



Citizens Budget Commission

This document is
a summary of the
CBC's latest report.

AN AFFORDABLE DEBT POLICY FOR NEW YORK STATE AND NEW YORK CITY

In the last decade the debt of both New York State and New York City more than doubled, and it is projected to grow further. By 2005, the State's debt will be \$43.0 billion. By 2004, the City's debt will be \$44.3 billion.

While the State Constitution puts limits on the debt of both the State and the City—limits that are different for the two entities—both entities have found ways to circumvent them.

These facts raise the question, "How much public debt is too much?" To answer that question, the CBC has developed a new approach to determining the affordability of public debt.

This approach focuses on the effect of debt on a jurisdiction's economic competitiveness. It yields a danger zone in which the burden of a jurisdiction's debt becomes relatively far out of line with other places.

The approach reveals that New York State's debt, at the end of fiscal year 2000, was \$3.0 billion above the danger zone threshold. New York City's debt was \$2.2 billion below the danger zone.

This unique approach to assessing the affordability of public debt is presented in a new report by the Citizens Budget Commission. While the report focuses on the level of debt of the two New Yorks, the approach is applicable to other states and cities throughout the nation.

The report analyzes the existing problem, presents criteria for deciding how much state and local debt is affordable, and recommends how those criteria should be applied to decisions by New York State and New York City.

Unfunded pension liabilities are another form of debt. New York is one of only five states with no unfunded pension liability.

Debt levels should allow for a safety margin in case of an economic downturn. In the last recession, personal income in New York State fell 2.2 percent, much more sharply than the 0.3 percent decline in the rest of the nation.

Comparisons of debt levels should consider what responsibilities states pass on to local governments. Only four states impose more of a financial burden on their localities than does New York.

A New Approach to Measuring Debt Affordability

Do New York State and New York City have too much debt? A sensible and realistic answer to this question should be rooted in the concept of affordability.

Debt affordability refers to the burden associated with repaying debt. To be affordable, the repayment of debt (a) should not cause a jurisdiction's tax rate to increase to uncompetitive levels in order to cover the debt service, and (b) should not require cutbacks in other public services that similarly cause the jurisdiction to become uncompetitive with other areas. That is, repaying debt should not require tax increases or service cutbacks that make a place less attractive than its competitors.

An important implication of this approach is that "too much" is defined relative to other places. The warning signal is not a particular number; rather, it is a position that is relatively far out of line with other places. A measurement of affordability can be thought of as having an upper bound that represents the beginning of a danger zone for states and cities.

A second implication of this approach is that affordability should be assessed as a relationship between the amount of debt and the resources available for repayment. Larger and wealthier places can afford more debt than smaller and poorer ones. Thus, affordability can be best measured in terms of a ratio between debt levels and resources available for repaying that debt.

Using this approach to derive policy guidance for New York State and New York City requires applying six analytic steps to the relevant jurisdictions:

1. Identify the amount of relevant long-term debt.
2. Adjust the amount of long-term debt to include unfunded pension fund liabilities.
3. Identify the resources available in the state or local economy to repay the debt.
4. Adjust the resources available to account for the division of service and financing responsibilities between the state and its localities.
5. Examine the distribution of the ratio of adjusted debt to adjusted resources in order to identify a point that is sufficiently "out of line" with most jurisdictions' practices that it constitutes the beginning of a danger zone.
6. Adjust the danger zone threshold to provide a safety margin for an economic downturn.

Each of these steps is described more fully in the report, and supporting data and technical information are presented in the Appendices.

Using this analysis, two calculations about the two New Yorks can be made:

- First, one can determine how much debt New York State and New York City could have before entering the danger zone. The answer is that, in 1997, the year of the comparisons, the State should have had \$29.2 billion in State-supported debt rather than the \$33.1 billion that it actually had. In fiscal 1998, the year from which the City comparative data are drawn, New York City could have incurred \$2.1 billion more in debt before reaching the danger zone.
- Second, the data can provide a basis for estimating a danger zone threshold for the latest fiscal year, 2000. In that regard, the following conclusions emerge:
 - New York State's debt was \$3.0 billion above the danger zone threshold at the end of fiscal year 2000.
 - New York City's debt was \$2.2 billion below the danger zone threshold.

Recommendations

Based on these findings, the CBC makes three recommendations.

1. New York State's elected leaders should bring the State's debt burden below the danger zone threshold, and New York City's leaders should keep their debt below the relevant danger zone threshold.

Current policies will not bring New York State's debt below the projected threshold through fiscal year 2005, the last year for which projections are available. New York State should develop a new plan to lower its outstanding debt. This should include doing more pay-as-you-go capital financing and devoting more of the current operating surplus to the retirement of outstanding debt. Development of the more precise actions to achieve this goal should rest with the Debt Policy Committee referred to in recommendation number two below.

