IS A STATE SPENDING CAP THE RIGHT APPROACH FOR NEW YORK?

A LOOK AT THE EXPERIENCE OF OTHER STATES

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INTRODUCTION

New York's ongoing budget crisis has prompted leaders and candidates to call for a cap on state spending. Citing Albany's consistent record of significantly increasing spending in good and bad times, they want future spending to grow no more quickly than the national inflation rate.

For New York State, this would be a remarkable reduction in the rate of spending. Over the past 25 years, the state operating budget[1] has increased at an average annual rate of 5.4 percent, far outpacing the average national inflation rate of 2.9 percent and the 4.8 percent average annual growth in personal income New Yorkers have experienced over the same period.[2] The rate of spending growth has topped revenue growth, even in some years when the economy and tax collections were booming, leading to a habit of relying on "one-shot" measures, tax increases and borrowing. This pattern has led to large future budget gaps.

Over the last four decades, 30 states have enacted some form of tax or spending limit at the state level. It is instructive for New York's policy makers to examine the experience of those states before committing to a formula-based spending limit. The results in many of these states suggest that the goals of a cap should be clearly defined and consideration should be given to the possible consequences and problems that may arise from a cap.

A review of other states' experiences with spending caps indicates that most have had little to no effect on government spending unless paired with similar limits on local governments. In states that do not apply restrictions at the local level, lawmakers usually find ways to shift the locus of tax collection and spending.

When spending caps are effective in curbing state spending they typically work in tandem with other limits on government including local property tax caps, local spending limitations, strict balanced budget requirements and state revenue caps. All of these are in place in some form in Colorado – the state credited with having the most stringent and most complicated tax and spending caps. Colorado's Taxpayer Bill of Rights (TABOR) sets a strict limit on state revenue growth as well as spending. But Colorado's story also carries a caution for New York. The state's multiple tax and spending limitations, built up over decades, have led to unintended budgetary imbalances and prevented lawmakers from responding effectively to economic decline. Colorado's cap problems grew so severe by 2005 that voters, urged on by a Republican governor who had refunded billions to taxpayers under TABOR in flush times, suspended the cap requirements for five years.

This paper examines the caps proposed for New York. It also analyzes the Colorado experience and that of three other states in order to help inform decision making for New York.

PROPOSALS FOR NEW YORK

Governor David Paterson has twice proposed spending cap legislation. In the 2010 legislative session, he proposed a constitutional amendment that would cap the annual growth of spending in "state operating funds" at the national three-year average rate of inflation. Spending above the cap would be permitted only if the Governor declares an emergency and a two-thirds majority of the legislature approves the additional spending.[3] In 2009, he promoted similar legislation that would have imposed a statutory, not constitutional, spending limit.[4] Neither bill attracted support from legislative leaders.

Governor Paterson's cap would not apply to expenditures derived from federal funds or spending on capital projects; it includes the general fund, special revenue funds and debt service. While State appropriations to public authorities such as the Metropolitan Transportation Authority would be subject to the cap, spending by authorities of revenues they raise independently (such as through fares and tolls) would not be subject to the cap.

The Governor argues that his spending cap would have curbed state spending by nearly $17 billion in State fiscal year 2007-08 had it been in place starting in 2002-03.[5] Limiting annual spending growth in those years to the three-year rolling average of the national inflation rate would have resulted in a $60.3 billion cap in 2007-08, an increase of just 2.7 percent per year over that time. In contrast, the state's actual average annual spending growth in that period was nearly 7.9 percent, and actual expenditures in state operating funds totaled just over $77 billion in fiscal year 2007-08.[6]

Paterson's 2010 proposed constitutional amendment does not mention how excess revenues, if any, above the cap are to be used. The 2009 statutory spending cap proposal called for depositing surplus revenues into the state rainy day fund and increased the capacity of the fund to 10 percent of general fund spending, up from the current 3 percent.

Gubernatorial candidate Andrew Cuomo's campaign policy book proposes a spending cap nearly identical to Governor Paterson's, adding more detail on the treatment of surplus revenue.[7] Cuomo stipulates that one-third of any revenues above the cap should be placed in the state's rainy day fund, which would expand to a maximum of 5 percent of the state's operating budget. Cuomo's proposal uses the same term, "state operating funds," from Governor Paterson's proposal to define what would be covered by the cap. Anything left would "be used to provide tax relief or to reduce the state's excessive debt load." Cuomo predicts that this proposal would generate a $1.1 billion surplus in fiscal year 2011-2012 (based on a projected three-year rolling average inflation rate of 2.0 percent).

New York had a spending cap in place for at least one period in the past. In 1990, Governor Mario Cuomo won approval for a law to limit spending for three fiscal years. The law imposed voluntary "spending targets" in fiscal years 1991-92 and 1992-93, and a statutory cap for fiscal year 1993-94. The cap was set at 10 percent of annual personal income statewide and applied to all government funds except federal funds and debt service.[8] Expenditures fell well below the cap, partly because personal income was growing rapidly as the state recovered from a

recession. The law expired in 1994. Because the cap was initially generous and personal income grew robustly in most years since, a cap set at that level would still not have any impact today. In fiscal year 2007-08, a spending limit set at that level would have been $93 billion, nearly $16 billion more than the actual spending in areas under the cap in that year.[9]

TAX AND SPENDING LIMITS IN OTHER STATES

Since the 1970s, 30 states have adopted spending and/or revenue caps that are still in effect. (See Table 1.) Most came in the late 1970s and early 1980s, with a second wave starting in the early 1990s. The latest was Ohio in 2006.

The nature of the caps varies widely. Fifteen states adopted them by constitutional amendment, 15 by statute. Seven caps were adopted by citizen initiative, and ten by referenda. Some use a combination of inflation plus population growth to determine the cap, but the most popular measure is state personal income, which historically grows at a higher rate than inflation. Some other states tie their limits to a percentage of actual or projected receipts.

