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The Long-Term Fiscal Outlook for New York State

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The Long-Term Fiscal Outlook for New York State

Roy Bahl

New York State's economic decline as a part of the overall decline of the Northeast economy has by now been well documented.[1] Similarly, there has been much popular and academic attention paid to the pressing fiscal problems of the two largest governmental units of this region, New York State and New York City. The relationship between the declining economy and the declining fisc, however, has not been adequately studied, or if it has, public policy makers have not understood the linkage. Perhaps it is because the relationship between the economy and the fisc is so difficult to formulate and because the state and local governments have so little control over the performance of the state/local economy that policy analysts have turned in other directions to grapple with fiscal problems. Indeed, more attention seems to have been focused on the financial management issues which surrounded the New York City and State near financial disasters than on the fiscal implications of the economic problems.

Whatever the reasons for what is seen here as this misplaced emphasis, it gives some credence to the central concern of this research: the implications of regional economic decline for the state's fiscal outlook. The conclusions reached here are pessimistic. The economy is moving toward a new lower equilibrium where income and employment

I am indebted to Daniel Lynch for helpful comments and to Franciena King and Kathy Owen for much assistance. This chapter is preliminary in that it is an early output of a longer-term research project.

will be lower compared to the rest of the nation than they now are. The level of fiscal activity in New York State is only beginning to decline, but it also must find a new lower equilibrium. This can only mean that expenditures must eventually become much lower, compared to the nation, than they now are. The policy task lies in the area of making the transition period as short as possible and controlling the distribution of the burden of the decline.

The implications of a deteriorating economic base for a state which has a highly developed public sector are particularly serious because of the difficulties of downward expenditure adjustment. Public service levels in New York, while not adequate in every area, are supported by a high level of expenditure. Public employee compensation, debt service, and certain nonlabor costs (for example, energy-related costs) are not easily controllable, much less reversible; hence, in the face of economic decline it is not likely that large cutbacks in spending can easily be effected. To the extent much of the state's expenditure increase is due to rising compensation rates, the ability to slow down the rate of growth in spending is limited, particularly in a period of inflation. On the other hand, revenues respond dramatically to a slowdown in the rate of economic growth; hence, the resources to finance rising expenditure requirements do not materialize. The result of all this is a required drastic cutback in level of public services and further increases in taxes which are already thought to be too high.

The objective in the following section of this chapter is to begin to develop this scenario more carefully and to use it to forecast the probable performance of the New York State public sector over the next decade. To do this, we briefly review the decline in the New York State economy relative to the nation and then examine changes in the state and local government sector in New York relative to the rest of the nation. In the third section we consider several factors which, in one way or another, are particular to New York and which are instrumental in evaluating the fiscal outlook for the state. These include the continued economic decline of the region, the special importance and problems associated with the New York City government, the heavily local-dominated government structure in New York State, the problems of controllability of state and local government expenditures, and the possible effects of higher taxation on industry location. In the fourth and fifth sections we turn to a more specific examination of the outlook for revenue and expenditures, and finally in the last section we discuss the long-term outlook and the implications of alternative public policies.

TRENDS IN NEW YORK STATE EMPLOYMENT, INCOME, AND PUBLIC FINANCES[2]

Though the purpose of this chapter is to examine the fiscal outlook for the state, the primary intent is to relate public-sector growth to the growth in economic activity. Hence, the nature of Northeast decline is described with comparisons between New York State and the nation in terms of both economic and fiscal activity.

Employment and Income Growth

After more than half a century of growing slightly faster than the national average, employment growth in New York State in the last 15 years has been significantly slower than in the rest of the United States. Between 1900 and 1960, New York State employment grew by 129.3 percent while employment in the United States grew by 120.7 percent. Between 1960 and 1970, however, New York State employment grew by only 8.7 percent compared to 16.4 percent in the United States as a whole. (It is worth noting that Census employment data [the source of these comparisons] are based on place of residence so they reflect the employment of New York State residents, not total employment in the state. Out-of-state residents who work in New York exceed New York residents who work in other states by a substantial margin, primarily because of New Jersey and Connecticut commuters to New York City. Therefore, Census data understate the number of jobs in the New York economy. Despite this, the *growth rate* of employment in New York State residents is a reasonable proxy for the relative health of the New York State economy. When employment of residents is rising, total employment in the state is also likely to be rising.)

