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Revenues Down, Spending Up

The Growth in New York's Long-Term Budget Gap

Almost all of the projected \$2.1 billion deficit in this year's New York State budget can be traced to falling tax receipts. But rising spending will represent a growing share of the problem over the next three years. In fact, more than one-third of the projected growth in next year's gap, and over *half* the growth in the gap for fiscal 2013, can be traced to spending increases beyond those forecast by the Division of the Budget (DOB) in April.

Assuming no recurring savings are adopted to mop up this year's red ink, the 2010-11 gap has more than doubled – and projected gaps for the two subsequent years have grown even larger, as shown below.

Out-Year General Fund Projections

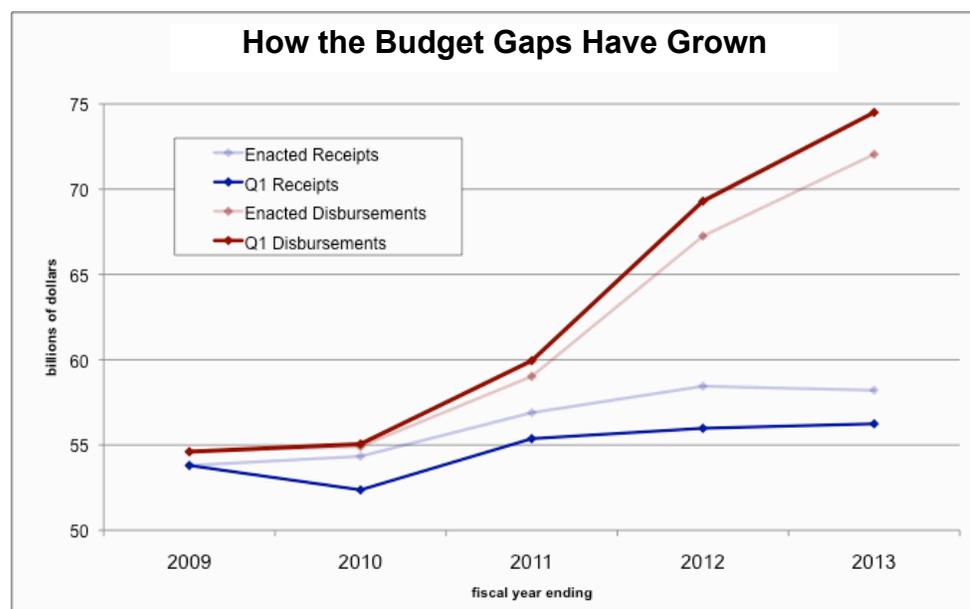
(Millions of Dollars)

SFY	Enacted Financial Plan (4/09)			First Quarter Update (7/09)		
	Receipts	Disbursements	Surplus (Gap)	Receipts	Disbursements	Surplus (Gap)
2009-10*	54,338	54,208	(570)	52,366	55,059	(2,693)
2010-11	56,896	59,022	(2,126)	55,373	59,941	(4,568)
2011-12	58,448	67,251	(8,803)	55,891	69,298	(13,317)
2012-13	58,290	72,045	(13,836)	56,243	74,505	(18,261)

* The initial deficit of \$570 million for fiscal 2009-10 is covered by prior-year reserves.

Source: Division of the Budget

The following chart depicts the elements of the budget gap and how it has widened between the issuance of DOB's Enacted Budget Financial Plan in April and the First Quarterly Update, issued at the end of July.



The projected gap nearly triples in size between fiscal years 2010-11 and 2011-12. Much of that increase reflects the scheduled expiration of federal stimulus aid; spending temporarily supported by the stimulus will be reclassified back into the general fund starting in fiscal 2011-12. Meanwhile, general fund receipts are projected to hold their own after the scheduled Dec. 31, 2011 sunsetting of this year's temporary income tax increase.

The drop in receipts is easy to explain: personal income taxes and sales taxes both have fallen even more sharply than expected, reflecting job losses, a sharp drop in wages and investment income among high-income households, and reduced consumer activity.

But where—and why—is spending growing beyond the projections issued in April? The growth is concentrated in two categories:

School aid disbursements out of the general fund are up \$241 million for 2010-11, a combination of higher aid claims from school districts and a drop in Lottery sales. The impact of larger aid claims tends to mushroom in later years. In addition, Lottery aid will be reduced by the Legislature's failure to approve a Video Lottery Terminal franchise for Belmont Park. As a result, the baseline school aid projection has been revised upwards by more than \$700 million for 2011-12.

Pension contributions for the next three years have risen by a cumulative \$2.1 billion. The Enacted Financial Plan reflected the assumption that pension fund contributions would be capped by "amortization" legislation backed by Governor Paterson and state Comptroller Thomas DiNapoli. But that bill stalled in the state Senate — and for good reason.¹ So DOB adjusted the financial plan in this area. It now projects that, in the absence of other action, the employer contribution rate, as a percentage of payroll, could rise from the current 7.2 percent to 24 percent by 2012-13. This is consistent with the new employer pension contribution rate announced by DiNapoli's office.

Looking Ahead

New York's exceptionally heavy dependence on personal income taxes paid by a small number of high-income households whose incomes have fallen sharply² has been a major factor in the growing state fiscal crisis. The income tax hike, leaving New York City residents with the highest marginal rate in the nation, will make state tax receipts more volatile and difficult to predict.³ September's tax collections — especially estimated income tax payments from high-income households — will be a crucial barometer of whether the state's current-year deficit (and out-year gaps) will grow even larger. But that's no argument for further delay in reducing spending, since potential savings shrink with every month the Governor and Legislature fail to take action.

— E.J. McMahon

¹ See <http://www.nyfiscalwatch.com/?p=1859> and "To Fix Pension Peril," by E.J. McMahon, *New York Post*, July 13, 2009, linked at <http://www.empirecenter.org/Articles/>.

² In 2007, the highest-earning 1 percent of taxpayers generated 41 percent of income tax receipts, according to DOB.

³ See further discussion at <http://www.nyfiscalwatch.com/?p=1639>.