

Fixing New York State's Fiscal Practices

**Citizens
Budget
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**Five Problems
That Hurt
New York State
and
What Can Be Done
to Fix Them**

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This document is provided as background for the Citizens Budget Commission's conference "Fixing New York State's Fiscal Practices" on November 13 and 14, 2003. The conference will bring together about 150 public officials, business and labor leaders, civic leaders, academic experts and media representatives to identify actions to "fix" the fiscal practices of New York State.

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The following pages are designed to explain the nature of the problems more fully and to identify options for addressing them. The analysis of these problems draws primarily on comparisons with the other 49 states. In addition, more detailed comparisons are made with 11 states that are identified as New York's major competitors. These 11 states are the nine other of the ten largest states measured by population size and the two additional neighboring states of Connecticut and New Jersey. The sources for the tables, figures and other statistics cited in this document are available at www.cbcny.org.

Five Problems That Hurt New York State

INTRODUCTION

This document is focused on five problems that hurt New York State:

- ▶ **PROBLEM 1**
New Yorkers are the most heavily taxed Americans.
- ▶ **PROBLEM 2**
New York's debt burden is among the highest in the nation.
- ▶ **PROBLEM 3**
New York has large and recurring budget gaps.
- ▶ **PROBLEM 4**
New York's budget process lacks timeliness, transparency, and responsibility.
- ▶ **PROBLEM 5**
Improvements in fiscal practices are hampered by unresponsive governmental institutions.

Many individuals and groups within and outside State government have developed proposals for reform that address these problems. For nearly two decades, the Citizens Budget Commission annually has offered recommendations to contain growth in costs, eliminate badly targeted spending, enact effective limits on debt, and properly align state and local responsibilities. However, the persistence of the problems listed above and the failure of the stakeholders to engage in a meaningful debate about how to change them suggest an underlying problem with the State's fiscal practices.

Therefore, in considering solutions to the State's problems, the options identified at the end of this document are related more to how State officials make budget decisions than to what specific annual steps should be taken to close the latest budget gap. By focusing on processes and institutions, the conference can identify a reform agenda that yields enduring progress.

PROBLEM 1

New Yorkers are the most heavily taxed Americans, largely because State actions create excessive spending by local governments.

This problem has two dimensions. First, New Yorkers are highly taxed. Second, much of this tax burden is necessary because the State imposes excessive costs on local governments.

- ▶ **New York has the highest state and local tax burden in the United States.**

New York has the largest combined state and local tax burden in the nation, raising \$141 for every \$1,000 of personal income. This is fully 26 percent above the national average. Among the 12 competitor states, California ranks second to New York with a tax burden

8 percent above the national average. Neighboring Connecticut and New Jersey are just 7 percent and 1 percent above the national average, respectively.

Significantly, however, State government taxes do not drive the high comparative burden. In New York, state taxes were 97 percent of the national average. Among the 50 states, New York's state-level burden ranked 29th. This competitive position represents improvement from the mid-1990s and is the result of the State's concerted effort at tax reduction. In fiscal year 1999-00, State taxes were \$9.4 billion less than they would have been without the tax cuts authorized in the previous five years.

Despite these reductions, state personal income taxes in New York are still about 50 percent higher than the U.S. average – \$38 versus \$25 per \$1,000 of personal

Table 1
State and Local Taxes per \$1,000 of Personal Income
Fiscal Year 1999-00

	COMBINED TOTAL STATE AND LOCAL TAXES		STATE TAXES		LOCAL TAXES	
	DOLLARS / \$1,000 PERSONAL INCOME	PERCENT OF U.S. AVERAGE	DOLLARS / \$1,000 PERSONAL INCOME	PERCENT OF U.S. AVERAGE	DOLLARS / \$1,000 PERSONAL INCOME	PERCENT OF U.S. AVERAGE
New York	\$141	126%	\$68	97%	\$73	172%
New Jersey	114	101	63	90	51	120
Ohio	112	100	64	93	48	113
Illinois	108	96	60	87	47	111
Texas	97	86	51	73	46	108
Georgia	109	97	63	91	45	106
Pennsylvania	107	95	65	94	41	97
Connecticut	120	107	79	113	41	96
Florida	99	88	59	85	40	93
Massachusetts	111	99	74	106	37	88
California	121	108	85	122	36	85
Michigan	114	102	82	118	32	75
U.S. Average	\$112	100%	\$70	100%	\$43	100%

income. However, it should be noted that this burden is somewhat overstated in these figures, because the denominator of personal income includes neither income of commuters from neighboring states nor residents' capital gains, both of which are part of the base for the state personal income tax. Nonetheless, New York's moderate standing in state level taxes is due primarily to its relatively low sales and gross receipts taxes.

The high tax burden in New York State is attributable to high local government taxes. Local government taxes in New York are the highest in the nation and are a striking 72 percent above the national average. Among the 12 competitor states, second place New Jersey is a much lower 20 percent above the national average, and six of these states have local taxes below the national average.

New York's high local tax burden is evident for every major category of local tax.

- ▶ The local income tax burden is nearly five times the national average;
- ▶ The sales tax burden is about double the national average;
- ▶ The property tax burden is about one-third higher than the national average.

The high local tax burden in New York State is not confined to New York City. The statewide difference in local taxes per \$1,000 of personal income between New York State and the national average is about \$31. Of this difference, more than half (\$17) is raised outside New York City. Most of the high burden in New York City is attributable to the local income taxes, while most of the high burden in the rest of the state is attributable to high property taxes. Taxpayers in both New York City and the rest of the state have a sales tax burden above the national average.

Table 2
State and Local Revenue by Type, Fiscal Year 1999-00
(Per \$1,000 of Personal Income)

	UNITED STATES	NEW YORK	TOTAL	DIFFERENCE	
				NEW YORK CITY	REST OF THE STATE
State-Raised Revenues	\$91	\$85	(\$6)	NA	NA
Taxes	69	68	(2)	NA	NA
Property	1	0	(1)	NA	NA
Sales and Gross Receipts	32	22	(11)	NA	NA
Personal Income	25	38	13	NA	NA
Corporate Income	4	5	0	NA	NA
Other	6	4	(2)	NA	NA
Charges and Miscellaneous	22	17	(5)	NA	NA
Locally-Raised Revenues	\$69	\$101	\$32	\$10	\$22
Taxes	43	73	31	13	17
Property	31	41	10	(4)	14
Sales and Gross Receipts	7	15	8	3	4
Personal/Corporate Income	3	14	12	13	(1)
Other	2	3	1	1	(0)
Charges and Miscellaneous	27	28	2	(3)	5

NA – Not Applicable

▶ **The high local taxes are required primarily because State actions drive up the cost of local public services.**

The high local taxes in New York State support a relatively high level of local government spending. Measured relative to personal income, both taxing and spending by New York local governments are about 72 percent above the national average, a spending difference equal to about \$32 per \$1,000 of personal income.