Since 1970 the employment growth gap between New York State and the rest of the nation has continued and in fact the gap has widened as the New York State economy has virtually stopped growing. Between 1970 and 1974, national employment grew by 11.0 percent while New York State employment actually declined by 1.0 percent. Moreover, New York State employment grew more slowly or declined faster than U.S. employment in every year of the period. Even in 1974–75, when national employment fell by about 1.8 percent, employment in the Northeast region fell by 3.4 percent and in New York State by 3.9 percent.

To appreciate the significance of this slower growth in employment, it is helpful to look at the number of jobs that New York State would have if its employment had grown at the national rate, that is, at its employment potential. Between 1960 and 1965, the difference between New York State and the United States in employment growth rates meant a loss to the state of more than 400,000 potential jobs. Between 1965 and 1970 the state lost another 475,000 potential jobs because it grew at a slower rate than the rest of the nation. During the first four years of the current decade, when New York's economy became stagnant and the growth gap between New York and the nation widened, the state lost nearly a million potential jobs because it grew so slowly. Over the entire 14-year period from 1960 to 1974, if the state had increased its employment at the national rate, it would have had more than 1.8 million additional jobs by 1974.

A similar pattern may be observed if we examine income growth in New York State over the period since 1950. (The income measure comparable to the employment figures presented above would be income earned in New York State. Unfortunately, most income data are reported on the basis of where received [the location of the employee's residence], not where earned. Furthermore, the data that are available on a "where earned" basis include only the portion of payrolls subject to Social Security taxation. Since the ceiling income for these contributions has changed and since New York is likely to have a disproportionate share of high incomes which would not be reflected by these data, we have chosen to present income on a residential basis as the best available proxy for our purposes.) Income growth in New York State has lagged behind the national rate for the past 25 years and has remained at about three-fourths of the national rate since 1960. Thus, the share of total national income earned by New York State residents has fallen by two percentage points since 1950.

Part of this change is the result of a population growth rate which has been below the national average. After adjustment for the differential population growth rates, New York State's income still grew more slowly than that of the nation as a whole, but the gap was narrower. It is interesting to note that, despite its slower growth rate, per capita income in New York State was about 13 percent higher than the national average in 1974. (This higher level of New York State income may be slightly overstated. In 1974, transfer payments accounted for 13.2 percent of personal income in New York, as compared with 12.2 percent in the entire nation [including New York State]. The comparable figures in 1964 were 7.1 and 7.5, respectively.)

These income growth data reinforce the conclusions of the employment trends analysis above—that there has been a significant long-term slowdown of growth in the state's economy. As in the employment case above, we may translate this into a "growth gap." That is, we may calculate the loss in potential income which resulted from the slower growth of the state's economy. Had New York State's income grown at the national average rate since 1960, it would have been $49 million or 43 percent higher than it actually was in 1974. If we translate these data to

TABLE 3.1: New York State and the Nation: Selected Comparisons for 1963 and 1975

	New York as a Percent of the United States		
	1963	1975	Percent Change
Population	9.3	8.5	-8.6
Personal income	11.5	9.6	-16.5
Urban population	11.4[a]	10.4[b]	-8.7
Employment	11.0	8.7	-20.9
Per capita personal income	122.0	113.0	-7.3

[a]1960 data.
[b]1970 data.

Sources: U.S. Bureau of the Census, *Governmental Finances, 1963-1975* (Washington, D.C.: U.S. Government Printing Office), Table 26; U.S. Bureau of the Census, *Census of Population General Social and Economic Characteristics*, Final Report PC (1)-C1, U.S. Summary (Washington, D.C.: U.S. Government Printing Office, 1960 and 1970); U.S. Department of Labor, Bureau of Labor Statistics, *Employment and Earnings, States and Areas, 1939-74* (Washington, D.C.: U.S. Government Printing Office). Data for 1975 provided by the Bureau of Labor Statistics Regional Office, New York, N.Y.

per capita incomes, the growth gap between 1960 and 1974 costs $252 per capita or approximately $1,000 for a family of four by 1974.

This pattern of decline is summarized by the data in Table 3.1, which show that the New York State share of employment, population, and personal income have all declined significantly over the past decade, with the decline being especially pronounced since 1970. As in all the time trends studied here, the employment decline was the most severe.

An important aspect of state economic decline is the extent to which it has been dominated by decline in the New York City area. Only within the last three years has employment in the balance of New York State exceeded employment in New York City. New York City's contribution to the state's employment growth problem is significant not only because the city accounts for approximately half of the state's employment, but also because the pattern of employment growth in recent years has been so drastically different in New York City from that in the rest of New York State.