States also vary in provisions for waiving the cap. Citizen approval, required in two states, is the most challenging prerequisite; 16 states require a supermajority in the legislature (seven of those also require a declaration of emergency from the governor). Six states allow limits to be changed or overridden with a simple majority vote in the legislature. Four states have no provisions for waiving the cap.

Finally, the states differ in how they use revenues above the cap. Some require taxpayer refunds, others allocate the surplus to a rainy day fund, and some do not address the subject.

Colorado's Center for Tax Policy devised a system for assessing the restrictiveness of cap legislation. Restrictiveness – the extent to which the cap is binding – is considered an important aspect because it indicates how easily lawmakers are able to evade the limits or change the law. Generally, the more restrictive the cap, the more effective it can be at restraining spending growth.

In this ranking system, a constitutional amendment is considered more restrictive than a statute because, at least in theory, future lawmakers would find it more difficult to avoid or change such limits. Caps passed by citizen initiative or referenda are considered more restrictive than those passed by the legislature. The ranking system also considers whether the cap applies to revenues or spending; limits on expenditures or appropriations are considered more restrictive than limits on projected revenues, which are more easily manipulated.

Table 1 lists the 30 states with spending or tax limitations according to the Center's restrictiveness ranking. This ranking does not assess whether states have also imposed spending or tax limitations on local governments since those are typically enacted through separate legislation.

Table 1: Tax and Spending Limitations

					Limits		Annual Cap Growth Factor			Surplus Provision			
State	**CfTP Score**	**Year**	**Enacted In**	**Enacted by**	*Spending*	*Revenue*	*Inflation + Population*	*Personal Income*	*Other**	*Refund*	*Rainy Day Fund*	*Other**	**Override Measures**
Colorado	21	1991	Constitution	Citizen Initiative	✓	✓	✓			✓			Voter Approval
California	16	1979	Constitution	Citizen Initiative	✓			✓		✓		✓	Voter Approval
Washington**	15	1993	Statute	Citizen Initiative	✓			✓				✓	Emergency Declaration and 2/3 Legislative Approval
Louisiana	15	1993	Constitution	Referendum	✓			✓				✓	2/3 Legislative Approval
Missouri	15	1996	Constitution	Citizen Initiative		✓			✓	✓		✓	Emergency Declaration and 2/3 Legislative Approval
Arizona	14	1978	Constitution	Referendum	✓			✓			No provision		2/3 Legislative Approval
Hawaii	14	1978	Constitution	Convention	✓			✓		✓			2/3 Legislative Approval
Oklahoma	14	1992	Constitution	Referendum	✓				✓		✓		2/3 Legislative Approval
Delaware	13	1978	Constitution	Referendum	✓				✓			✓	Emergency Declaration and 2/3 Legislative Approval
Michigan	13	1978	Constitution	Citizen Initiative		✓		✓		✓		✓	Emergency Declaration and 2/3 Legislative Approval
Alaska	13	1982	Constitution	Referendum	✓		✓				No provision		Reserve Funds may supplement Decreased Revenue
Connecticut	13	1991	Statute	Legislative Vote	✓				✓		✓		Emergency Declaration and 3/5 Legislative Approval
Florida	13	1994	Constitution	Referendum		✓		✓		✓	✓		2/3 Legislative Approval
South	13	1984	Constitution	Referendum	✓			✓				✓	Emergency Declaration and 2/3 Legislative Approval
Tennessee	12	1978	Constitution	Convention	✓			✓			No provision		Majority Legislative Approval
Texas	12	1978	Constitution	Referendum	✓			✓			No provision		Majority Legislative Approval
Ohio	12	2006	Statute	Legislative Vote	✓		✓				✓		2/3 Legislative Approval
Nevada	12	1996	Statute	Legislative Vote	✓		✓				No provision		2/3 Legislative Approval
Oregon	12	1996	Statute	Legislative Vote	✓	✓		✓		✓			Majority Legislative Approval
Massachusett	11	1986	Statute	Citizen Initiative		✓			✓	✓	✓		Majority Legislative Approval
Rhode Island	11	1992	Constitution	Referendum	✓				✓		✓		None
Wisconsin	11	2001	Statute	Legislative Vote	✓			✓			✓		2/3 Legislative Approval
Utah	10	1989	Statute	Legislative Vote	✓						No provision		Emergency Declaration and 2/3 Legislative Approval
North Carolina	10	1991	Statute	Legislative Vote	✓			✓				✓	Cap growth may reflect growth in Medicaid, prisons and other costs
Indiana	10	2002	Statute	Legislative Vote	✓						✓		Majority Legislative Approval
Maine	10	2005	Statute	Legislative Vote	✓			✓			✓		Majority Legislative Approval
Mississippi	9	1982	Statute	Legislative Vote	✓				✓		✓	✓	None
New Jersey	9	1990	Statute	Legislative Vote	✓			✓			No provision		2/3 Legislative Approval
Iowa	9	1992	Statute	Legislative Vote	✓				✓		✓		None
Idaho	8	1980	Statute	Legislative Vote	✓		✓				No provision		None

*These states marked other use a variety of indicators to determine their growth factor and have a number of different surplus provisions.

** Washington has moved to a personal income limit from an inflation-based limit since this ranking was calculated.

*** This theoretical ranking for New York assumes that a constitutional amendment is approved, via referendum, capping spending at the inflation rate and that surpluses would be directed to a more robust rainy day fund.

Source: Adapted from National Conference of State Legislators, http://www.ncsl.org/default.aspx?tabid=12633, "State Tax and Expenditure Limits"; Center for Tax Policy, "Fiscal Cap Style in the States: An Inventory and Evaluation", http://www.centerfortaxpolicy.org/reports/fiscal_cap.pdf

Colorado's constitutional amendment, the Taxpayer's Bill of Rights (TABOR) takes the top spot on the list. Passed in 1992, TABOR caps revenue and spending growth at all levels of government throughout the state at inflation plus population growth. Until 2005, the baseline for the calculation was the previous year's actual revenues. Any excess revenues are returned to taxpayers, and voter approval is required for any new taxes or spending above the cap.