What does this extra spending buy? The added local burden in New York can be attributed to five factors, four of which are related to State policy:

- ▶ **Medicaid.** The single largest source of the added local tax burden in New York is the Medicaid mandate. It accounts for more than \$8 of the \$32 difference, or about one-quarter. Both total Medicaid costs and the locally financed share are dictated by State policy.
- ▶ **Education.** Almost as important as Medicaid in explaining the high local tax burden is spending for elementary and secondary education. It also accounts for about one-quarter of the difference between New York and the national average, with all of that difference evident in the school districts outside New York City. A significant part of this high spending reflects local discretionary decisions. However, as explained more fully below, the high locally financed spending also is related to State policy, because in New York the State provides a relatively low share of the public schools’ funds and because the State sets the rules under which school districts negotiate salaries with their teachers.
- ▶ **Pensions and Fringe Benefits.** Another \$7 of the \$32 difference between New York and

the rest of the nation is due to high spending for local government employees’ pensions and fringe benefits. For pensions, this is directly tied to State policy, because State law and the State Constitution determine the benefits of most teachers and other local government employees.

Table 3
Locally Financed Expenditures by Function, Fiscal Year 1999-00
(Per \$1,000 of Personal Income)

	UNITED STATES	NEW YORK	TOTAL	DIFFERENCE	
				NEW YORK CITY	REST OF THE STATE
Locally-Financed Spending	\$69	\$101	\$32	\$10	\$22
Elementary & Secondary Education	20	29	8	(2)	10
Other Education & Libraries	4	3	(1)	(1)	1
Public Safety (Police, Fire, Corrections & Inspection)	12	16	4	3	1
Medicaid/Intergovernmental Payments to the State	1	10	8	6	3
Interest on Debt	5	9	4	3	0
Pensions and Fringe Benefits	6	14	7	4	3
Other	21	21	0	(3)	3

The other major component of fringe benefits is health insurance, and the premiums for health insurance also are regulated by the State. While local governments can negotiate the share of the premium they pay, the basic cost of health insurance is driven by State regulatory decisions.

- ▶ **Salaries and Staffing Levels.** The wages and relative number of local government employees are each 25 percent above the national average in New York. To some extent this is a function of local officials’ discretion, but the State decides which functions to devolve to local governments and regulates the collective bargaining between local officials and their employee unions.
- ▶ **Local Discretion in Service Quality.** A significant part of the high local tax burden can be traced to local decisions to provide higher quality services than may prevail in other parts of the country. While it is not always possible to isolate the impact of State rules and regulations on service cost, it is nonetheless true that some communities want and willingly pay for high standards of service.

It is worth noting that the high cost of local government in New York State does not appear to be related to the often cited “fragmentation” of local government and creation of multiple overlapping jurisdictions. In fact, New York’s number of local governments relative to population is below the national average. New York has 3,400 local government units, but that amounts to 1.88 per 10,000 residents versus the national average of 3.27 per 10,000 residents. This number places New York 35th among the 50 states. Even after excluding New York City, where one consolidated unit of local government serves 8 million residents, the ratio for the rest of the state is still lower than in 29 other states.

Table 4
Number of Local Governments Per 10,000 Residents
Fiscal Year 1996-97

STATE	GENERAL GOVERNMENT	SCHOOL DISTRICTS	SPECIAL DISTRICTS	ALL UNITS	50-STATE RANK
Illinois	2.35	0.79	2.55	5.69	15
Pennsylvania	2.19	0.43	1.60	4.22	23
Ohio	2.09	0.59	0.53	3.21	29
New York (excl. NYC)	1.48	0.64	1.05	3.16	
Michigan	1.90	0.60	0.34	2.84	31
Texas	0.74	0.56	1.13	2.43	33
New York	0.88	0.38	0.62	1.88	35
Georgia	0.92	0.24	0.63	1.80	36
Connecticut	0.55	0.05	1.18	1.78	37
New Jersey	0.73	0.69	0.35	1.76	38
California	0.16	0.33	0.93	1.43	40
Massachusetts	0.59	0.14	0.68	1.41	41
Florida	0.31	0.06	0.36	0.74	48
U.S. Average	1.46	0.51	1.30	3.27	

► **Medicaid: New York’s program is the most expensive and requires the highest local funding in the nation.**

New York’s unique state Medicaid policies are doubly damaging for local taxpayers. First, the State requires local governments, specifically the City of New York and the 52 counties, to pay an unusually high share of Medicaid costs. These localities are required to pay 25 percent of the cost of acute care services and 10 percent of the cost of long-term care services for Medicaid enrollees from their jurisdiction. The resulting financial burden is especially severe in areas with large numbers of Medicaid beneficiaries. In fiscal year 2002-03, the Medicaid match cost the City of New York about \$4 billion and consumed 13 percent of its local tax dollars. In some upstate urban counties the Medicaid match requires virtually all the revenues raised by the county from the local property tax.

Second, the State has created the most expensive Medicaid program in the nation. In federal fiscal year 1999-00, the latest period for which comparative data are available, New York spent \$26 billion – more than every other state. On a per beneficiary basis, New York’s average expenditures of \$7,646 are nearly twice the national average and are 20 percent above the closest competitor state, Connecticut. A multitude of state policies create these high costs, including relatively generous eligibility rules for the elderly seeking Medicaid coverage for long-term care, high payment rates for nursing homes, and use of Medicaid funds to support graduate medical education programs at teaching hospitals.

Table 5
Medicaid Expenditures
Federal Fiscal Year 1999-00

STATE	EXPENDITURES (IN MILLIONS)	EXPENDITURES PER BENEFICIARY		
		TOTAL AMOUNT	PERCENT OF U.S. AVERAGE	50-STATE RANK
New York	\$26,148	\$7,646	194%	1
Connecticut	2,839	6,762	172	3
New Jersey	4,707	5,724	145	8
Ohio	7,090	5,434	138	9
Massachusetts	5,397	5,153	131	11
Illinois	7,807	5,150	131	12
Pennsylvania	6,366	4,266	108	22
Michigan	4,881	3,611	92	35
Texas	9,075	3,487	89	36
Florida	7,350	3,114	79	42
Georgia	3,578	2,774	70	46
California	17,060	2,155	55	49
U.S. Total	\$168,307	\$3,936	100%	

► **Education: Limited State support creates a local fiscal burden and serious inequities among school districts.**

The distinguishing features of public education policy in New York State are: (1) high spending, (2) a low share of the cost paid for by State revenues, and (3) wide disparities among local districts in their spending and tax burdens.