After growing relatively slowly during most of the 1960s, employment in New York City has declined dramatically in recent years. From a peak of just under 3.8 million in 1969, New York City employment had declined by 11.2 percent, to less than 3.4 million by June 1975. During the same period, employment in the nation as a whole rose by 8.3 percent.

TABLE 3.2: Employment Growth in New York City and the Rest of New York State, 1960–74

	New York City		Rest of State		State
Year	Employment	Percent Growth	Employment	Percent Growth	Employment
1960	3,538,400	–	2,643,500	–	6,181,900
1965	3,577,300	1.1	2,941,400	11.3	6,518,700
1970	3,744,800	4.7	3,410,000	15.9	7,154,800
1974	3,458,400	–7.6	3,626,400	6.3	7,084,800
1960–74	–	–2.3	–	37.2	–

Source: U.S. Department of Labor, Bureau of Labor Statistics, *Employment and Earnings, States and Areas: 1939–75* (Washington, D.C.: U.S. Government Printing Office, 1977).

TABLE 3.3: Employment Growth in New York City, Its Suburbs, and Combined Area, 1960–74

	New York Metropolitan Area*		New York City		Suburbs	
Year	Employment	Percent Growth	Employment	Percent Growth	Employment	Percent Growth
1960	4,253,900	–	3,538,400	–	715,500	–
1965	4,459,600	4.84	3,577,300	1.1	882,300	23.31
1970	4,836,800	8.46	3,744,800	4.7	1,092,000	23.77
1974	4,642,100	–4.03	3,458,400	–7.6	1,183,700	8.40
1960–74	–	9.13	–	–2.3	–	65.44

*Includes New York City and Nassau, Rockland, Suffolk, and Westchester counties.

Source: U.S. Department of Labor, Bureau of Labor Statistics, *Employment and Earnings, States and Areas: 1939–75* (Washington, D.C.: U.S. Government Printing Office, 1977).

The city's employment growth is much slower than the rest of the state and because the city accounts for roughly half of the state's total employment, aggregate state employment data are significantly affected. The difference in growth rates between New York City and the rest of the state is dramatic: a loss of 2.3 percent of employment in New York City compared to a gain of 27.2 percent in the rest of New York State.

Calculation of employment growth rates in New York City and the rest of the state for the years 1960 to 1972 allows comparisons with regional and national employment growth rates. During this 12-year period, New York City's employment grew by only 0.6 percent while the rest of the state experienced an increase in employment of 31.0 percent, nearly as large as the national average of 34.2 percent for this period and well above the 23.1 percent growth rate of the rest of the Northeast. Such a huge discrepancy in growth rates in different parts of the state reduces the state growth rate to a weighted average of two very different growth patterns. Such an average can be misleading since it does not reflect what

TABLE 3.4: Overall Responsiveness of Revenues to Economic Activity, 1963–75

	New York State			Rest of Nation		
	1963–70	1970–75	1963–75	1963–70	1970–75	1963–75
Percent increase in revenues from own sources	102.7	63.3	231.2	100.8	66.6	236.1
Annual average	12.8	10.5	17.7	12.6	11.1	18.1
Percent increase in personal income	53.1	37.0	109.9	62.8	56.8	155.2
Annual average	6.6	6.1	8.4	7.8	9.4	11.9
Percent increase in total employment	14.0	-5.0	8.2	26.4	11.6	41.1
Annual average	1.7	-.19	.6	3.3	1.9	3.1
Percent increase in manufacturing employment	-2.4	-20.0	-22.0	15.7	-4.0	11.0
Annual average	-.3	-3.3	-1.6	1.9	-.66	.8

Source: U.S. Bureau of the Census, *Governmental Finances, 1963, 1970, and 1975* (Washington, D.C.: U.S. Government Printing Office), Tables 17 and 26; U.S. Department of Labor, Bureau of Labor Statistics, *Employment and Earnings, States and Areas, 1939-74* (Washington, D.C.: U.S. Government Printing Office). Data for 1975 provided by Bureau of Labor Statistics Regional Office, New York, N.Y.