While the spending cap proposed for New York would not be quite as restrictive as Colorado's, it would rank near the top. The constitutional amendment proposed by Governor Paterson would rank especially high for restricting spending growth exclusively to inflation. No other state uses such a restrictive measure; the other inflation-based caps also include an adjustment for population growth.

Empirical Studies on the Impact of Caps on Spending Growth

Researchers have used historical tax and spending data to try to determine whether caps succeed in limiting the growth of state and local government spending. The majority of the research on state-level limits suggests that they have had little success in curbing spending growth. Research indicates that restrictions at the local level – whether spending limits or property tax caps – have been more effective in slowing spending growth. However, the results of research on the effectiveness and ancillary effects of state spending caps vary depending on the breadth and depth of data used, and the variables used in the comparisons of budgeting systems.

Joyce and Mullins analyze data from the period 1960 to 1987, comparing capped and non-capped states.[10] They find that state caps had no effect on the state's share of combined state and local tax and spending responsibility. But the limits at the local level do affect the structure of state and local spending and taxation, shifting responsibility toward the state level and causing local governments to rely more heavily on fees and charges.

Using data from 1972 to 1987 Shadbegian compares states with and without limits in terms of expenditures per capita. He finds that caps limited spending growth in low-income states, but had no such effect in high-income states.[11] High income states with limits actually had greater expenditure growth than similar states without caps. His study only applies to state spending and does not address effects on local spending. Shadbegian warns that in his results, as in those in other studies, evidence of reduced taxes or spending could stem from a predisposition towards limiting the size and growth of government in those states and not from the imposition of caps themselves.

Building on their earlier work, Mullins and Joyce used slightly more recent data (1970 to 1990) to assess how limits affect the state versus local share of spending responsibility and revenue sources. They again find that limits have little effect on state-level revenues and expenditures. But limits do tend to shift tax collection responsibility toward the state and encourage a move toward charges and fees. They find that state limits do not affect the absolute size of state and local government.[12]

Other research shows that state limits do limit spending and revenue growth. Bails and Tieslau, using data covering 1969 to 1994, find an aggregate $41 reduction in per capita state and local spending in capped states compared to states without caps.[13] They find the per capita reductions are larger if the spending limits are paired with other limits, such as balanced budget provisions or supermajority vote requirements for tax increases.

Similarly, using data from 1972 to 1996, New finds that caps generally do restrain state and local tax and spending growth if they: 1) result from a citizen initiative, not a vote of the legislature, 2) tie limits to inflation plus population, not personal income or other measures, and 3) mandate that extra revenues are refunded to taxpayers. Notably, New finds that state caps lacking those additional restrictions often lead to tax and spending increases compared to non-capped states.[14]

Finally, Kousser, McCubbins and Moule, using data from 1969 to 2000, find that few state caps reduced spending.[15] Their analysis of per capita expenditures and revenues at the state and local level suggests that only Colorado's TABOR provisions restricted growth; Colorado's per capita spending was $348 lower than it would have been without the cap. They find that only half of the states with spending or revenue caps also have limits on local governments and suggest that without those local limits lawmakers shift spending to the local level. As found in other studies, a majority of states increased charges and fees following the adoption of a cap.

Other studies have analyzed the ancillary effects of state spending and tax caps specifically. Three are worth noting.

Poterba and Rueben studied the effect of caps on state borrowing costs.[16] Analyzing yields on tax-exempt bonds issued by states between 1973 and 1997, they find that states with expenditure limits or strict anti-deficit provisions generally enjoy lower rates than other states. However, states with revenue limits or supermajority requirements experience the opposite effect and generally pay more to borrow.

Poterba and Rueben subsequently analyzed the effects on borrowing costs when states with limits experience fiscal and unemployment shocks. Based on state bond yields from 1988 to 1998, they find that states with revenue limits experience greater borrowing costs when faced with unexpected deficits. Their findings are mixed for expenditure limits. Unexpected deficits had little effect on borrowing costs among states with limits, but increases in state unemployment did. States that impose strict debt limits face no increased borrowing costs in either shock scenario.[17]

In a paper that centers on Colorado's experience with the TABOR, Martell and Teske suggest that strict state limits cause some voters to launch new local governments as a way to replace declining services from the state and other local governments.[18] This conclusion contradicts the results from Mullins and Joyce, who find a trend away from increased reliance on local taxes. The difference may be the result of Colorado's unusually robust set of tax and spending limits.

Finally, it should be noted that there is no systematic empirical evidence on the extent to which spending caps have had adverse impacts on the delivery and/or quality of government services, as fast-growing functions such as health and education force cuts in others that may not be able to absorb them readily.

In sum, most statistical research suggests spending and revenue caps have limited effect on state government, and slightly more on local government. However, since effectiveness seems to depend in large part on the details of the particular cap, it is helpful to look at the experience in selected states.

Case Studies of Recent State Experience with Caps

More than a half dozen states have passed some form of tax or spending limit since 1990. During that time Colorado and Washington adopted the most restrictive limitations. Colorado's tight TABOR cap has been held up as a model for other states by cap proponents. Washington's cap design – also hailed by proponents of lower government spending when it was passed – is similar to what is being proposed for New York. New Jersey and Connecticut, neighbors of New York, also adopted limits in the same era, and it is worth looking at their experience. Another neighbor, Massachusetts, also has a long-standing revenue limitation (in addition to a 2.5 percent cap on property tax growth at the local level). However, we leave Massachusetts aside because its spending cap relates to the growth rate of wages and salaries in the state, an unusual approach not similar to what is proposed for New York.

