Policy Brief

Financial Plan

February 2017

The Fiscally Responsible Choice to Extend the Millionaires' Tax

Governor Cuomo's decision to extend the millionaires' tax is the fiscally responsible budget choice, eliminating the projected FY 2018 budget shortfall, funding important new initiatives and providing fiscal breathing room in the out-years. The legislature should follow the governor's lead. In the last few years, New York State has not counted on the extension of the millionaires' tax past calendar year 2017 in its four-year financial plans. Extending the tax provides about $4 billion annually in additional revenues at a time when the state faces considerable uncertainty regarding federal funds. It's important to note that federal funds account for one-third of the state's All Funds Budget, and as a new administration assumes office—along with an emboldened majority in the House of Representatives seeming particularly set on draconian budget cuts—this funding stream becomes critical to our state's financial well-being.

The governor's signature new budget initiative is his proposal for Excelsior Scholarships to close the gap in paying for tuition for SUNY and CUNY students of families making up to $125,000 per year. When fully phased in, the annual price tag for the tuition-free public university aid program is $163 million, though few details were provided in the first few weeks following the initial announcement.

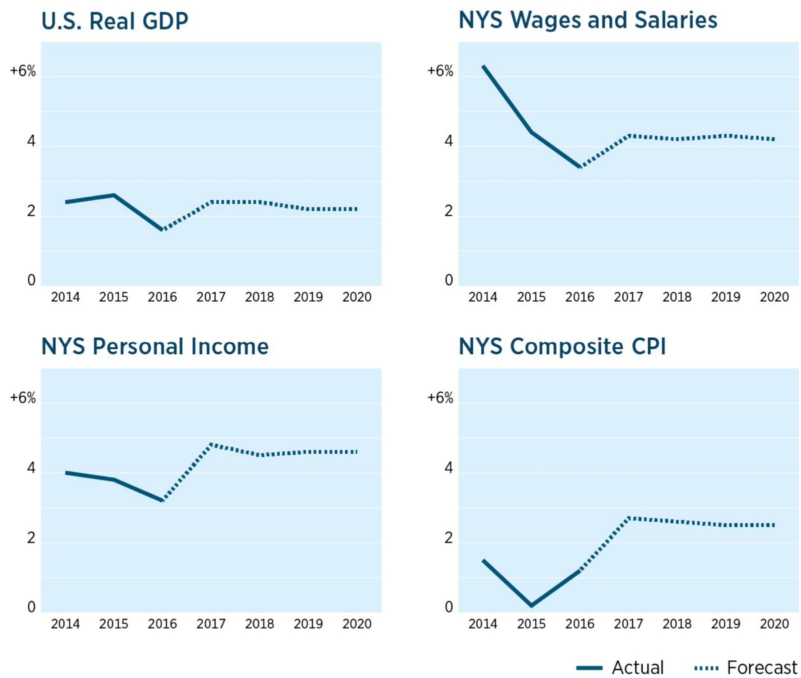
The governor also pledged resources rising to about $200 million a year to "raise the age" of juvenile jurisdiction from age 16 to 18. In another long-sought criminal justice reform, the governor proposed to have the state fund the entire cost of providing effective criminal defense to individuals who cannot otherwise afford counsel. This promise must, however, be matched with funding to make it a reality.

The Executive Budget proposal includes an enhancement to the child and dependent care tax credit for middle-income families, and again includes the DREAM Act that would extend student financial assistance to undocumented immigrant college students in New York State.

Since the FY 2017 budget was enacted last spring, general fund tax collections have weakened by nearly $1.6 billion, entirely related to the personal income tax (there were slight increases in other tax revenues). Roughly half of the tax shortfall was offset by additional monetary settlements generated by enforcement actions against financial institutions.

The Division of the Budget's forecast calls for the pace of national economic growth to pick up in the year ahead, with GDP growing 2.4 percent in 2017 and 2018 (considerably higher than the 1.6 percent growth rate for 2016). Even with New York's job growth expected to slow slightly over the next four years, the pace of total New York wage and personal income growth is predicted to be faster compared to 2016.