TABLE 3.5: Growth in State and Local Government Expenditures: New York and the Rest of the Nation, 1963–75

Year	New York State		Rest of the Nation		New York as a Percent of the Nation	
	Per Capita	Per Dollar of Personal Income	Per Capita	Per Dollar of Personal Income	Per Capita	Per Dollar of Personal Income
1963	$ 393.81	13.12	$ 308.59	12.94	124.39	101.19
1964	458.18	15.38	352.29	14.96	126.50	102.46
1965	479.84	15.31	377.16	15.26	124.07	100.29
1966	530.11	16.31	411.96	15.47	125.33	104.76
1967	614.62	17.70	459.54	15.96	129.69	109.57
1968	703.89	18.50	493.33	16.12	137.37	112.91
1969	816.23	19.93	554.32	16.72	141.20	116.71
1970	919.35	20.61	626.04	17.28	140.87	116.81
1971	1,075.50	22.71	700.48	18.39	146.51	120.40
1972	1,238.72	24.80	762.08	18.94	154.02	126.71
1973	1,319.41	25.03	819.41	18.71	152.90	129.29
1974	1,448.20	25.17	891.92	18.08	154.13	134.06
1975	1,611.14	25.49	1,027.07	19.31	149.63	127.91

Source: U.S. Bureau of the Census, *Governmental Finances, 1963–1975* (Washington, D.C.: U.S. Government Printing Office) Series GF/No. 5, Tables 17 and 18. Table 17 in 1963/64.

is really happening in either part of the state. It should be noted, however, that part of the employment in the rest of the state is occurring in the suburbs of New York City. Much of this employment growth is dependent on its proximity to the city and would not have taken place if the city was not nearby. In other words, the city's existence contributes to the growth of the rest of the state regardless of the growth rate of the city itself. While it is difficult to gather data which accurately reflect this pattern, the importance of New York City's suburban employment growth to the overall growth in the state can be roughly illustrated. From Tables 3.2 and 3.3 it may be seen that over the same period the growth in employment in New York City's suburbs was 91,700, more than 42 percent of the total growth in the rest of the state. Hence, while New York City itself has been growing at a much slower rate than the balance of the state, its contribution to overall state economic growth is considerably greater.

Fiscal Activity

On the other hand, the fiscal activity of the state has not been curtailed to the same extent by this decline in economic activity. As may be seen in Table 3.4, between 1963 and 1975 when state income increased at only 71 percent of that in the rest of the nation and employment at only 19 percent, revenues were continuing to rise at about the national rate. Indeed, during the 1970–75 period, for each 1 percent increase in personal income there was a 1.72 percent increase in revenues raised from own sources in New York State. The comparable figure in the rest of the nation was 1.18 percent. For the preceding 1963–70 period, these rough income elasticities were 1.94 in New York State and 1.61 in the rest of the nation (see Table 3.4). This pattern is more pronounced for per capita expenditures. As may be seen from Table 3.5, per capita spending rose from 24 percent above that in the nation in 1963 to 54 percent above in 1974. Over the same period, personal income increased by only 71 percent of the national average and employment by only 19 percent of the national average.

To compare these changes in real terms it is necessary to deflate each series by the approximate index of purchasing power increase. Unfortunately, there is no index appropriate to both New York and the nation. To approximate the differential effects of inflation on New York State and local government finances, an index has been constructed. If the ratio of the GNP deflator for state and local government purchases to the national Consumer Price Index (CPI) is assumed to hold in New York State, and if the New York City CPI is taken as a proxy for the whole of the state, then the trend in the state and national government purchases deflator would be as follows:

Year	Nation	New York	New York as a Percent of Nation
1963	.850	.845	99.4
1964	.875	.873	99.8
1965	.900	.897	99.7
1966	.946	.948	100.2
1967	1.000	1.000	100.0
1968	1.060	1.061	100.1
1969	1.126	1.135	100.8
1970	1.206	1.232	102.2
1971	1.277	1.324	103.2
1972	1.346	1.411	104.8
1973	1.430	1.500	104.9
1974	1.576	1.650	104.7
1975	1.747	1.900	108.8

These results suggest that inflation had a relatively greater effect on New York State expenditures, and also rose relatively faster than consumer prices in New York State. The estimation of an index for New York State requires more detailed data than are given here, hence we do not make heavy use of this series to deflate New York State expenditures in the balance of this chapter. Where it is used, cautious interpretation is necessary.[3] In any case, the meaning of these results is clear. Through a series of discretionary adjustments, governments in New York State have more or less maintained their share of national fiscal activity, even though their resource base has dwindled markedly. The growth in total revenues relative to the rest of the nation during this period was due to some combination of aggressive discretionary actions by state and local governments and an income-elastic tax system which has captured more than the inflation-induced increases in income. To the extent the former is the case, it suggests that revenue levels are primarily determined by expenditure demand. This in turn suggests that expenditure growth is not easily controlled and has not responded to the slowdown in economic growth.