Colorado

Voters approved the Taxpayer's Bill of Rights (TABOR) in 1992. This constitutional amendment caps state revenue growth at the annual rate of inflation plus population growth. The law requires that excess revenues be refunded and that voters approve any tax increases. Unlike other states that address limits on local government in separate legislation, if at all, Colorado's TABOR applies to "all districts," meaning the state house down to the local fire district are all subject to the revenue cap.

Thanks to the TABOR revenue limit, Colorado sent rebate checks to taxpayers totaling $3.2 billion between fiscal year 1996-97 and fiscal year 2000-01 largely due to the national economic expansion of the late 1990s.[19]

However, TABOR caused budgeting problems during the recession that followed. When revenues declined 12 percent in 2000-01, lawmakers could not raise taxes to make up the shortfall. State and local lawmakers can, and did, increase service fees without voter approval. They also used accounting gimmicks, fund transfers and other revenue enhancements to help offset the tax revenue losses.

Once the economy picked up, TABOR hampered lawmaker's ability to restore services. The baseline for the annual limit was the prior year's actual revenues, rather than the prior year's

cap or a fixed base year adjusted for a growth cap. This meant that the cap for the following year would remain relatively low, a process known as "ratcheting-down." The state's revenue cap essentially had been permanently reset to a lower level.

The TABOR limit would not allow the state to restore services that had been cut during the recession. The ratcheting down meant that government spending in Colorado would take several years just to return to its pre-recession levels. Since the costs of government services had not dropped and continued to grow, in 2005 Colorado found itself sending tax rebates out while lawmakers were confronting further cuts to service levels.

In response to this problem, Colorado voters approved an overhaul of TABOR known as Referendum C in 2005. The initiative suspended TABOR-mandated tax refunds for five years, allowing the state to use all available tax revenues to catch up to pre-recession spending levels. Referendum C stipulates that the surplus funds kept during the "time-out" period be spent only on healthcare, education, firefighter and police retirement plans, and strategic transportation projects.

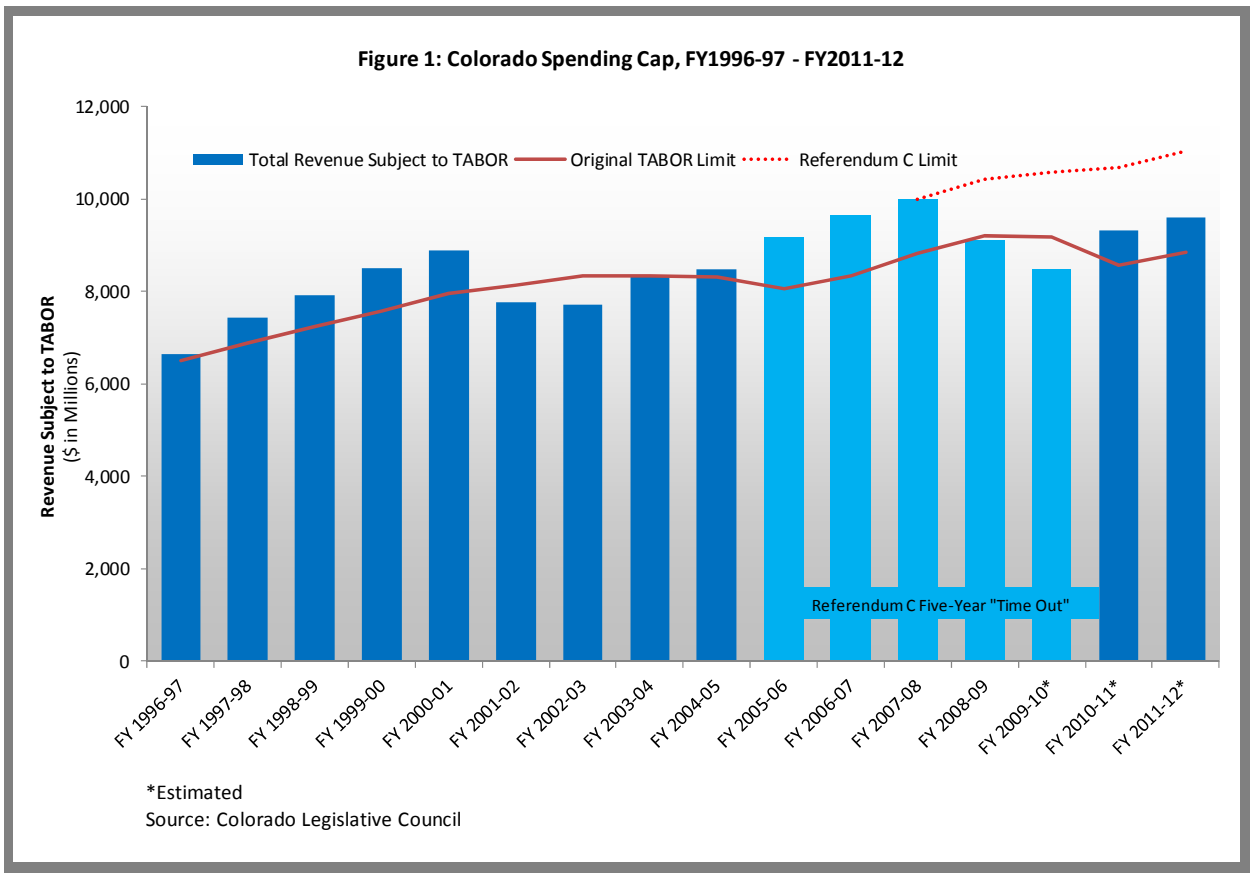
Referendum C also eliminated the "ratcheting-down" of spending by tying future TABOR limit calculations to a new base. Going forward, the cap is calculated using fiscal year 2007-08 as the base, not the previous year. The growth rate remains inflation plus population.

Figure 1 shows how Referendum C allows the state to retain revenues during the time-out period, when refunds would have been necessary under the old TABOR limit. Tax refunds due to the limit are not expected again until at least 2013-14.