Fig 1. While the Economy Slowed Slightly in FY 2016, the Forecast is for Better Economic, Wage, and Income Growth In Out-Years



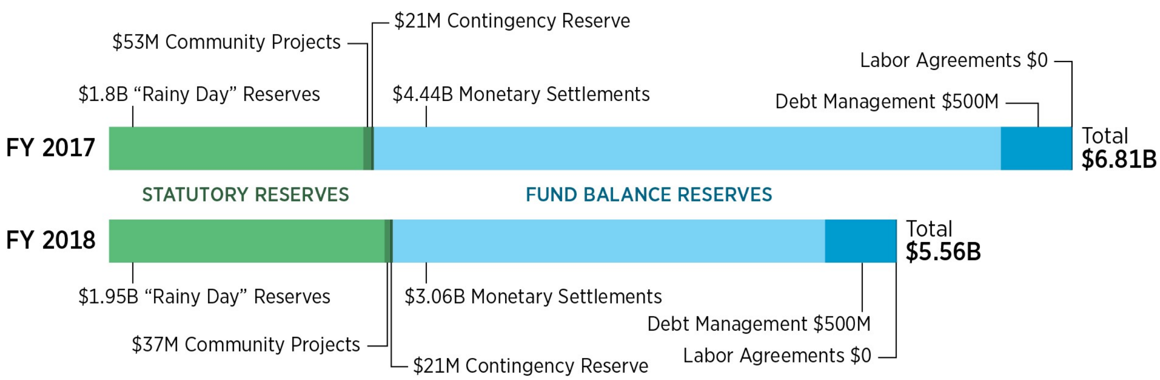
Source: NYS Division of the Budget, FY 2018 Executive Budget Economic and Revenue Outlook, p.125; DOB composite CPI January 2017.

Overall, the Executive Budget projects a sharp rebound in tax collections, with growth of 5.6 percent (All Funds taxes) in FY 2018 and 4.1 percent in 2019. As discussed in a later chapter, the extension of the millionaires' tax is necessary to offset the rising impact of tax cuts enacted in recent years.

The state should end FY 2017 with a substantial $6.8 billion balance in its General Fund. While statutory reserves—mainly in two "rainy day" reserve funds—are not high relative to the state's operating budget, the state plans to keep several billion dollars out of the $9.4 billion received in monetary settlements in recent years in its General Fund for 2018 and beyond. The state plans to spend most of the settlement proceeds on various infrastructure projects, but could redirect those funds to other purposes should the budget need arise.

The amount of settlement cash in the General Fund falls from $4.4 billion at year-end FY 2017 to $3.1 billion at year-end FY 2018 (see the chart that follows) as a result of shifting those funds to something called the Dedicated Infrastructure Investment Fund. The 2015 legislation establishing that fund allows for the transfer of settlement monies back to the General Fund, should the economy and revenue collections weaken significantly. This sound budget management approach to reserves is one of the reasons the state is enjoying it highest credit ratings in more than four decades.

Fig 2. General Fund Balances Bolstered with Bank Settlements



Source: FY 2018 Executive Budget Financial Plan, p. 26.

The governor often touts his two percent spending cap as the core feature of his approach to fiscal responsibility. However, the budget's selective adherence to the two percent cap has been causing real harm to many critical human infrastructure investment areas and to certain state operations. Increasingly in recent years, budget actions are taken to reclassify expenditures or to shift funding to revenue sources outside of funding sources covered by the spending cap. By way of illustration, in the Executive Budget proposal, funding for 3,000 state agency maintenance workers is shifted to the capital budget (which is not included in the two percent spending cap); and $125 million in FY 2018, as well as $400 million thereafter in tobacco settlement funding, is used to pay for part of the state takeover of local Medicaid costs, freeing up state Medicaid spending now subject to the cap.

Such budget maneuvers likely would not be made were it not for the search for more spending room under the artificial cap. In his report on the enacted FY 2017 budget, the state comptroller noted that if spending from state operating funds were adjusted for prepayments and the use of various budget management actions, spending growth would be more than 3.6 percent rather than the claimed two percent.[1] However, when it suits the governor's purposes, the inflexibility of the two percent spending cap is invoked to restrict other spending.