FACTORS AFFECTING THE OUTLOOK

The already difficult task of making a fiscal prognosis for New York state and local governments is further complicated by a number of important considerations which are more specific to New York than to most other state and local governments in the United States: the probable continued decline in the state economy; the special economic and fiscal problems of New York City; the important financing role played by local governments in the state; the existing deficiencies in public services in the large cities and the low element of controllability in state/local government expenditures; the possibility that increased taxes will have harmful effects on industry location decisions; and the fact that the present financial condition of the state and many of its largest local units is already precarious.

These considerations are crucial in the formulation of any model to project the long-term behavior of the state-local sector. In particular, they explain why a prognosis for New York State differs markedly from the rather optimistic results obtained from aggregate state-local sector projections, made by the Tax Foundation and the American Enterprise Institute.[4] In the paragraphs below, we briefly review these factors.

Continued Economic Decline

There is every indication that the economic decline in the state will continue. At least one forecast is that the state's manufacturing employment will stabilize at a level below that reached in 1971.[5] Most analysts, however, are hesitant to predict how far down the state's economy will finally slide. There is the possibility that the decline will steepen during the next five years. If the national economy grows at an overall slower rate as some predict, and if New York continues to attract a smaller share of that growth, even greater job losses could be realized in the next few years. Even if national economic growth is higher, it is not implausible to expect that with the comparative disadvantages of the state, little if any employment growth will occur. On the other hand, the State Budget Division in its five-year projections assumes a 1 percent annual increase in nonagricultural employment.[6] This much "recovery" seems overoptimistic.

In the face of continued decline it is difficult to forecast real increases in the bases of major state and local government taxes. Already, however, there is evidence that tax-base growth is slowing in response to the slower rate of economic growth. This past fiscal year (1975/76) was the first in which New York State fiscal activity fell relative to other state and local governments in the nation. The important implication of this expected continuing decline is that a shrinking resource base will severely constrain the rate of increase in state and local government spending.

The Special Case of New York City

The fiscal outlook for the state cannot be examined apart from that for New York City. The city in many ways dominates the fiscal activities in the state and has done so for years. However, the pattern of this

TABLE 3.6: New York City and New York State Selected Economic and Fiscal Comparisons, 1965 and 1974

	New York City		New York State (all local governments)		New York City as a Percent of New York State	
	1965	1974	1965	1974	1965	1974
Per capita income	4,895.5[c]	6,209.0[d]	3,134.1	5,753.2	156.2	107.9
Employment[a]	3,577.3	3,458.4	6,518.7	7,084.8	54.9	48.8
Population	7,840,000	7,895,563	18,075,000	18,111,000	43.4	43.6
Expenditures[b]	2,798.1	9,678.2	5,570.0	17,397.5	50.2	55.6
Revenues raised from own sources[b]	2,495.0	5,104.0	4,710.9	11,098.1	53.0	46.0
Per capita expenditures[b]	356.9	1,225.7	300.7	960.6	118.7	127.6
Per capita revenues raised from own sources[b]	318.0	646.0	260.6	612.8	122.0	105.4

[a]In thousands.
[b]In millions of dollars.
[c]New York, New York-New Jersey SMSA data.
[d]1973 New York, New York-New Jersey SMSA data.

Sources: New York State Department of Audit and Control, Division of Municipal Affairs, Special Report on Municipal Affairs, 1965, 1974 (Washington, D.C.: U.S. Government Printing Office), Table 1; U.S. Bureau of the Census, *Governmental Finances, 1965, 1974* (Washington, D.C.: U.S. Government Printing Office) Tables 17 and 26; U.S. Department of Labor, Bureau of Labor Statistics, *Employment and Earnings, States and Areas, 1939-1974* (Washington, D.C.: U.S. Government Printing Office); U.S. Department of Commerce, Social and Economics Statistics Administration, *Survey of Current Business*, May 1974 and April 1975; *Annual Report of the Comptroller of the City of New York* for the Fiscal Years 1964/65, 1973/74, Part 2A, Statement 5.

relationship has changed over the past decade. Per capita spending in New York City has risen from 18.7 percent higher than other local governments in the state to 27.6 percent higher (see Table 3.6). More important, the New York City share of total local government spending in the state has risen to about 55 percent while its population share has remained constant at about 43 percent. On the other hand, city revenues are only about 45 percent of the state total for all local governments.

An assessment of the outlook must recognize the need to finance what surely will be continuing shortfalls facing the city. The drastic decline in the city economy has substantially eroded the tax base[7] but expenditures, though cut back recently, will become increasingly rigid downward. The latter results from a number of considerations, including the large amounts of "fixed" obligations: debt, pensions, and public assistance are notable among these.