TABOR also interacts with other constitutional provisions in Colorado, often getting in the way of legislative priorities. For instance, in response to the perception that the state was falling behind in education funding, Colorado voters passed a constitutional amendment in 2000, known as Amendment 23, requiring the state to increase per-pupil K-12 education funding by at least inflation plus one percent for ten years and by the inflation rate thereafter. Since local governments cannot raise property taxes without voter approval, the mandated spending increases from Amendment 23 have largely been covered by the state. TABOR supporters argue that Amendment 23 is responsible for the pressure to cut spending on non-education services and recommend eliminating that mandate.[20]

TABOR also encourages the state to convert government agencies and programs to "enterprise status" – in New York they would be called public authorities. The new independent enterprises may receive no more than 10 percent of their annual budget from the general state revenues, but the state general fund revenues used to support independent enterprises are not subject to the TABOR limit. The rest of their revenues must come from service fees and charges.

Close to a dozen government activities, including the state nursing home system, the state fair, the division of wildlife, and higher education institutions have been converted to enterprise status since TABOR was enacted.[21] These enterprises receive less than 10 percent of their revenues from government sources and need not compete with other programs for funds



available under the spending limit. However, they become dependent on the revenues generated by user fees, increasing the costs on those who use the services.

Evidence also suggests that TABOR has led to a proliferation of local governments. Between 1996 and 2007, the number of local special districts in the state climbed 56 percent to 1,420. Martell and Teske suggest this is an effort by voters to reverse a trend of declining services from state and local governments.[22] They also point to an increasing number of localities and school districts voting to override TABOR restrictions or to amend them permanently.

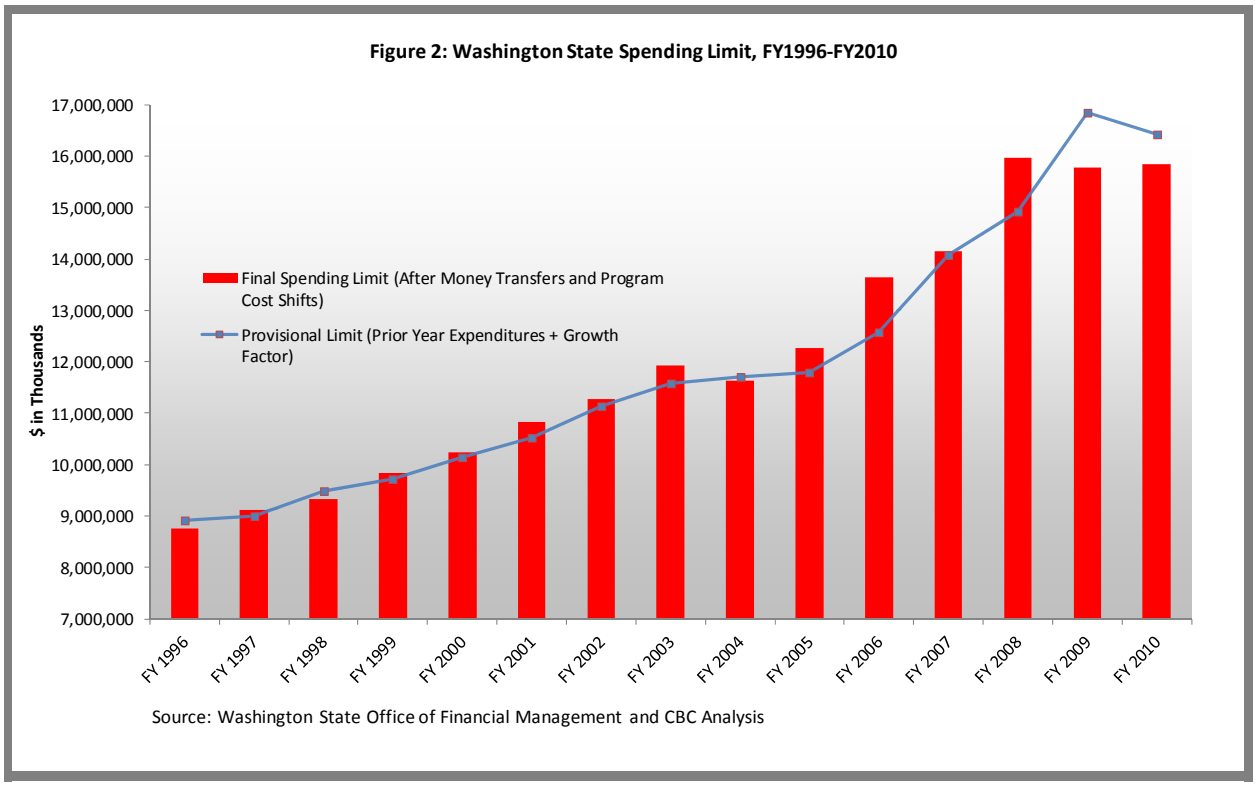
Washington

A state spending cap, approved by voters in 1993, took full effect in 1996. It limited expenditure growth to the three-year average of inflation plus population growth. The limit applies to all state spending, excluding federal funds.

As in Colorado, the cap in Washington was hailed by supporters as an example of a strict limit for other states to follow. In the four years immediately after the cap was passed, it seemed to curb spending. Lawmakers in Olympia enacted modest income tax cuts and eliminated the state's motor vehicle tax. Legislative exemptions from the limit were granted for certain revenue streams, including agricultural and forestry charges, vehicle registration fees and lottery proceeds, beginning in 1997.

Beginning in 2000, lawmakers responded to calls to increase funding for programs seen to be shortchanged by the spending cap. The state's emergency fund was expanded and it was drawn upon to fund education. The 2000 reforms also changed the way the cap was set. A new Expenditure Limit Committee was charged with calculating the annual spending cap. The Committee structure allowed for input from the Legislature and other officials. An office run by the Governor had previously been in charge of setting the expenditure limit. The Committee calculates the spending limit using the previous year's anticipated expenditures as the baseline and makes adjustments to account for "money transfers and program cost shifts" into and out of the capped portion of the budget.

