	1.012	14,475,991	0.81%	14,593,641	0.366
New Hampshire	1,066,046	127,446	1,193,492	3,644,613	0.888	3,236,621	1.63%	3,289,220	0.363
Vermont	719,951	80,971	800,922	1,665,398	1.302	2,168,047	1.99%	2,211,203	0.362
Maine	743,529	359,538	1,103,067	3,111,332	0.975	3,032,120	2.41%	3,105,071	0.355
Montana	504,577	291,350	795,927	2,084,839	1.138	2,373,321	-1.73%	2,332,181	0.341
South Dakota	563,274	(7,035)	556,239	1,892,980	0.893	1,691,356	-1.75%	1,661,779	0.335
Arizona	4,429,459	(272,907)	4,156,552	12,257,508	0.990	12,140,019	2.76%	12,474,881	0.333
Texas	11,349,750	2,176,491	13,526,241	51,406,653	0.819	42,087,855	-1.06%	41,641,289	0.325
Virginia	5,963,597	38,819	6,002,416	19,162,246	0.973	18,644,208	0.81%	18,796,075	0.319
Iowa	1,647,030	433,887	2,080,917	6,393,474	1.012	6,473,161	1.13%	6,546,349	0.318
Georgia	7,049,842	(1,044,992)	6,004,850	20,287,312	0.964	19,565,604	0.07%	19,579,571	0.307
Colorado	2,538,823	614,030	3,152,853	12,512,190	0.839	10,499,203	-0.92%	10,402,207	0.303
Michigan	7,101,166	1,297,232	8,398,398	24,274,150	1.202	29,178,309	-1.01%	28,883,542	0.291
Missouri	2,643,141	1,071,836	3,714,977	13,672,518	0.972	13,295,135	2.19%	13,586,070	0.273
Arkansas	1,518,232	375,435	1,893,667	5,134,678	1.363	6,997,297	0.80%	7,052,993	0.268
Minnesota	3,378,500	935,314	4,313,814	13,214,236	1.207	15,951,164	0.80%	16,079,360	0.268
North Carolina	6,445,970	(1,086,732)	5,359,238	17,850,961	1.159	20,697,479	0.18%	20,733,926	0.258
North Dakota	210,745	108,225	318,970	1,508,419	1.089	1,642,447	1.19%	1,661,966	0.192
Idaho	377,969	237,357	615,326	2,846,915	1.163	3,309,780	2.26%	3,384,733	0.182
Nebraska	342,034	168,456	510,490	3,973,698	0.948	3,768,365	-1.35%	3,717,435	0.137
Tennessee	1,370,234	116,144	1,486,378	13,147,658	1.013	13,313,162	2.07%	13,588,863	0.109
Wyoming	147,407	41,955	189,362	1,752,846	1.014	1,777,348	2.02%	1,813,172	0.104
United States	\$363,682,439	\$34,584,423	\$398,266,862	\$703,601,854	1.000	\$703,601,854	0.00%	\$703,601,854	0.566
Standard Deviation									0.320
One SD above mean (Danger Zone)									0.886

The method used to calculate affordability is an update of the method presented in *An Affordable Debt Policy for New York State and New York City* and in Charles Brecher, Kurt Richwerger, and Marcia Van Wagner, "Measuring the Affordability of State Debt," *Public Budgeting and Finance*, Winter 2003, pp. 65-85.

SOURCES AND NOTES:

Debt data for fiscal year 2002-03 were obtained from the U.S. Census Bureau, <<http://ftp2.census.gov/govs/state/03state-cd.txt>> (March 17, 2005). For New York, the debt issued by the Municipal Assistance Corporation (MAC) was excluded to reflect the fact that the debt service on MAC debt was paid by New York City.

Pension data are from Wilshire Associates, Inc., *2004 Wilshire Report on State Retirement Systems: Funding Levels and Asset Allocation*, March 12, 2004. The pension data from the Wilshire Report were adjusted in three ways. First, New York's unfunded pension liability was adjusted to include New York City's unfunded pension liability. Data for the City's five pension plans was taken from the City of New York, Office of the Comptroller, *Comprehensive Annual Financial Report of the Comptroller for the Fiscal Year Ended June 30, 2004*, October 2004. Second, each state's share of combined state-local unfunded pension liability was estimated based on the state's share of total state and local full-time equivalent employment. This data was taken from the Census Bureau's *Statistical Abstract of the United States: 2004-05, State and Local Government Finances and Employment*, <<http://www.census.gov/prod/2004pubs/04statab/stlocgov.pdf>>. Fiscal year 2001-02 is the last year for which these data were available. Third, unfunded pension liability was adjusted to reflect only the share assigned to employer contributions. The split in contribution between employer and employees was calculated for each state, and then the employer's share of contributions was multiplied by that state's unfunded pension liability. Data for calculating contribution splits is from the Public Pension Coordinating Council, *2001 Survey of State and Local Government Employee Retirement Systems*, PPCC2001Data Database, <<http://ppcc.grsnet.com>> (July 10, 2003).

State and local revenue data are from the U.S. Census Bureau, *State & Local Government Finances*, State & Local Summary Tables by Level of Government, <<http://www.census.gov/govs/www/estimate02.html>> (March 17, 2005).

Personal Income data are from Bureau of Economic Analysis, Regional Economic Data, Annual State Personal Income, SA1-3 - Personal Income 2001, <<http://www.bea.doc.gov/bea/regional/spi/drill.cfm>> (March 17, 2005). The "adjusted revenue capacity" is an adjustment to personal income based on the ratio of revenues under a representative tax system to personal income using data available only for 1999. For details on the revenues under a representative revenue system see the Citizens Budget Commission, *An Affordable Debt Policy for New York State and New York City*, October 18, 2000, <<http://cbcny.org/debt1018.pdf>>.

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