The solutions to New York City's financial problems lie beyond the ability of that city's resource base. Some form of transfer—from Albany, Washington, or New York City suburbs—will be required.

The Role of Local Government in New York State

The expected growth in New York state and local government expenditures is complicated by the important financing role played by local governments in the state. New York is a relatively local-government-dominated state by comparison with the rest of the nation. The 75.6 percent of direct expenditures by New York State local governments in 1975 was well above the median of 62.3 percent among the 50 states. In terms of revenues, the 53.2 percent raised locally was also above the 46.5 percent U.S. median.[8]

The significance of local domination is that the state does not tax all of its resources evenly. Certainly that portion of services which is financed through property tax levies places more onerous burdens on the core cities than on the suburbs, even though the latter are areas where relatively more employment and income growth has taken place.

While overall economic growth in the state is low, that portion of it which is taxed most heavily is in the central cities where growth is the slowest. This differentiates New York from many other states on two counts: the local governments' fiscal importance *and* the stark city/suburb disparities.

Expenditure Control

There may be some differences betwen New York and other states in terms of the extent to which expenditures are controllable. Debt levels and obligations are higher in New York relative to revenue availability than in most other states. Pension obligations also are high and represent an irreversible commitment.[9] There are as well a set of commitments to provide health and subsistence benefits to the poor and the disadvantaged which are likewise fixed.

There are other considerations which suggest less controllability in New York than elsewhere. One is the possibility that the increase in consumer prices is different in New York from the rest of the nation. (See Note 3.) If this difference does exist, the implication is for more/less pressure for increased public-sector compensation.

Finally, there are the special problems that are related to provision of substandard services to the poor in central cities. These services are beyond the scope of the public sector in many states and yet must be upgraded in New York.

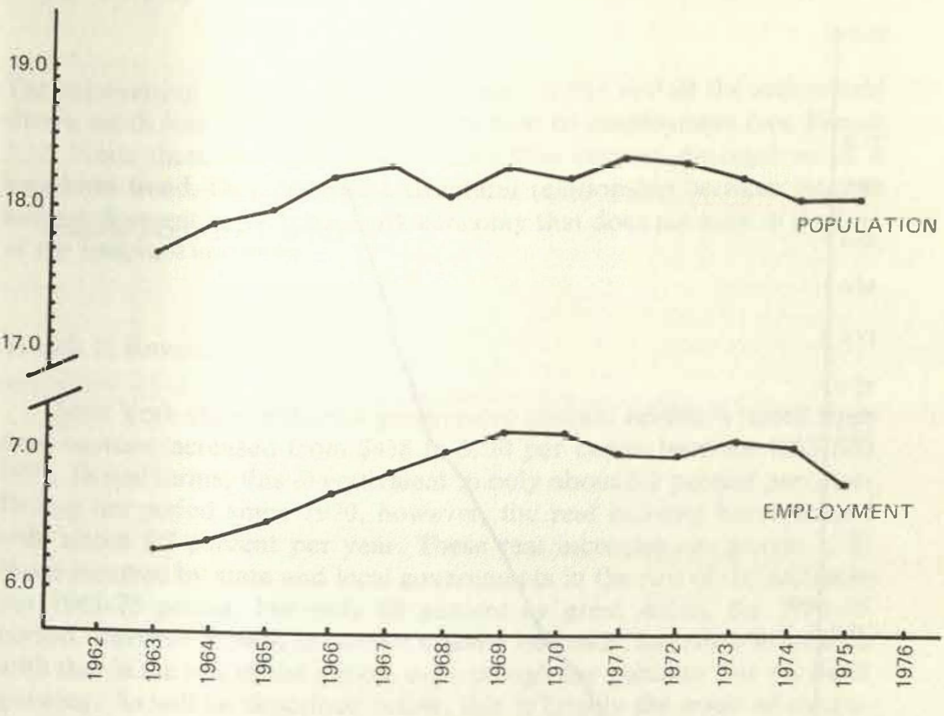
Taxation and Industrial Location

Reports dealing with the decline of the New York State economy never fail to mention high taxes as a cause. Studies of industrial location decision factors almost never show taxes as a primary consideration. Very often, the level of public services is considered more important. It is clear that taxes are relatively high in New York State, and that direct personal taxes are among the highest in the nation. To the extent this is an important determinant of location, it does make New York State different from the rest of the nation.