Since he came into office six years ago, Governor Andrew Cuomo has sought to tightly limit the growth in state spending to less than the broader growth in the state's economy and taxes, and to rigidly limit local property taxes and spending by local school districts, counties, towns, and villages, regardless of need.[2] Early in his first term, the governor asserted that state government spending in New York had long grown faster than the state's economy and that state government spending needed to be restrained so taxes could be reduced.[3] But, recent growth in state spending has been well below growth in total personal

[1] New York State Comptroller Thomas P. DiNapoli, Report on the State Fiscal Year 2017-17 Enacted Budget Financial Plan and Capital program and Financing Plan, July 2016, pp. 12-14.
[2] A better way to relieve high local property tax burdens is to enhance the state's property tax circuit breaker in the personal income tax.
[3] The governor maintained that state spending had been outpacing income growth for the past fifty years, yet a closer look at the historical trend shows that while state taxes did grow much faster than income from the early 1960s until the mid-1970s, since then income has generally grown parallel to or faster than state taxes. Both state taxes (continued)

income, which is a reasonable proxy for growth in the state tax base. General-purpose aid the state provides to local governments has declined in inflation-adjusted terms, which in turn heightens the fiscal pressure on localities that face a tight limit on property taxes.

This unforced austerity budgeting and the selective enforcement of the spending cap is having a harsh impact on many state services and on New York's children, families, and communities. When coupled with the governor's two percent local property tax cap, unforced austerity has meant that local government capacity in most parts of the state has suffered, resulting in deteriorating services and an inadequate public response to hardships afflicting many families. Some examples:

- State spending for social welfare programs fell by 18 percent in inflation-adjusted terms from FY 2011 to FY 2017. At the same time, despite several years of recovery, family hardships are still elevated. While there has been some reduction over the past two years, the number of people receiving aid from the Supplemental Nutrition Assistance Program (food stamps) is still 76 percent greater than in late 2007 (outside of New York City) before the recession. Meanwhile, the number of people receiving safety net assistance, which is mainly funded by local governments, is nearly one-third greater than before the recession.
- The Board of Regents reports that, while state-funded school aid allocated according to the Foundation Aid formula has risen during the past three years—even with a further increase proposed in the Executive Budget—there is still a $3.9 billion shortfall compared to what it should be based on the state's 2007 response to the court ruling in the Campaign for Fiscal Equity case.
- The squeeze on state agency budgets has resulted in the loss of more than 10,000 state workers (over 8 percent of the non-SUNY/CUNY workforce) since 2011. In some agencies, such as OPWDD and OMH, steep staffing reductions have forced up the use of overtime to alarming levels, jeopardizing the well-being of workers as well as that of clients under their care.
- The combined effects of declining general purpose state aid and the restrictive local property tax cap have dramatically constrained the ability of local governments to continue providing quality public services. According to the state comptroller's data on expenditures by the 57 counties outside of New York City, inflation-adjusted county spending on community colleges fell by 10 percent in the first three years after the imposition of the property tax cap (FY 12-15.) Over the same period, county spending on senior services dropped by 12 percent, mental health services spending fell by 15 percent, and county social service spending for youth plummeted by 30 percent.

Not surprisingly, state budget austerity has led to a steep decline in local government employment in recent years. From 2009 to 2015, New York local governments outside of New York City cut jobs for personnel such as teachers, police officers, social workers and parks workers, by 56,800, or 8.4 percent, which is one of the sharpest declines among all states over this period. Local school district employment fell by 8 percent, and all other local government employment dropped by 9 percent.[4] Besides a reduction in public services, public sector job losses have cost jobs that offer a middle-class life; jobs held by people whose spending in their communities directly leads to more private sector employment. In many

(continued) and local taxes outside of New York City relative to personal income were at about the same level in 2012 as in 1995. Only New York City had an increase in taxes relative to personal income between 1995 and 2012. (See Fiscal Policy Institute, New York City Taxes—Trends, Impact and Priorities for Reform, January 13, 2015, p. 27.).

