



Governor Pataki Presents 2006-07 Executive Budget

State Fiscal News: Vol. 4, No. 9

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January 2006

New York State Governor George Pataki presented his 2006-07 Executive Budget on Tuesday, January 17, 2006. Projections included in the budget indicate the State's fiscal outlook is improving significantly. The current year is forecast to end on March 31 with a surplus of just under \$2 billion, compared to the \$1 billion projected in October. Tax receipts are greatly exceeding projections — the Governor raised these estimates by another \$1.4 billion since October's Mid-Year Update.

Despite the good news on taxes, the 2006-07 General Fund (GF) budget would still contain a gap of \$751 million. The Governor proposes to close this gap with General Fund spending reductions (primarily Medicaid). He also proposes a three-year plan of tax cuts — these reductions focus on the personal income and business taxes — and reduce state revenues by \$844 million in 2006-07, rising to \$3.3 billion in 2008-09.

Fiscal Highlights

New York State's budget is presented in a fund accounting structure and in both cash and Generally Accepted Accounting Principles (GAAP) formats; the main focus is on the General Fund, which must be balanced on cash, but not GAAP. Out-year projections need not be balanced.

Under the Governor's proposal, General Fund spending for 2006-07 is estimated at \$49.6 billion, an increase of \$2.4 billion — or 5.1 percent — from 2005-06. All Funds, which includes the General Fund, special revenue or dedicated funds, capital, and debt service, would total \$110.7 billion, for a 4.1 percent increase.

Improving Tax Collections

New York State's tax collections for the current (2005-06) fiscal year through the end of December 2005 were \$36.8 billion, an increase of 9.6 percent from the previous year. The 2005-06 budget was based on an estimate of 5.5 percent growth. Most other states have also been seeing revenue growth above their projections and are now expecting to run surpluses for the current fiscal year. This faster revenue growth accounts for most of the \$2 billion surplus now projected in New York State for the current fiscal year.

Against this backdrop of greatly improving tax collections, New York's short-term and long-term budget outlook has steadily improved. When the 2005-06 budget was enacted in April 2005, the state projected a small GF surplus leading to a significant gap in the 2006-07 year. As shown below, these projections have gotten considerably more positive:

	2005-06 Budget (\$ in millions)	2006-07 Projections (\$ in millions)
April 2005	\$601	(\$3,167)
October 2005	\$1,039	(\$3,066)
January 2006	\$1,991	(\$751)

SOURCE: New York State Division of the Budget

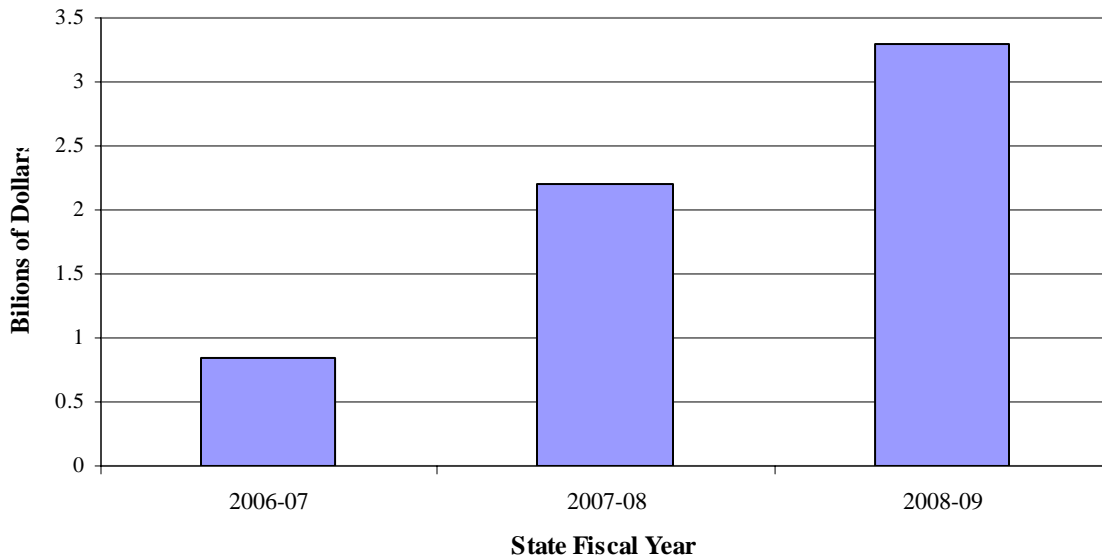
Although the actual projections have changed, the pattern has held constant — a sharp turnaround from a position of surplus in the current year to a baseline deficit in 2006-07. Factors contributing to this pattern include rising state costs associated with a cap imposed last year on local Medicaid spending (counties and New York City have traditionally financed approximately one-quarter of the state's Medicaid spending), the takeover of the local costs of the Family Health Plus program, the scheduled phase-out of the Personal Income Tax (PIT) surcharge imposed during the recession, and the loss of one-time resources used in 2005-06.

Major Budget Actions

In constructing the 2006-07 budget, the Governor had to program the use of the nearly \$2 billion surplus from 2005-06, close the \$751 million baseline budget gap, and fund his initiatives.