REVENUE PROSPECTS

To measure properly the relationship between economic and fiscal activity in New York State, it is necessary to relate conceptually the growth in New York state and local government revenues to the growth in state employment and income. Income on one hand is probably the best single measure of capacity to pay taxes, yet changes in the rate of personal income growth may not markedly affect the growth in some tax bases, for example, property taxes or corporate income taxes. The relationship between tax revenue growth and employment growth is an even more difficult one to establish, yet employment is the most commonly used measure of the health of a state's economy and it is the one for which data are most easily and frequently available. Probably the best approach is to link conceptually income, employment, and tax bases—for example consumption and property values—and then determine the sensitivities of each base to changes in the overall level of employment and income. Such

FIGURE 3.1: Growth in Employment and Population, New York State, 1963–76



Source: Compiled by the author.

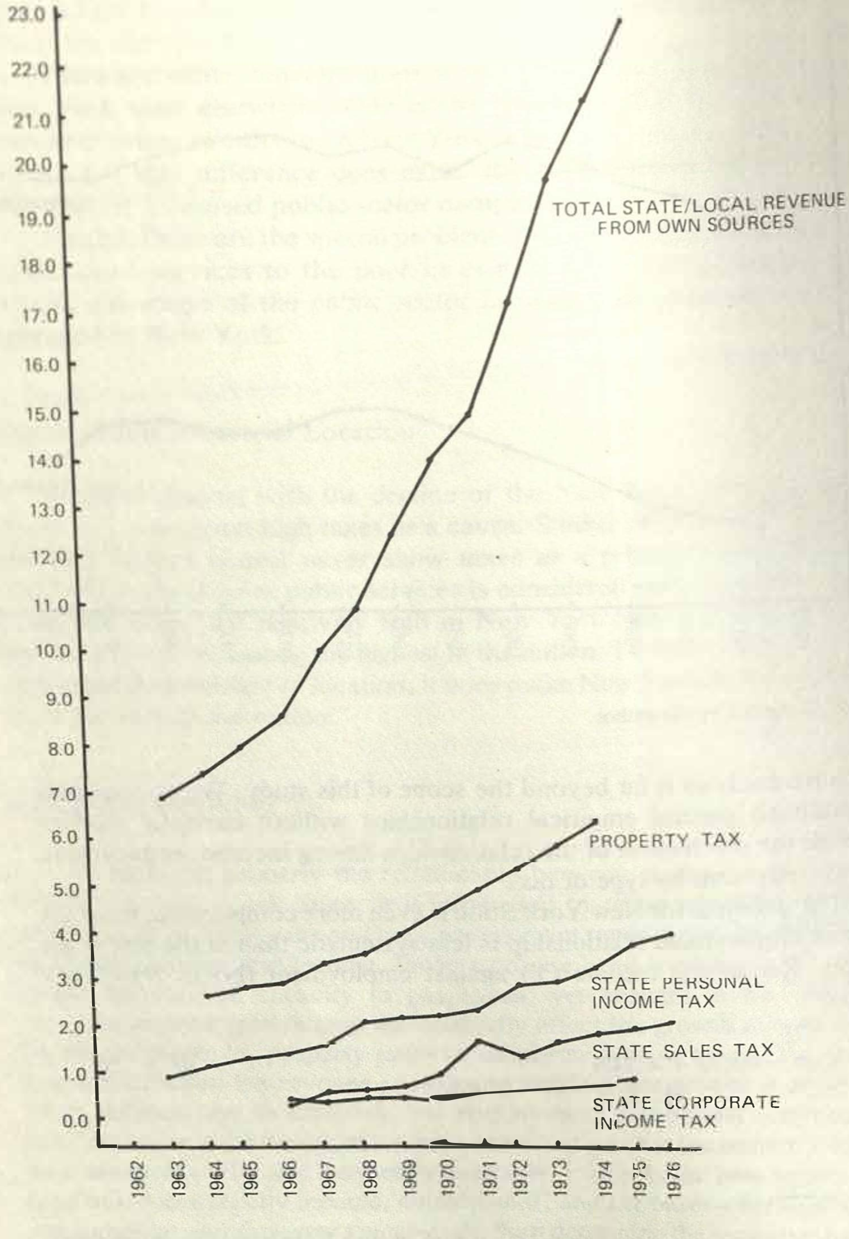
a precise analysis is far beyond the scope of this study. We attempt only to establish general empirical relationships without carefully working through the mechanism of the relationships among income, employment, and tax payment by type of tax.[10]

The problem for New York State is even more complicated, since the income-employment relationship is less systematic than in the rest of the nation. Regressing income (Y) against employment (N) in New York yields*

$$Y = -40.33 + \underset{(13.3)}{4.14N} \qquad \bar{R}^2 = .50$$

*All variables are in logarithms, the period covered is 1963–75, and the figure in parentheses is a t-value.