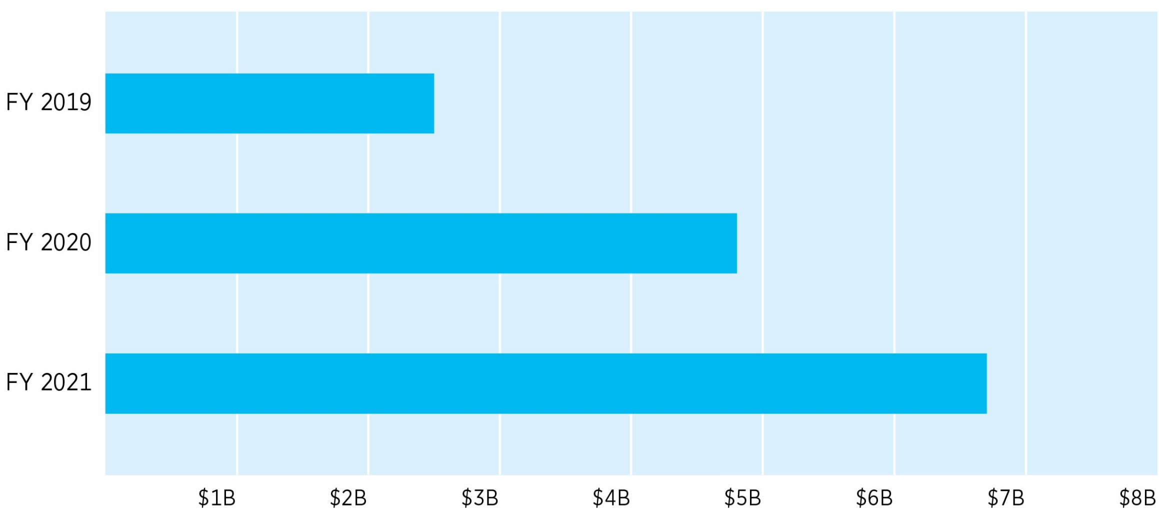
[4] Fiscal Policy Institute analysis of NYS Department of Labor current employment statistics data. State government employment fell by 10.5 percent in New York City, and by 2.9 percent in the rest of the state.

upstate regions, the state's budget austerity has accounted for much of the erosion occurring in middle-class jobs.

Even with the extension of the millionaires' tax, continued adherence to a two percent spending cap means that unforced austerity will continue, and worsen, since the outlook is for inflation to increase. For the past three years, the rate of inflation averaged one percent per year. For 2017, the Budget Division forecasts inflation of 2.7 percent, and projects a 2.6 percent rate in 2018 and 2.5 percent during the following two years. Thus, with school aid and Medicaid growing at about four percent per year or more, the Executive Budget is proposing real overall inflation-adjusted spending declines for the next three fiscal years. In some areas, the real cuts are likely to be much greater.

The mechanics of continued adherence to the two percent spending cap will trigger human services and agency-heavy cuts of $14 billion during the three out-years: $2.5 billion in FY 2019, $4.8 billion in FY 2020 and $6.7 billion in FY 2021. These prospective cuts have not yet been detailed.