In fiscal year 2000-01, the latest for which comparative data are available, New York school districts spent an average of \$10,922 per pupil. This is 139 percent of the national average and placed New York first among the 50 states. In second place at \$10,893 per pupil was New Jersey, the only one of the 12 competitor states with spending approaching that in New York. An *Education Week* study adjusted the per-pupil spending for cost-of-living differences and student needs, and this changed New York’s standings somewhat. Its adjusted spending was still 127 percent of the national average, and its ranking fell to third behind West Virginia and Vermont.

Although New York’s schools have unusually high spending, they get comparatively low aid from the State. In school year 1999-00, the latest for which comparative data are available, New York school districts received 46.8 percent of their nonfederal funds from the State. This was nearly ten percentage points below the national average of 56.7 percent and placed New York 36th among the 50 states.

New York’s State education aid is not only relatively limited, it is also badly targeted. The poorly designed aid formulas combined with a heavy reliance on the local property tax base produce wide variation in spending among school districts. These disparities can be measured with an index (which expresses the variation as a percent of the average) that is larger when the disparities within the state are greater. The index for New York State of 15 percent placed it behind 40 of the 50 states. Among the 12 competitor states, ten were substantially better than New York, with only Massachusetts having a similar disparity index.

This problem of disparities was at the root of the recent decision by the State Court of Appeals on the State funding of New York City schools. To comply with this ruling, the Governor and Legislature must determine the cost of providing a “sound basic education” in New York City, and must enact appropriate funding and accountability reforms by July 30, 2004.

Table 6
Selected Features of Elementary-Secondary Education Spending
School Year 1999-00

STATE	ADJUSTED SPENDING PER PUPIL		STATE SHARE OF FUNDING		INDEX OF VARIATION IN PER PUPIL SPENDING	
	AMOUNT	50-STATE RANK	STATE SHARE	50-STATE RANK	INDEX	50-STATE RANK
New York	\$9,563	3	46.8%	36	15.0%	41
Connecticut	9,136	6	40.6	45	12.0	25
Michigan	8,479	12	69.8	6	12.3	27
Pennsylvania	8,461	13	39.6	49	13.1	31
Massachusetts	8,429	14	43.2	42	15.1	42
Ohio	8,407	15	44.6	39	13.7	36
New Jersey	8,328	16	41.3	44	13.2	33
Georgia	8,194	18	52.4	29	9.1	13
Illinois	7,363	30	40.4	46	14.0	37
Texas	7,248	31	47.5	35	13.3	34
Florida	6,512	42	54.7	27	5.9	3
California	6,161	46	63.8	17	11.5	23
U.S. Average	\$7,654		56.7%		12.1%	

► **New York State local governments have unusually high employee salaries and staffing levels, partly due to the State-controlled system for collective bargaining.**

Employees are the largest expense item for local governments, and New York has a lot of them and pays them relatively well. In New York, local governments have almost one million employees – half of whom work in New York City. The number of local government employees per 10,000 residents was 508 as of March 2000, the latest period for which comparative data are available. New York’s ratio is 125 percent of the national average and ranked second only to Wyoming. Among the 12 competitor states, New York was the highest by far, with second place Texas having a ratio 113 percent of the national average.

The high local government staffing ratio is not a practice evident only in New York City. Among the other local governments in New York, the number of employees per 10,000 residents is 453 – fully 111 percent of the national average and greater than in ten of the competitor states.

New York’s numerous local government employees are paid relatively well – an average of more than \$47,500 annually excluding pensions and fringe benefits. This figure is 125 percent of the national average and places New York third among the 50 states.

Table 7
Local Government Employment and Average Earnings by State
(As of March 2000)

STATE	FULL-TIME EQUIVALENT EMPLOYEES PER 10,000 OF POPULATION		STATE	ANNUAL EARNINGS	
	NUMBER	PERCENT OF U.S. AVERAGE		AMOUNT	PERCENT OF U.S. AVERAGE
New York	508	125%	California	\$48,744	128
New York City	579	142	New Jersey	47,604	125
New York (excl. NYC)	453	111	New York	47,532	125
Texas	460	113	New York City	49,800	131
Georgia	437	107	New York (excl. NYC)	45,303	119
Ohio	410	101	Connecticut	46,272	122
Illinois	409	100	Michigan	42,216	111
California	405	100	Massachusetts	40,836	107
Florida	389	96	Illinois	39,684	104
New Jersey	389	96	Pennsylvania	39,552	104
Massachusetts	378	93	Ohio	37,416	98
Michigan	357	88	Florida	34,380	90
Connecticut	338	83	Georgia	32,124	84
Pennsylvania	323	79	Texas	31,716	83
U.S. Total	407	100%	U.S. Total	\$38,028	100%

more than \$47,500 annually excluding pensions and fringe benefits. This figure is 125 percent of the national average and places New York third among the 50 states.

The relatively high pay also is not confined to New York City. New York City taken alone had average earnings higher than all of the 50 states and 131 percent of the national average. However, the other local governments in New York State averaged 119 percent of the national norm, paying more than local governments in eight of the 12 competitor states.

Multiple factors lead to the high personnel costs in New York, but one important feature is the statewide system for collective bargaining between local governments and their employee unions. Collective bargaining determines salaries, fringe benefits, and a wide range of working conditions. New York State sets a separate legal framework for this collective bargaining for New York City and for other jurisdictions,

permitting some unions in New York City to opt for the system they believe will work most favorably for them. Outside of New York City, the State sets the rules for collective bargaining and administers them through a State Public Employee Relations Board. This body has sometimes permitted unions to “whipsaw” local government employers by arguing for large increases in the wealthiest jurisdictions based on “ability to pay” and then arguing for similar compensation in other places based on comparability of work.

The problem of relatively generous compensation in New York is compounded by the tendency of the State Legislature to let unions circumvent local collective bargaining by using legislation to enhance pension benefits. For example, a recent Independent Budget Office analysis of rising pension costs in New York City found that 43 percent, or \$771 million, of the \$1.8 billion in added pension fund contribution expenses in fiscal year 2003-04 is due to enhancements enacted by the Legislature.

► **Local governments in New York State are experiencing downward credit pressures more pronounced than in other states.**

One consequence of the fiscal pressures that confront local governments in New York is a downward trend in their credit ratings. Moody’s Investors Services rating activity during calendar year 2002 was to upgrade 569 municipal credits and downgrade 194 – an upward-to-downward ratio of 2.93.

However, the trend in New York was downward: 34 credits were upgraded and 37 were downgraded – for a ratio of .92. Among the competitor states, only Georgia was worse than New York.