This practice has routinely led to spending higher than would have been allowed under the formula. Between fiscal year 2001 and 2008 spending in the capped portion of the budget grew an average of 4.1 percent per year, compared to the previous statutory average rate of 3.6 percent. Figure 2 shows the initial limit in a line and bars represent the final spending limit established by the Committee.



Lawmakers in Olympia continue to tinker with the cap. Legislators temporarily suspended the two-thirds majority requirement for tax increases, moving to a simple majority, in 2002 and again in 2005. The vote to suspend the supermajority requirement only needed majority approval. In 2007, lawmakers changed the annual growth factor to the 10-year average of state personal income growth from inflation plus population growth.

Connecticut

Lawmakers in Hartford have been coping with a spending cap since 1992. The limit was adopted by voters at the same time as the state's personal income tax.[23] Expenditures may not grow faster than the previous year's inflation rate or the five-year average of personal income growth, whichever is greater. Personal income has been the operative limit every year thus far.

The limit applies to about 80 percent of Connecticut's total spending, including federal funding except for the first year of new, federally-mandated programs or increases. The limit does not include debt service. Connecticut also uses the prior year's expenditures as the baseline for the cap, meaning that the state's annual limit is subject to the same ratchet-down effect seen in Colorado.

This would suggest that Connecticut has a strict cap, but, as in Washington, the spending cap in Connecticut is better described as a guidepost than a limit. In eight budget cycles (fiscal years 1998-2001 and fiscal years 2005-2008), the Governor and three-fifths of the Legislature have declared a fiscal emergency and approved spending above the cap.

The limit also allows lawmakers to shift budget items in and out of the cap as needed. For instance, in fiscal year 2004, lawmakers added appropriations and prepaid expenses totaling $235 million in order to raise the spending cap for the following year. (Since prior year spending is the base for the growth calculation, more spending in the current year translates into the option for more spending later.) As noted above, even with those manipulations, the fiscal year 2005 budget exceeded the limit by $380 million, forcing lawmakers to declare an emergency to account for extra spending.

The spending cap arguably has shaped the state's finances in other ways. The state constitution limits the amount of planned borrowing allowed for operating expenses in the state's two-year budget cycle, but it allows debt to cover "unforeseen shortfalls." Connecticut borrowed $1.1 billion at the end of last year for an unexpected deficit, and it transferred rainy day funds to close anticipated deficits in 2010 and 2011. The spending cap did not create lawmakers' preference for borrowing over raising taxes or cutting spending, but in this case it seems to facilitate the behavior since debt service is not subject to the cap.

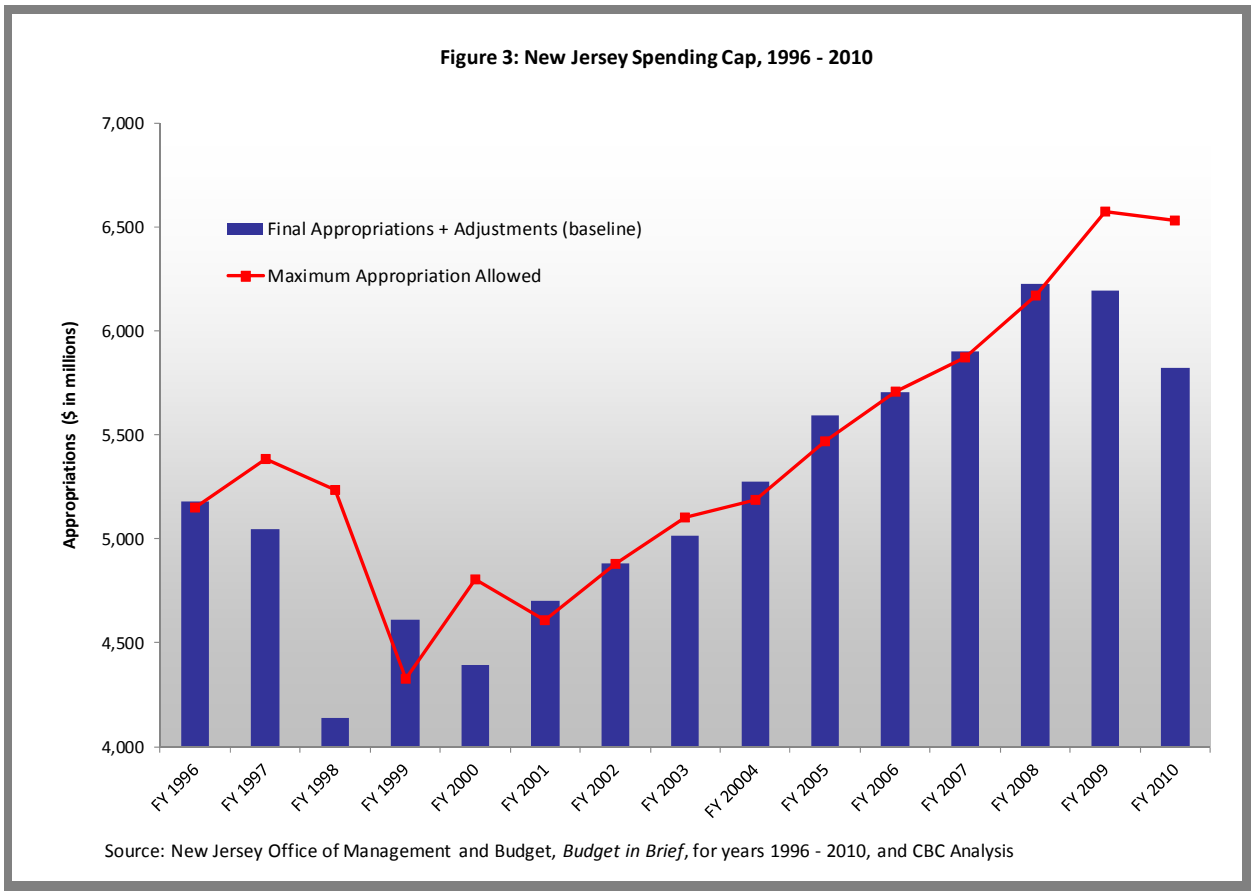
New Jersey

New Jersey law limits growth in a specific budget area – "direct state services" – to the average three-year growth in personal income. Direct state services are only a segment – typically 20 percent – of the state's budget. In fiscal year 2009, the cap applied to $6 billion out of the state's $28 billion total budget.[24] The cap excludes big ticket items like Medicaid, aid to localities, and funding for the state's public colleges and universities.