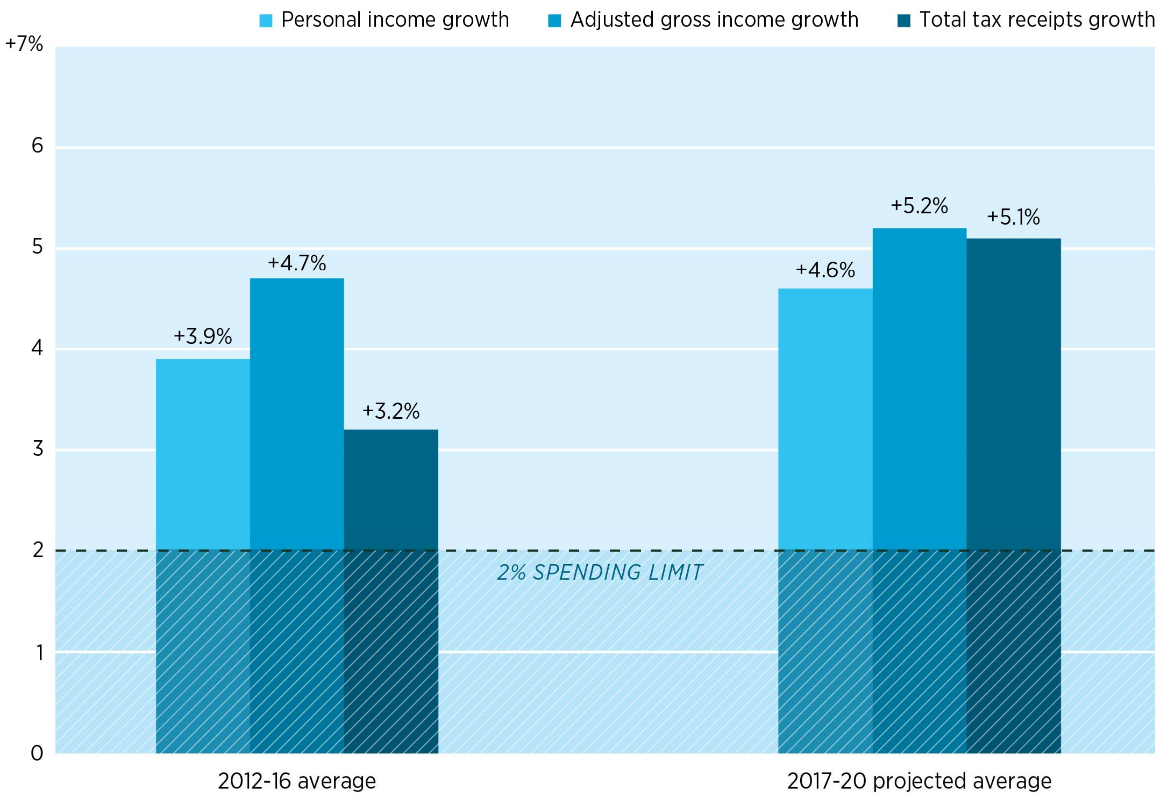
Fig 3. Spending Cuts in Local Assistance and State Agencies that Will be Needed to Stay Within the Governor's 2% Spending Limit



Source: FY 2018 Executive Budget Financial Plan, Jan. 2017.

Unforced austerity built into future budgets means the state will not make up for several years of harmful reductions, nor will it address a host of critical human needs that have mounted in the wake of the Great Recession (and relatively weak recovery). As the figure below illustrates, New York clearly has the overall income and tax receipt wherewithal to do better. By various measures, the state's tax capacity has exceeded two percent over the past few years, and is projected to grow even more in 2017 and the following three years. Personal income and adjusted gross income, the starting point for determining state personal income tax liability, are projected to grow by about 4.6 to 5.2 percent annually this year and for the next three years. New York's total tax receipts, even with the many tax cuts already enacted, are projected to grow by 5.1 percent annually—two-and-a-half times the two percent spending limit. Each one percentage point growth in New York's tax receipts translates into $800 million a year.