Table 8
Moody’s Investors Service Municipal Rating Revisions
Calendar Year 2002

STATE	NUMBER OF UPGRADES	NUMBER OF DOWNGRADES	RATIO OF UPGRADES TO DOWNGRADES
Texas	86	11	7.82
Michigan	23	5	4.60
California	20	5	4.00
Pennsylvania	28	12	2.33
Ohio	20	9	2.22
Illinois	31	15	2.07
Massachusetts	26	13	2.00
New Jersey	30	18	1.67
Florida	17	12	1.42
Connecticut	7	6	1.17
New York	34	37	0.92
Georgia	3	5	0.60
U.S. Total	569	194	2.93

PROBLEM 2

New York’s debt burden is among the highest in the nation.

New York has more debt than any other state. Its long-term debt exceeded \$38 billion, about \$5 billion more than second-place California, in fiscal year 1999-00, the latest period for which reliable comparative data are available.

While interesting and dramatic, such simple comparisons can be misleading. More meaningful comparisons of state debt burdens should recognize at least three other factors. First, debt should be gauged relative to ability to pay, typically measured in terms of the income of the state’s residents. Second, states have other long-term obligations – most notably, unfunded pension fund obligations – that should be recognized as liabilities equivalent to long-term debt. Third, states vary in how they share public service responsibilities with local governments. For example, in Hawaii the state funds the public schools and there are no local school districts, so the state’s debt includes debt that in other states would be borne by independent school districts.

When consideration is given to these factors, New York’s state debt burden is somewhat lighter. Its residents are relatively wealthy; its employee pension funds are relatively well fund-

ed, and it puts a relatively heavy burden on its local governments. Nonetheless, after appropriate adjustments are made, New York State’s debt burden is still among the highest in the nation – fourth among the 50 states. Of the 12 competitor states, New York ranks second behind Massachusetts.

Table 9
Adjusted State Long-Term Debt and Unfunded Pension Liability
Fiscal Year 1999–00

STATE	ADJUSTED LONG-TERM OBLIGATIONS AS A PERCENT OF PERSONAL INCOME	50-STATE RANK
Massachusetts	7.9%	3
New York	7.3	4
Connecticut	7.1	6
New Jersey	6.0	7
Ohio	4.4	20
Illinois	3.4	24
Florida	3.0	28
Texas	2.7	30
California	2.6	31
Pennsylvania	2.2	32
Georgia	2.1	35
Michigan	1.9	37
U.S. Average	3.8%	

A 2000 report by the Citizens Budget Commission, *An Affordable Debt Policy for New York State and New York City*, used appropriate techniques to take into account the relevant factors, and concluded that New York State was in a “danger zone” with regard to its level of debt. The Commission recommended debt reductions based on more pay-as-you-go capital investment and use of operating surpluses to retire outstanding debt. In 2000, the State did enact a statutory debt limit, but it has achieved only modest debt reduction in the recent years of fiscal imbalance. Moreover, the statutory debt limit excludes the borrowing against the tobacco settlement revenues.

Combined with the structural imbalance in its budget, New York’s high debt burden has an adverse impact on the ratings of its General Obligation bonds by the three major rating agencies:

- ▶ **Moody’s:** New York has an A2 rating, the sixth-ranked category. Only California has a lower rating and the 39 other rated states have higher positions.
- ▶ **Standard & Poor’s:** New York has an AA rating, the third-ranked category, a position shared by 13 other states. Twenty states have higher ratings and 10 have lower ratings.
- ▶ **Fitch:** New York has an AA minus rating, the fourth-ranked category, a position shared with three other states. Thirty states have higher ratings and three have lower.

Table 10
State General Obligation Bond Ratings
(As of August 26, 2003)

MOODY'S			STANDARD & POOR'S			FITCH		
RATING	NUMBER OF STATES	NEW YORK	RATING	NUMBER OF STATES	NEW YORK	RATING	NUMBER OF STATES	NEW YORK
Aaa	8		AAA	10		AAA	10	
Aa1	7		AA+	10		AA+	6	
Aa2	12		AA	14	X	AA	14	
Aa3	11		AA-	8		AA-	4	X
A1	1		A+	1		A+	2	
A2	1	X	A	0		A	1	
A3	1		A-	0		A-	0	
Baa	0		BBB	1		BBB	0	

PROBLEM 3**New York State has not resolved its large and recurring budget gaps.**

New York faces a major structural imbalance in its State budget which developed over several decades. The problem abated during the economic boom of the late 1990s, but emerged again strongly in recent years. The underlying cause is an expenditure base which cannot be supported with recurring revenues.

In the last three years, rather than address this underlying cause, the State used short-term measures to manage its fiscal situation. The result is large, recurring gaps that loom in future budgets.

Like most states, New York enjoyed robust revenues in the late 1990s. That position changed in fiscal year 2000-01 and worsened markedly in subsequent years. From fiscal year 2000-01 to fiscal year 2002-03, general fund receipts declined by \$3.9 billion or nearly 11 percent. Business tax receipts fell most precipitously, by \$948 million or 22 percent.

Meanwhile, the State continued to increase expenditures. General fund spending increased 8.8 percent in fiscal year 2000-01 and 5.2 percent in fiscal year 2001-02. In each of those years, the rate of growth in New York was greater than the average among all 50 states. In fiscal 2002-03, spending declined 1.3 percent, but only because certain disbursements were delayed until the next fiscal year.

Table 11
State of New York
Annual and Accumulated General Fund Surplus/(Deficit)
In Accordance With Generally Accepted Accounting Principles
Fiscal Year 1992-93 to 2002-03
(dollars in millions)

FISCAL YEAR	ANNUAL SURPLUS/(DEFICIT)	ACCUMULATED SURPLUS/(DEFICIT)
1993-94	\$914	(\$1,882)
1994-95	(1,426)	(3,308)
1995-96	380	(2,928)
1996-97	1,933	(995)
1997-98	1,562	567
1998-99	1,078	1,696*
1999-00	2,229	3,925
2000-01	245	4,170
2001-02	(3,420)	493*
2002-03	(4,222)	(3,320)*

* Accumulated figure includes impact of annual audit adjustments as well as annual surplus or deficit.

State leaders closed the gap between declining revenues and growing expenses with a series of short-term measures that exhausted reserves built up in better days. The State enjoyed annual surpluses in the mid-1990s and had an accumulated surplus of \$4.2 billion by fiscal 2000-01. Nearly \$3.7 billion of those reserves were used in fiscal year 2001-02, and

the remainder in the following year. The State managed its way through fiscal year 2002-03 with short-term borrowings and expenditure deferrals. By the end of fiscal year 2002-03, New York had an accumulated deficit of \$3.3 billion – larger than the deficit created by the recession of the early 1990s.

In the current 2003-04 fiscal year, the State faced a gap of \$9.3 billion. Compared to other states, New York’s budget problem was among the most severe. The gap for fiscal year 2003-04 represented 23 percent of New York’s general fund. This ranked New York fourth among the 50 states and second behind California among the 12 competitor states.