Tax Cuts: The Governor's major budget priority is to reduce taxes. He has advanced a plan that cuts taxes over three years by nearly \$3.5 billion when fully implemented. The figure on the following page shows how the cost will increase over the next three fiscal years:

Tax Cuts Over Three Years



SOURCE: New York State Division of the Budget

Personal income tax (PIT) reductions comprise the largest portion of this plan, and include a reduction in the top rate from 6.85 percent to 6.75 percent; eliminating the marriage penalty; increasing the income threshold (e.g., from \$40,000 to \$60,000 for married taxpayers) above which the top tax rate applies; and providing seniors with a refundable credit for increased energy costs (meaning the taxpayer receives a check if the credits exceed their tax liability).

Property tax relief is provided through rebates for qualified taxpayers who live in school districts that control spending increases.

Business tax cuts include eliminating the Alternative Minimum Tax (AMT), reducing the top tax rate on net income from 7.5 percent to 6.75 percent, and allowing businesses to immediately “expense” or write-off the costs of capital investments (rather than expensing these costs over a multi-year period.)

The estate tax would be eliminated. And a two-week sales tax exemption is proposed for clothing purchases under \$250.

Cost Containment: To close the 2006-07 gap and fund the first year cost of his initiatives, the Governor is recommending a number of budget actions, including:

- ❖ Restructuring the Tuition Assistance Program (TAP), which provides financial aid to college students
- ❖ Limiting state support growth for SUNY and CUNY while allowing tuition increases
- ❖ Changes in welfare to encourage work participation

- ❖ Additional patient income recoveries in mental hygiene

Medicaid: The largest cost containment target is Medicaid. Spending from the GF would grow 22 percent **before** cost containment due to underlying cost increases, the local Medicaid takeover and other factors. This growth would add nearly \$1.9 billion to GF spending in 2006-07. The Budget reduces that growth to \$550 million or 6.5 percent. Cost containment actions are estimated to produce \$1.3 billion in savings in 2006-07 in the General Fund through:

- ❖ Imposing reimbursement rate caps, and authorizing selective contracting with hospitals to achieve savings
- ❖ Capping reimbursement rates for and collecting delinquent assessments (taxes) from nursing homes
- ❖ Strengthening the new Preferred Drug Program and eliminating the “wrap-around” drug coverage for dually eligible (Medicaid and Medicare) recipients except for certain special populations (e.g., the mentally ill)
- ❖ Revamping the State’s anti-fraud activities, including establishing a Medicaid Inspector General’s office

School Aid: A \$634 million aid increase is recommended for the 2006-07 school year (which starts in July 2006.) Of this amount, \$375 million is funded with video lottery terminal (VLT) revenue and would be deposited to a reserve for Sound Basic Education (SBE) with allocations contingent on adoption of a plan to disburse the funds consistent with SBE principles. No specific solution was advanced to address court-ordered increases in funding.

Out-year Projections

The Budget includes projections for the 2007-08 and 2008-09 fiscal years. These projections assume adoption of the Governor’s budget recommendations and the use of \$2.044 billion in reserves projected to be available at the end of the current (2005-06) fiscal year. The projections are as follows:

	2007-2008 (\$ in millions)	2008-09 (\$ in millions)
Baseline Gap	(\$2,888)	(\$4,865)
Use of 2005-06 Surplus	\$1,022	\$1,022
Net Gap	(\$1,866)	(\$3,843)

SOURCE: New York State Division of the Budget

Budget and Debt Reforms

Voters in November defeated a proposed constitutional amendment – advanced by the Legislature over the Governor’s objections – to change the state budget process. In his budget, the Governor recommended a package of changes to the budget process as well as reforms to the process by which debt is incurred by the state and its public authorities.

Budget reforms: Proposals include requiring the Legislature to enact a balanced budget, authorizing the State Comptroller to set a binding revenue estimate if the Legislature and Governor cannot agree on one, requiring the Legislature to hold conference committees to iron out budget differences, requiring the public reporting of the impact of proposed budget changes three days before they can be acted on the Legislature, and changing the start of the fiscal year to July 1 and requiring the Legislature to enact the budget by May 1.

Debt reforms: The Governor has recommended such constitutional changes as banning “backdoor” borrowing by authorities, requiring that half of all new debt be approved by the voters, and by limiting debt and debt service.

Outlook

The increases in tax collections experienced by New York, coupled with attempts to curb Medicaid spending, have enabled the Governor to advance a broad tax cut agenda. Because New York does not require that out-year projections be balanced, only the first year cost of the tax cuts must be funded within a balanced budget framework. But the tax cut program would grow sharply, with the costs in the third year nearly four times greater than the first year’s impact.

We expect the good revenue news to be repeated in other states as their governors propose 2006-07 spending plans. And we also expect that other states will cut taxes, especially those that enacted temporary or permanent revenue raising measures to close recent budget deficits. We could be at the beginning of a period in which tax cuts dominate state budgetary developments. Tax reductions were the rule during the period from 1994 through 2000 when aggregate reductions totaled approximately \$33 billion, according to the National Association of State Budget Officers (NASBO). But the economic and federal policy environment is much different now. Global economic challenges are keener. And pressures on the federal budget are likely to lead to repeated efforts to reduce domestic spending.

New York State Executive Budget documents are available online at www.budget.state.ny.us.