Adopted in 1990, the statute caps appropriations made by the Governor and the Legislature in their adopted budget. A two-thirds majority is required to exceed the cap. However, the limit

does not apply to supplemental appropriations made after the budget has been adopted. Those additions or subtractions only require majority approval.

In the ten years between fiscal years 1999 and 2008, end-of-year appropriations exceeded the cap published by the State's Office of Management and Budget six times. (See Figure 3.) Spending in the capped portion of the budget grew on average only 3.9 percent annually over that period. But that was due mostly to a shift in funds out of "direct state services" in fiscal year 2000 that reduced funds subject to the cap by over $400 million or about 5 percent. Remove that anomalous year and the average annual growth rate was 4.9 percent.[25]



Governor Chris Christie has proposed making the limit a constitutional amendment and capping growth at no more than 2.5 percent annually. Christie's proposed limit would have been stricter than the average annual growth of 3.9 percent available to lawmakers between fiscal years 1999 and 2008.

New Jersey's cap has had little success in restraining the growth of the budget for two main reasons – it does not require lawmakers to abide by the limit with respect to final appropriations, and it applies only to a thin slice of the budget pie. Between fiscal years 1999 and 2008, total appropriations climbed by an average annual rate of 7.1 percent.[26]

QUESTIONS FOR NEW YORK

The experience of other states raises four important questions for those designing a spending cap for New York.

First, what growth benchmark should determine the cap? No other state uses an inflation-only rate to calculate a cap. The five states that use an inflation-based cap all adjust for population growth to account for increases in demand for existing services.

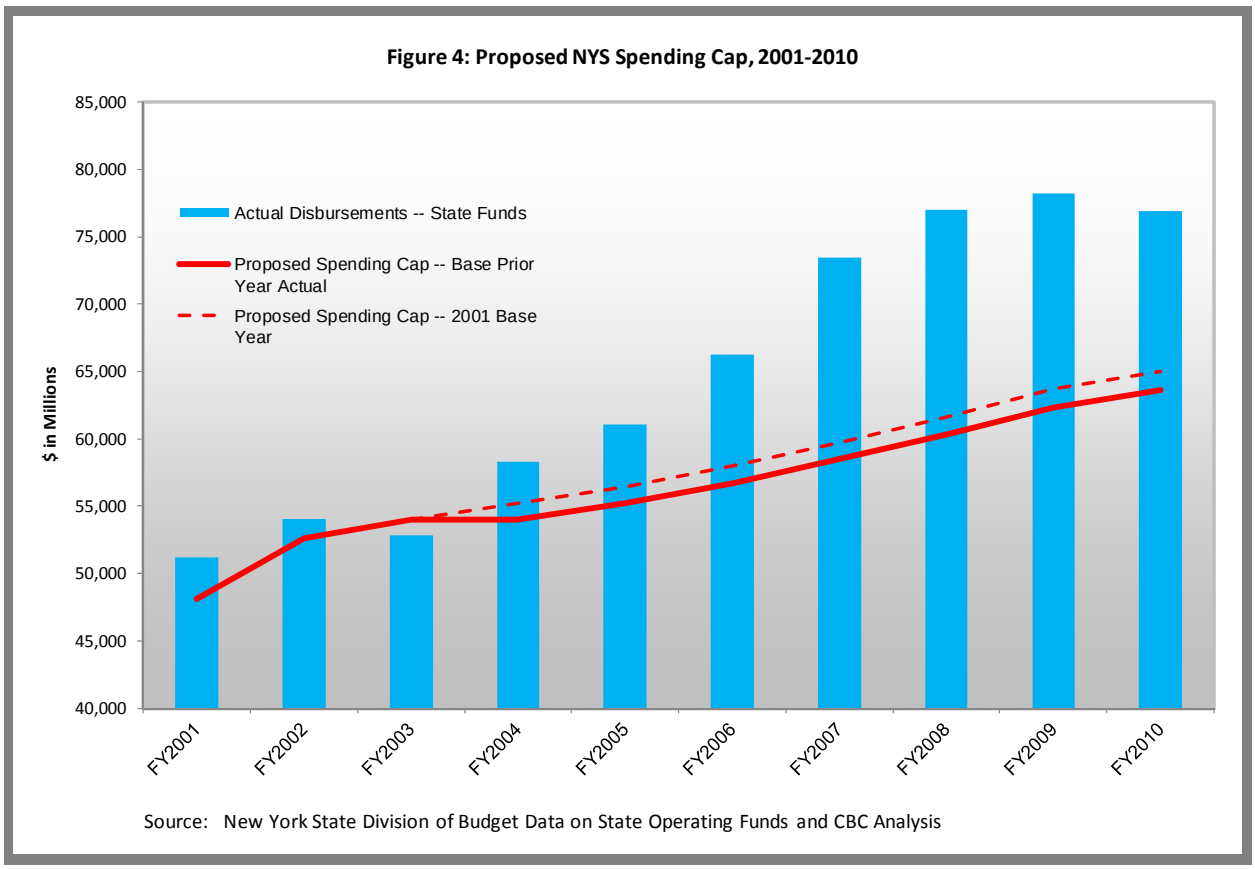
A growth factor set at the rate of inflation likely would require the state to reduce the services it provides. Costs for some services like education and health care historically grow at rates that exceed inflation – and even inflation plus population. Limiting overall state spending growth to inflation would likely cause spending cuts in some areas as portions of the budget with faster growth rates consume a larger share of the resources and squeeze out other services.