The major actions to close the current year’s gap included borrowing against the proceeds of a national tobacco settlement and temporary increases in the personal income and sales taxes that expire in three years. In total, the State relied upon \$5.7 billion in one-time actions and disappearing revenues. Expenditures were curtailed but still grew 5.8 percent in the adopted budget.

This recent history of failure to confront the unsustainable expenditure base has serious future consequences. The large structural imbalance still is unresolved. The budget gap is estimated to be at least \$5 billion in fiscal year 2004-05 and \$8 billion in fiscal year 2005-06. These gaps do not include the cost of settlements with the major civil service unions, whose members are working under contracts that have expired. They also do not include the impact of complying with the State Court of Appeals ruling on the need to fund a “sound basic education” for every school child.

Table 12
Projected State Budget Gaps Prior to Budget Adoption
Fiscal Year 2003–04

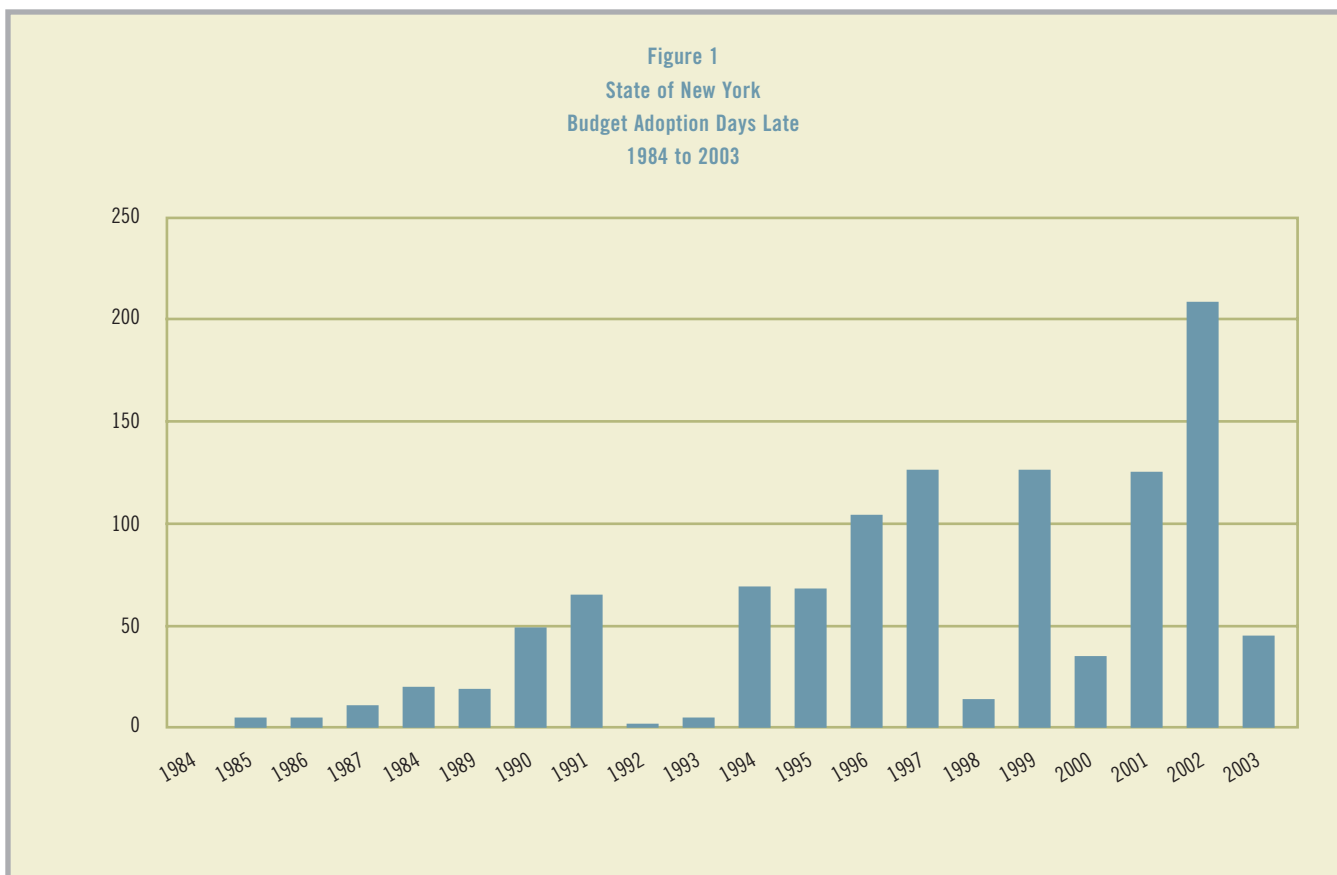
STATE	DOLLARS IN MILLIONS	GAP AS A PERCENT OF GENERAL FUND	50-STATE RANK
California	\$29,100	32.6%	2
New York	9,300	22.8	4
New Jersey	5,000	21.1	5
Michigan	1,700	19.8	6
Illinois	3,500	15.2	12
Connecticut	2,007	14.7	15
Massachusetts	3,000	13.1	16
Texas	3,700	12.0	18
Florida	2,000	10.1	20
Ohio	2,000	9.2	23
Georgia	721	4.9	41
Pennsylvania	500	2.4	43

PROBLEM 4

New York’s budget process lacks timeliness, transparency, and responsibility.

- ▶ **New York State has a 20-year history of lateness in adopting its budget that has grown worse in recent years and is unusual compared to other states.**

The State’s fiscal year begins April 1, and the budget should be passed by that date. But the budget has been late in every one of the past 19 years, and the problem has grown worse in the last decade. In five of the last 10 years, the budget was over 100 days late. The worst year was 2002, when the budget was 208 days late. The lateness impairs the ability of State agencies and local governments to plan and manage effectively – because they do not know how much money they will have until well into the fiscal year.



Compared to other states, New York stands out for its lateness. Among the competitor states, in the last 20 years six have always passed their budgets on time. Of the other states, Connecticut has been late only twice, Pennsylvania four times, California 14 times, and Massachusetts 17 times. Only twice have any of these states adopted a budget more than 100 days late.

The budgetary impasses that develop in New York between the Governor and Legislature have deep political roots, but part of the problem of lateness in New York may be due to a comparatively short time for the Legislature to consider the budget. The Governor proposes an Executive Budget in early January and, with an April 1 deadline, the Legislature has 10 weeks to consider the budget. Eight of the competitor states have longer periods of time, from 13 to 33 weeks, for legislative deliberation. Only Florida and Georgia have shorter periods, while Ohio has a span similar to New York's.