New York City's current financing plans will not cause it to exceed the projected danger zone threshold in coming years. For City leaders, some caution in new debt issuance is appropriate, but the amounts do not seem unaffordable. However, it is important that the City stay within its plan and keep debt at affordable levels.

2. New York City and New York State should create Debt Policy Committees to recommend long-run debt strategies and annual debt issuance limits.

The State and the City should each have a Debt Policy Committee to advise public officials about the amounts that should be borrowed, the forms of borrowing that are appropriate, and other aspects of a comprehensive debt policy. The Committee should have members appointed by the political leaders with authority over debt including the City Council, the Mayor and Comptroller for the City and each house of the Legislature, the Governor and the Comptroller for the State.

3. The State Constitution should be amended to establish new limits on State and City debt.

The existing constitutional limits on State and City debt have proven neither effective nor sensible. New constitutional limits should be made effective by having them apply to all forms of debt that draw upon tax and other general governmental revenues. That is, in the case of the State the limit should apply to all forms of State-supported debt; in the case of the City the limit should apply to all forms of debt supported by local tax revenues including those of the Municipal Assistance Corporation, the Transitional Finance Authority and other relevant authorities.

The new limits should be made more sensible by replacing the existing constraints with an approach based on that developed in this report. That is, the City should no longer be subject to a numerical limit related to property values, and the State should not have a procedural limit that requires all debt to go before the voters. Instead, for each entity there should be a periodic analysis following the affordability approach outlined in this report. The analysis should be conducted by an independent board, which would arrive at a debt limit for each entity based on the comparative approach to affordability developed in this report. Its charge would be to set rolling, multiyear limits for debt based on analysis that takes into account trends in the resources of the City and State and in the patterns of debt issuance by other competitive jurisdictions. These limits should be binding on the City and the State.

The sole safety valve or exception to the limit set based on analysis of affordability should be the will of the electorate. If the voters opt to approve debt for a specific purpose, then such debt should be permitted above the limit set by the independent board. The will of the voters should be supreme, but it should be guided by information on the affordability of debt. The voters should be empowered to go beyond that limit, when and if they are convinced it serves an important public purpose.

For most of the 1980s, New York City debt grew at about 4.0 percent annually and New York State debt at 8.3 percent annually. In the 1990s, the respective increases were 8.8 percent and 10.4 percent.

Along with New York, the eight other states in the danger zone, based on fiscal year 1997 data, were Rhode Island, Hawaii, Connecticut, West Virginia, Oklahoma, Massachusetts, Louisiana, and Washington.

Of the ten largest cities in the nation, only Detroit and Philadelphia were in the danger zone, based on fiscal year 1998 data.

CONCLUSION

It is often assumed that if a government is not in danger of defaulting on its debt, then its debt is not too large. A jurisdiction's debt level, however, has a great impact on its competitiveness, and its competitiveness determines how attractive it is as a place to work and live.

This report offers a way of looking at levels of debt in competitive, rather than absolute, terms. It provides another measure, in addition to default and credit ratings, to assess levels of debt.

In doing so, it provides a measure that can be used by states and cities throughout the nation to judge the impact that their debt, or proposed debt, will have on their ability to compete with other jurisdictions effectively. It also provides a measure that can be used broadly by watchdog organizations to ensure that government borrowing is appropriate and does not place the burden of costs incurred today unnecessarily on future generations.

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Founded in 1932, the Citizens Budget Commission is a nonpartisan, nonprofit civic organization devoted to influencing constructive change in the finances and services of New York State and New York City governments. The Commission conducts research and regularly issues reports and recommendations based on that research. The research is conducted by staff members and consultants, and guided by committees composed of Trustees of the CBC.

This report was prepared under the auspices of the Commission's Debt and Capital Investment Committee, co-chaired by Karen Daly and David R. Greenbaum. The other members of the Committee are: Paul R. Alter, Jay I. Anderson, Lawrence B. Bittenwieser, Herman Charbonneau, Anne E. Cohen, Denis Curtin, Evan Davis, Bud H. Gibbs, Kenneth D. Gibbs, Marianne Kozlowski, Robert Kurter, William McCarthy, Hector Prud'homme, Jon Rotenstreich, Heather Ruth, William Saubert, Richard Sigal, Albert Simons, III, Arthur Siskind, Merrill H. Tisch, W. James Tozer, Jr., David Weprin, and Eugene J. Keilin, ex-officio.

Kurt Richtweger, Associate Research Director, was the lead analyst for this report. Cynthia Searcy, Research Associate, provided research support. Charles Brecher, Executive Vice President and Research Director, oversaw their efforts and edited the working drafts. Nicolette Macdonald, Publications Coordinator, prepared the report for publication.

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