An alternative – and more prevalent – benchmark is personal income growth, which is the basis for the caps in 15 states. This typically provides for more generous limits. Based on past trends, in New York a cap based on personal income growth would allow growth of nearly twice the rate of inflation in a typical year.

Second, how can New York avoid the ratchet-down effect experienced by Colorado? The current proposals for New York would make the state vulnerable to this problem because they use the previous year's actual spending as the base for calculating the next year's cap. A single fiscally difficult year with a significant drop in spending could pull future years' caps down for an extended period, even if the economy and tax revenues bounced back. Using a multi-year average of inflation or another growth factor would help alleviate this risk, but a cap linked to a fixed base year, the approach adopted by Colorado to fix its problem, seems an even better approach.

Figure 4 illustrates the difference for New York of a cap based on the previous year's actual spending versus a cap using a fixed base year. Beginning in fiscal year 2001, a fixed base year cap (with three-year average inflation) would yield a cap in fiscal year 2004 of $55.2 billion; in contrast a cap using the actual prior year's spending would have been $1.2 billion lower in fiscal year 2004. The difference between these two hypothetical caps grows to $1.6 billion by fiscal year 2010.

Third, how can some of the unintended consequences for local governments of a state spending cap be avoided? Significant unintended consequences can take two forms. One is that the state shifts spending responsibilities to local governments. This has been evident in other states. A response has been to impose limits on local taxing and/or spending, but this has been found to lead to greater reliance on user fees, other exempt revenue sources, and enterprise funds for selected government activities. A state-only cap will inevitably affect local governments, and any New York action should anticipate the most likely local government consequences.



A second questionable consequence of a state spending cap is to limit otherwise desirable shifts of responsibility from local governments to the state. For instance, the State has adopted a 3 percent cap on the growth of the local share of Medicaid costs, and many county and state officials would like to see the State absorb an even greater share of Medicaid costs in the future in order to keep local property taxes down. Yet the State's ability to assume local Medicaid spending responsibilities would be impaired by a strict state spending cap.

This issue highlights the difficulty in creating a cap that offers meaningful spending discipline, and the flexibility for rational, systemic change. It also points to the importance of carefully defining which portions of the budget fall under the cap. Some advocates might argue that a cap should apply to all state spending, but there are areas that might be excluded in order to meet other goals related to realigning state and local responsibilities or service expectations. Similarly, exclusions to the cap might be preferable to the "spinning off" of selected activities to public authorities in order to take advantage of uncapped user fees.

Finally, how could a spending cap affect the budget process and state government operations? The experience of other states suggests that spending limits tend to amplify the political pressures on budget makers. Well-organized interest groups may seek and achieve exemptions from the cap, while other programs that lack a dedicated and vocal political base have their resources squeezed. States with weaker limits are susceptible to manipulation of the

calculation of the cap and inadequate public disclosure, making it easier for lawmakers to shift spending and more difficult for the public to understand and engage in the budget process.

While few doubt the need to better control New York's spending, there is room for legitimate debate about whether formulaic limits are the best approach. Elected officials are responsible for making sound budgetary choices. If they fail to execute that responsibility, voters should remove them from office at the polls. Designing a cap that satisfactorily balances the democratic function of elected representatives with the imperative for limited spending growth is a difficult challenge that no other state appears to have met in a fully satisfactory manner.

Alternative approaches to a spending cap are available to New Yorkers. These measures might help bring spending growth more in line with the growth of the state's economy, without the manipulation and side effects of a state spending cap:

- Establish a more rigorous and comprehensive balanced budget requirement.
- Move the executive and legislative budgets from a cash basis to an accrual system in accordance with generally accepted accounting principles.
- Enhance the allowable size of the state's rainy day fund and require that funds are dispersed only in an emergency.
- Impose a new constitutional debt limit to rein in state borrowing.
- Provide more timely and meaningful fiscal information to legislators and to the public.

[1] New York State operating funds include expenditures from the state's general fund, special revenue funds and debt service funds, but exclude Federal and capital project funds.
[2] Average annual growth rates are based on state fiscal years 1984-85 and 2009-10 and calendar years 1985 and 2010. New York State Division of Budget, *2010-11 Enacted Budget Financial Plan*, August 20, 2010. United States Department of Labor, Bureau of Labor Statistics, *All Urban Consumers Consumer Price Index US City,* accessed August 9, 2010 from ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt. United States Department of Commerce, Bureau of Economic Analysis, Regional Economic Accounts, accessed August 9, 2010, from http://www.bea.gov/regional/spi/.
[3] New York State Governor, Program Bill #226, 2010.
[4] New York State Governor, Program Bill #16, 2009.
[5] New York State Governor, Memorandum in Support of Program Bill #226, 2010.
[6] New York State Division of the Budget, 2009-10 Enacted Budget Financial Plan, April 28, 2009.
[7] The proposal states in a footnote that funds used to provide property tax relief would be exempt from the cap. Cuomo, Andrew. "The New NY Agenda: A Plan for Action, Chapter 2: Get Our Fiscal House in Order" 2010. Accessed September 22, 2010 from http://www.andrewcuomo.com/issues_and_agenda.
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[22] Martell and Teske, 2007, op. cit.
[23] Connecticut voters originally approved the limit as a constitutional amendment, but the Legislature has never approved certain definitions required to enact the amendment, so it remains a statutory limit.
[24] New Jersey Office of Management and Budget, *Budget in Brief*, 1996-2010 editions.
[25] New Jersey Office of Management and Budget, *Budget in Brief*, 1996-2010 editions.
[26] New Jersey Office of Management and Budget, *Budget in Brief*, 1996-2010 editions.

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