Table 13
Fiscal Year Start and Legislative Deliberation Time
New York and Its Competitors

STATE	JULY 1	OTHER	NUMBER OF WEEKS LEGISLATURE CAN CONSIDER BUDGET
California	X	–	20
Connecticut	X	–	13-17
Florida	X	–	9
Georgia	X	–	6
Illinois	X	–	16-18
Massachusetts	X	–	26
Michigan	–	Oct. 1	33
New Jersey	X	–	20
New York	–	Apr. 1	10
Ohio	X	–	8-10
Pennsylvania	X	–	18
Texas	–	Sept. 1	20

▶ **Unlike many states, New York has no method to reconcile differences among the Governor and the two houses of the Legislature over revenue forecasts.**

Revenue estimation is usually the first step in budget-making, and failure to agree on how much money is available for spending programs stalls the process at an early stage. Historically, the Governor's budget staff was the only group with the technical competence to develop credible revenue estimates. In the last 25 years, however, the Senate and Assembly have built large fiscal staffs capable of producing their own projections. Thus, the budget process typically begins with conflicting revenue estimates from the Governor, the Assembly, and the Senate.

In 1996 an effort was made to resolve the issue of competing revenue forecasts through new statutory procedures. They require the Governor's budget director and the chairs of the fiscal committees in the Senate and Assembly to convene a three-way conference to develop a consensus forecast and to report on that conference by March 10. However, the law does not require the Governor or the Legislature to accept the report or to use its conclusions. Thus, the revenue dispute still can and does remain an obstacle to budget agreement.

Other states resolve the issue of politicized revenue estimates by providing for a forecast that is binding on the major parties. These states set a deadline by which a revenue forecast must be agreed upon by the executive and legislative branches. If there is no agreement, then a specified forecast (usually from a third party) must be adopted. This appears to be a "best practice" among states with strong credit ratings. Of the 10 states with the top ratings from both Moody's and Standard and Poor's, nine have requirements for binding revenue forecasts. Among New York's competitor states, six require a mandatory agreement on revenues: Connecticut, Georgia, Massachusetts, New Jersey, Pennsylvania, and Texas. Two other states, Florida and Michigan, practice de facto revenue agreements.

Another common practice lacking in New York State is the existence of an independent budget office – meaning a fiscal staff with technical capability not under the direct control of governors or legislative leaders. Much like the Congressional Budget Office at the federal level, these entities provide objective analysis of fiscal and economic conditions that provides a common basis of information for all members of the legislature. Among the ten states with strong credit ratings, five have such an office, as do eight of the competitor states.

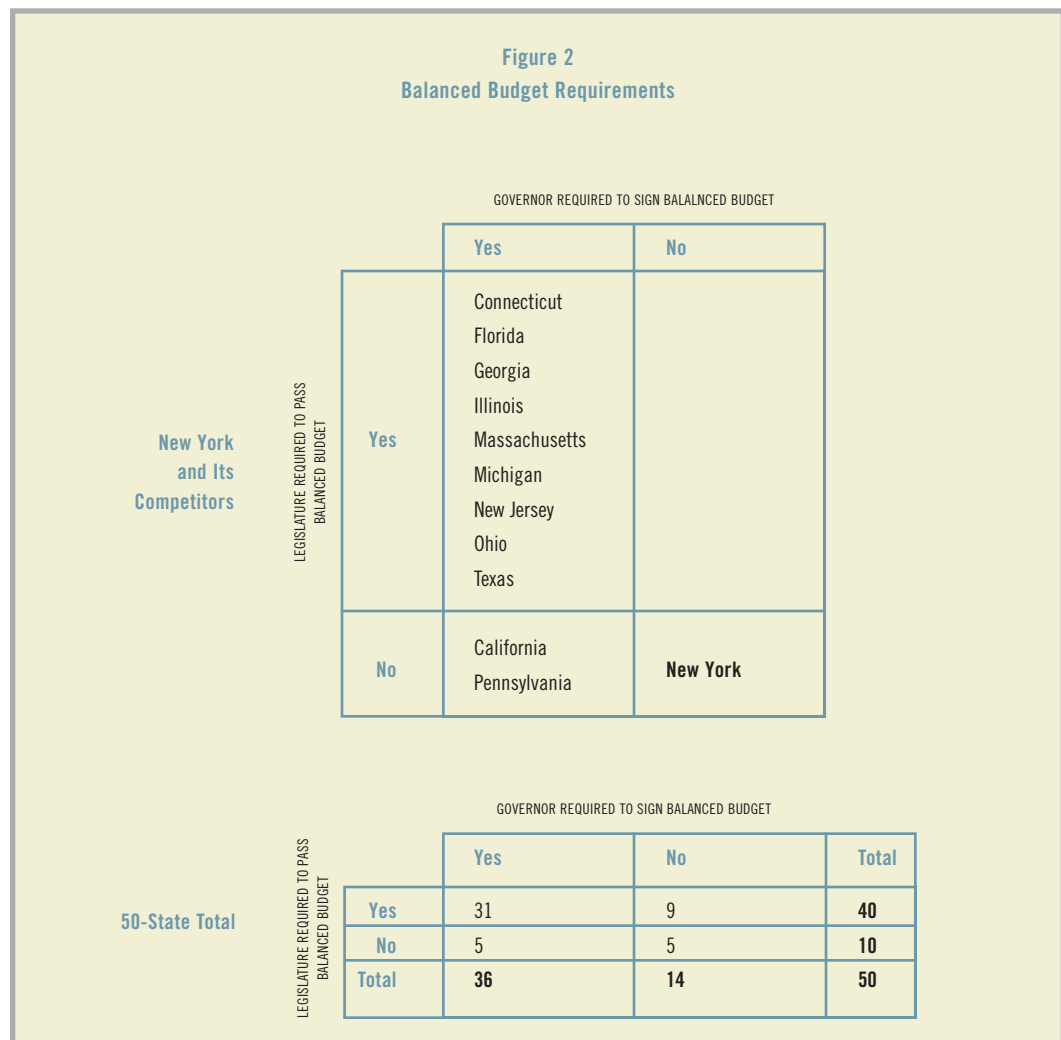
Table 14
Presence of Independent Analysts and Revenue Forecasting Process
New York and Its Competitors

STATE	PARTICIPANTS IN REVENUE FORECAST PROCESS	REVENUE FORECAST IS BINDING	LEGISLATIVE BUDGET OFFICE IS INDEPENDENT	NAME OF THE INDEPENDENT LEGISLATIVE BUDGET OFFICE
California	Budget department, legislative budget committees, and independent budget office	—	X	Legislative Analyst's Office
Connecticut	Joint legislative budget committee, budget department, and independent budget office	X	X	Office of Fiscal Analysis
Florida	One representative each from Governor's office, House, Senate and independent budget office	X	X	Office of Economic and Demographic Research
Georgia	Governor and executive staff	X	X	Legislative Budget Office
Illinois	Governor and general assembly	—	—	—
Massachusetts	Revenue department and legislative budget committees	X	—	—
Michigan	Independent budget office and budget department or state treasurer	X	X	Senate Fiscal Agency House Fiscal Agency
New Jersey	Treasury department	X	X	Office of Legislative Services
New York	Budget department and legislative budget committees	—	—	—
Ohio	Budget department and independent budget office	—	X	Legislative Service Commission
Pennsylvania	Revenue department	X	—	—
Texas	State comptroller	X	X	Legislative Budget Board
Total		8/12	8/12	

► **New York is one of only five states that do not require that its adopted budget be balanced.**

Most states require, by statute or in their constitution, that the adopted budget be balanced on a cash basis. Of the 50 states, 31 require that both legislative adoption and gubernatorial approval be contingent on a balanced budget. Nine states require only legislative adoption of a balanced budget, and five states require just gubernatorial signature. New York is one of only five states that have no such requirement. The other four states are Indiana, New Hampshire, Vermont, and Washington. All of the 11 competitor states have some form of balanced-budget requirement.