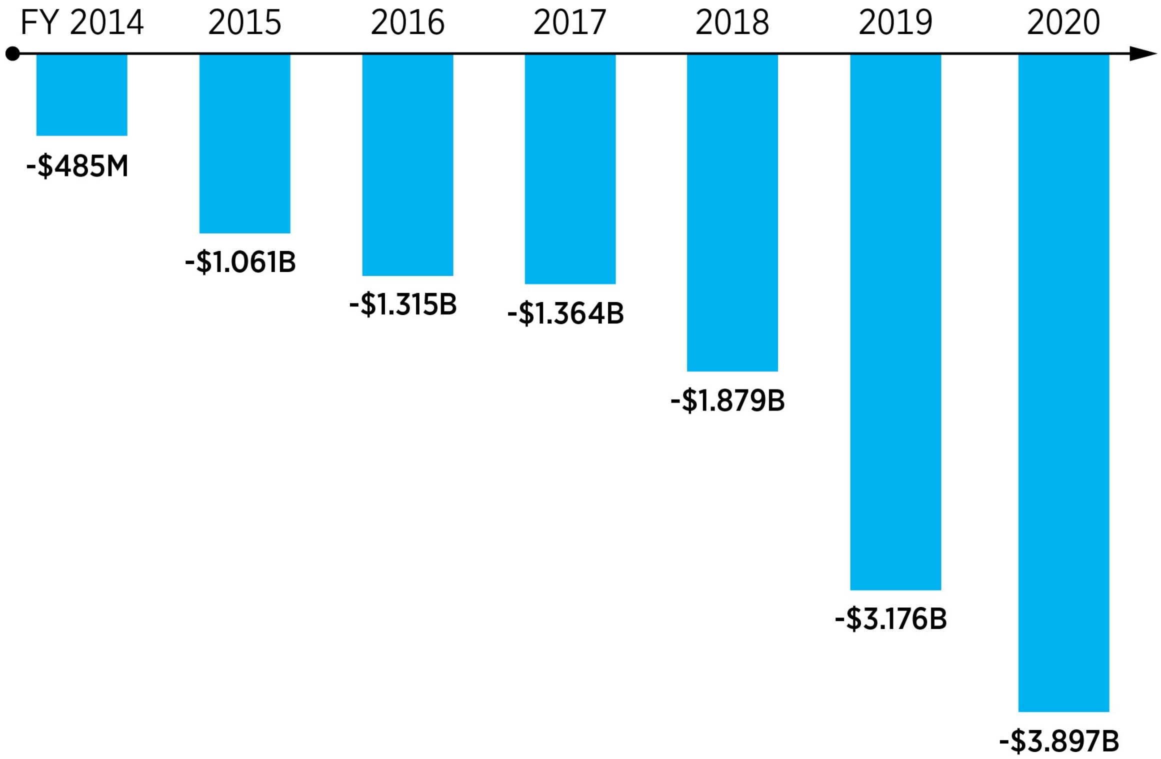
Fig 4. NY's Economic Ability to Pay Well Exceeds the Governor's 2% State Spending Limit



Source: Bureau of Economic Analysis; NYS Division of the Budget, FY 2018 Economic and Revenue Outlook. Personal income data for calendar years, AGI for tax years, and tax receipts for subsequent fiscal years.

One of the major reasons that the extension of the millionaires' tax is needed is to make up for the various tax cuts enacted over the past four years. As the chart below indicates, tax cuts enacted with the FY 2014-2017 budgets translate into $3.9 billion in lower tax receipts in FY 2020. That is close to the amount of revenue that will result in FY 2020 from the millionaires' tax extension. The steady growth in the cost of the cumulative tax cuts starting in FY 2018 is due to the multi-year middle class income tax cuts enacted last year. These cuts rise in value from $236 million in the coming fiscal year, to $1.1 billion in FY 2019, and $1.5 billion in FY 2020. When fully phased in FY 2025, the middle-class tax cuts reduce state tax receipts by an estimated $4.2 billion.

Fig 5. NYS tax cuts in the last four years, FY 2014-FY 2017, and the resulting loss in state tax receipts



Source: FPI analysis of NYS Division of Budget and Office of State Comptroller enacted budget reports.

Given that high-income taxpayers are benefitting from some of the more prominent tax cuts in recent years, such as the estate tax changes, the corporate tax rate reduction, and the sales tax breaks for yachts and private jets, it is entirely fitting that the millionaires' tax be extended to help offset the myriad enacted tax cuts.

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The Fiscal Policy Institute (www.fiscalpolicy.org) is an independent, nonpartisan, nonprofit research and education organization committed to improving public policies and private practices to better the economic and social conditions of all New Yorkers. Founded in 1991, FPI works to create a strong economy in which prosperity is broadly shared..