The most significant check on the need to balance the budget in New York is the State’s frequent need to borrow in public credit markets. To meet creditors’ and legal requirements, the Governor and Comptroller must certify that the budget is balanced on a cash basis. But they are not bound by the more stringent and timely rules that exist in other states.



► **New York State has weak multi-year financial planning practices compared to more credit-worthy states and to the practices it requires of the City of New York.**

New York State does not have strong procedures for multi-year financial planning. The Executive Budget as presented by the Governor includes two additional years of revenue and expense projections. However, that plan is typically changed significantly by the Legislature before adoption, and no multi-year financial plan accompanies the adopted budget. Neither the Legislature nor the public necessarily knows the longer-term consequences of the actions taken in the adopted budget.

In contrast, the states with the top credit ratings from Moody’s and Standard & Poor’s are better at multi-year planning. Of the 10 top-rated states, seven have financial plans that extend at least four years beyond the current budget cycle. Most of the competitor states are more like New York. Four have no multi-year plans, and four provide a forecast for only one year into the future.

Interestingly, since the 1975 fiscal crisis in New York City, the State has required the City to have a sound and credible, multi-year financial planning process. It is required to prepare a four-year financial plan on the basis of Generally Accepted Accounting Principles. The adopted budget is accompanied by three additional years of detailed revenue and expenditure projections. The impacts of actions in the current year’s budget on future years’ fiscal outlook are clearly identified. The plan is modified quarterly. This process has brought transparency and discipline to the City’s budgeting practices.

Table 15
Financial Plan Reporting

STATE	MULTI-YEAR EXPENDITURE FORECAST	YEARS BEYOND CURRENT BUDGET CYCLE
New York and Its Competitors		
California	–	–
Connecticut	X	3
Florida	–	–
Georgia	X	1
Illinois	X	1
Massachusetts	X	1
Michigan	X	1
New Jersey	X	3
New York	X	2
Ohio	–	–
Pennsylvania	X	4
Texas	–	–
States with AAA/Aaa Rating for Standard & Poor’s, Moody’s and Fitch		
Delaware	X	5
Georgia	X	1
Maryland	X	4
Michigan	X	1
Minnesota*	X	4
Missouri	X	4
North Carolina*	X	4
South Carolina	–	–
Utah	X	5
Virginia	X	4

* Minnesota and North Carolina have AAA rating for Standard & Poor’s and Fitch only.

► **New York State has a minimal “rainy day” fund.**

The basic goal of a “rainy day” fund is to save money during fiscally healthy years in order to assist in years when revenues decline because of a weak economy. According to the National Conference of State Legislatures, the size of a rainy day fund relative to spending is “the most useful simple measurement of a state’s fiscal well-being.”

The rainy day fund in New York is known as the Tax Stabilization Reserve Fund. It is required by the State Constitution, and the terms for its administration are defined in statute. Under current law, the Fund receives any available budgetary surplus up to 2 percent of that year’s General Fund spending.

Of the 50 states, 44 maintain funds that are relatively larger than New York’s. This includes 18 with funds between 2.1 percent to 5 percent of spending, 16 with funds between 5.1 and 10 percent of spending, and 10 states with no limit on their rainy day fund. Only five states do not have any rainy day fund.

Table 16
Limits on Rainy Day Fund Size (As a Percent of General Fund)

NO RAINY DAY FUND	2% OR LESS	BETWEEN 2.1% AND 5%	BETWEEN 5.1% AND 9.9%	10%	NO LIMIT
Arkansas	New York	Delaware*	Alabama	Connecticut	Alaska
Colorado		Idaho	Arizona	Florida	California
Illinois		Iowa	Georgia*	Massachusetts	Hawaii
Kansas		Kentucky	Indiana	Missouri*	Maryland*
Montana		Louisiana	Maine	Nevada	Michigan*
		Minnesota*	Mississippi	New Hampshire	Nebraska
		New Jersey	Utah*	Oklahoma	New Mexico
		North Carolina*		Texas	North Dakota
		Ohio		Virginia*	Pennsylvania
		Oregon			Wyoming
		Rhode Island			
		South Carolina*			
		South Dakota			
		Tennessee			
		Vermont			
		Washington			
		West Virginia			
		Wisconsin			

* States with AAA/Aaa rating

▶ **The State increasingly relies on “off-budget” accounts to support program spending.**

“Off-budget” spending refers to disbursements outside the normal process of legislative appropriation, executive approval, and audit review. The extent of the practice in New York State is difficult to document since, by definition, it takes place outside the framework of regular financial reporting. However, use of off-budget accounts appears to be growing. Specifically, many of the programs authorized and recently expanded under the Health Care Reform Act (HCRA) are financed off-budget.

An April 2003 report by the State Comptroller highlighted the problems associated with the HCRA. That legislation supports many of the State’s health care programs: graduate medical education, bad debt and charity care, elderly pharmaceutical insurance coverage, the Family Health Plus program, and others. Major revenue sources include the tobacco settlement funds, cigarette tax revenues, and surcharges on hospital and clinic services. Disbursements for some programs are made by third-party pool administrators. In fiscal year 2002-03, \$1.7 billion out of \$2.5 billion in HCRA spending was disbursed outside the traditional budget process. The Comptroller’s report identified the following issues with this practice:

- ▶ Under traditional contract and budget processes, no vendor can be paid unless the State Comptroller approves the contract and payment. No such controls exist for off-budget contracts.
- ▶ Off-budget actions mask the true level of State receipts and spending, which results in a loss of accountability to policymakers and taxpayers.
- ▶ Off-budget items are not subject to the usual State audit process.

Even though precise expenditure data are not available, other major areas of off-budget spending include regional economic development programs, community development block grants, and university student housing.

PROBLEM 5

Improvements in fiscal practices are hampered by unresponsive State governmental institutions.

Reforms are made difficult by a near permanent division of party control over the two houses of the Legislature, limited competition in contests for individual seats, and a “strong leader” system.

- ▶ **New York is unique among the states for the extended period during which the divided partisan control of the two legislative chambers has remained unchanged.**

Many states have divided partisan control of their legislatures, but none rivals New York for the stagnation of the pattern. In no other state has there been a divided legislature with the same party controlling each house of the legislature continually for the past 29 years. In analyzing legislatures, the most relevant group with which to compare New York is eight other states that can be characterized as having a “professional” legislature based on criteria such as staff support and time in session. Among this group, all except Massachusetts have had more frequent turnover in party control of the legislative bodies than New York. In Massachusetts, the large Democratic majority of registered voters is associated with steady Democratic control of both houses rather than a divided legislature.

Table 17
Changes in Partisan Control of Legislative Houses
in “Professional” State Legislatures
1974 to 2003

	HOUSE (ASSEMBLY)	SENATE
California	1992, 1994	1974
Illinois	1978, 1980, 1992, 1994	1974, 1992, 2002
Massachusetts	None	None
Michigan	1990, 1992, 1994, 1996	1974, 1984
New Jersey	1984, 1988, 1992, 2002	1992, 2002
New York	1974	None
Ohio	1992	1974, 1980, 1982, 1984
Pennsylvania	1974, 1994	1980, 1992, 1994
Wisconsin	1992	1994, 1996, 2002

The long period of divided partisan control in the New York State Legislature is due to the way the State officials use their authority to draw district lines. Leaders in each house have agreed to district boundaries that perpetuate each party’s control of one house and governors have approved this arrangement. In this way, the decennial redistricting practices have made divided partisan control of the Legislature a “permanent” feature of government in New York.

This partisan division of the Legislature is an obstacle to reform. Any change requires the Governor and a majority of both parties to agree.

► **New York’s Legislature has relatively little turnover among its members.**

In New York, turnover among members of the legislature is rare. The significance of this is debatable. Limited turnover may be a sign of voter satisfaction and good performance. Alternatively, it may be a symptom of limited competition and structural advantages for incumbents.

In the last decade, New York had less turnover among members of its Senate than did any of the other eight states with professional legislatures. Among members of the lower house, New York’s turnover in the past decade was less than in every relevant state except Pennsylvania. In many comparison states, legislative seats change hands twice as often as in New York.

In New York, the ability of incumbents to gain re-election is close to automatic. In the seven Assembly elections between 1990 and 2002, 89 percent of the incumbents chose to run for re-election and 98 percent of that group won. In the Senate in the same period, 91 percent chose to run for re-election and 98 percent won.

The power of incumbency in New York is related to the superior capacity of sitting legislators to raise campaign funds. In the 2002 election, on average the funds raised by Assembly incumbents exceeded those raised by challengers by a ratio of more than ten to one. In the Senate, incumbents raised two-and-a-half times as much as challengers. The phenomenon of well-financed incumbents is explained in large part by the willingness of major interest groups to contribute to both Assembly Democrats and Senate Republicans.

Table 18
Average Turnover of Legislative Seats
in States With “Professional” Legislatures

	HOUSE			SENATE		
	1971 TO 1980	1981 TO 1990	1991 TO 2000	1971 TO 1980	1981 TO 1990	1991 TO 2000
Michigan	22%	20%	30%	48%	30%	30%
California	27	16	40	22	11	28
Ohio	21	17	26	24	17	24
New Jersey	40	27	23	50	28	21
Massachusetts	22	17	19	20	19	19
Illinois	26	15	22	24	14	16
Wisconsin	24	23	17	24	20	15
Pennsylvania	24	13	11	18	11	12
New York	24	15	14	18	11	11

Table 19
Funds Raised by New York State Legislative Candidates, 2002
(Average per Candidate)

	WINNERS	LOSERS	INCUMBENTS	CHALLENGERS	OPEN SEAT
Assembly	\$92,119	\$16,172	\$91,072	\$7,918	\$50,388
Senate	\$251,628	\$89,564	\$252,799	\$97,385	\$105,158

▶ **The Legislature follows a “strong leader” system, which limits individual member participation and influence.**

The long period of partisan control over each chamber of the Legislature has led to a “strong leader” system. The Speaker of the Assembly and the Majority Leader of the Senate dominate their respective chambers. They select the members who serve in other leadership posts, determine the number of committees and appoint committee members, control political resources and staff appointments, and set the legislative agenda and calendar.

The strong leader system limits the role of committees in the legislative and budgetary processes. The leaders and their senior staff make the key decisions on these issues. Individual members of the Legislature often vote on bills and measures about which they have limited knowledge and involvement. Unlike the U.S. Congress, there is no forum for individual members to play a meaningful policy role.

Two developments over the past 20 years have enhanced the powers of the legislative leaders. First, the leaders have established and enlarged campaign funds to assist the re-election of their members. The fund raised by the Senate Republicans for the 2002 elections was more than \$14.7 million, and the Assembly Democrats’ fund in that year exceeded \$7.5 million. Second, the “member items” in the budget controlled by the leaders have grown in scale. These items give legislators funds for special projects or programs in their districts. From 1984 to 2003 the amount appropriated for such items increased from \$26 million to \$170 million. The member items and the campaign funds are used to reward members for their loyalty and adherence to priorities set by the leaders.

How to Fix the Problems That Are Hurting New York

Participants in the conference on November 13 and 14, 2003 will consider and evaluate the following proposals to reform the fiscal practices of New York State. Additional material will be distributed at the conference to inform the discussion of these proposals.

- ▶ **REFORM 1**
Require that the adopted budget be balanced in accord with generally accepted accounting principles.
- ▶ **REFORM 2**
Require a four-year financial plan with quarterly modifications.
- ▶ **REFORM 3**
Replace the constitutional requirement for voter approval of general obligation debt with a constitutional limit on the amount of all state debt that is set based on relevant, changing economic factors.
- ▶ **REFORM 4**
Create a professional, non-partisan Legislative Budget Office to provide fiscal information to both houses of the Legislature and to the public.
- ▶ **REFORM 5**
Require that independently prepared revenue projections be used in the adopted budget, if the Governor and Legislature do not agree on revenue projections in a timely way.
- ▶ **REFORM 6**
Require a “rainy day” fund larger than the current Tax Stabilization Reserve Fund.
- ▶ **REFORM 7**
Eliminate the use of “off-budget” accounts.
- ▶ **REFORM 8**
Change the budget calendar to allow more time for deliberation on the Executive Budget by the Legislature.
- ▶ **REFORM 9**
Strengthen the committee process of the State Legislature to allow more participation by members in budgetary decisions.

In addition to these primarily fiscal reforms, the discussion at the conference will be open to broader reforms that affect features of State government identified in problem 5 in this document. These may include a more independent system of legislative redistricting and campaign finance reform.

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