FIGURE 3.2: Growth in Major Taxes, New York State and Local Governments, 1963-76 (billions of dollars)



Source: Compiled by the author.

For the nation, the same equation fits

$$Y = -23.0 + 2.80N \qquad \bar{R}^2 = .94$$
$$(13.43)$$

The relationship is much more systematic in the rest of the nation and shows much less responsiveness of income to employment (see Figure 3.1). While these statistics are no more than cursory descriptions of a long-term trend, they suggest a structural relationship between income and employment in the New York economy that does not exist in the rest of the nation.

Trends in Revenues

New York state and local government current revenues raised from own sources increased from $438 to $720 per capita betwcen 1963 and 1975. In real terms, this is equivalent to only about 5.2 percent per year. During the period since 1970, however, the real increase has averaged only about 1.7 percent per year. These real increases are greater than those incurred by state and local governments in the rest of the nation in the 1963–75 period, but only 80 percent as great during the 1970–75 period. Revenue growth in current dollars, however, has about kept pace with that in the rest of the nation, even though the economy has not been growing. As will be described below, this is largely the result of discretionary fiscal actions.

The structure of revenues raised from own sources in New York State has changed during the period since 1973 toward a relatively more diversified system. Particularly in the 1970–75 period, the reliance on income-based taxes has declined in favor of the sales tax (see Figure 3.2). In the rest of the nation, reliance on income taxation has increased over the 1970–75 period, largely at the cost of a reduction in property tax revenues (see Table 3.7).

Revenue Potential

The decline in the New York economy since 1970 has clearly slowed the growth in revenues. To roughly gauge this loss in revenue, we have defined two measures of "revenue potential." Both relate revenue yield to income that would have resulted if the New York State share of national income had remained constant since 1969. The first shows the revenue that would have resulted at the constant share of income and the 1969 level of revenue effort, that is, 16.6 percent of total income (see

TABLE 3.7: Percent Distribution of State and Local Government Revenues, 1963, 1970, and 1975

	New York State			Rest of the Nation		
	1963	1970	1975	1963	1970	1975
Total taxes	83.8	84.9	81.1	81.9	78.9	77.6
Personal income	14.7	19.3	17.7	4.8	9.6	11.8
Corporate income	9.0	6.5	5.5	1.8	2.6	3.6
Sales	5.3	13.3	15.1	13.2	16.8	16.1
Property	38.8	30.8	29.1	36.7	35.3	28.3
Other taxes	16.7	15.0	12.9	25.4	14.6	17.9
Nontax general revenue	16.1	15.0	18.8	18.1	22.8	22.3
Total revenue from own sources	100.0	100.0	100.0	100.0	100.0	100.0

Sources: U.S. Bureau of the Census, *Governmental Finances, 1963, 1970, 1975* (Washington, D.C.: U.S. Government Printing Office), Table 17; U.S. Bureau of the Census, *State Tax Collections, 1963, 1970, 1975* (Washington, D.C.: U.S. Government Office), Table 10; *Annual Report of the Comptroller of the City of New York, 1963, 1970, 1975*, Part 2E, General Fund–Statement 4; State of New York, State Comptroller, *Special Report on Municipal Affairs, 1971*.

TABLE 3.8: New York State and Local Government Revenue Potential, 1970–75 (billions of dollars)

	1970	1971	1972	1973	1974	1975
Revenue Potential at Constant Revenue Effort[a] (1)	13.581	14.574	15.554	17.062	19.296	21.008
Revenue Loss Implied (2)	0.426	0.514	1.663	2.546	1.902	1.877
Revenue Potential at Actual Revenue Effort[b] (3)	14.064	15.190	17.565	20.910	23.628	25.257
Revenue Loss Implied (4)	-0.057	-0.102	-0.347	-1.302	-2.425	-2.372
Revenue from Own Sources as a Percent of Income (5)	17.2	17.3	18.7	20.3	20.3	19.9

[a] 16.6 percent of income, 1969 revenue effort; New York State share of national income at 1969 proportion.

[b] New York State income at 1969 share of national income, revenue effort at actual annual percent of income.

Source: Compiled by the author.

column 1 of Table 3.8). The positive signs in column 2 mean that actual collections were greater than potential collections as shown in column 1. This results because revenues increased (automatically or from discretionary actions) as a share of income (see column 5) by an amount adequate to offset the decline in the base.

A second possible measure of revenue potential is the amount that would have been generated by the actual level of effort at the potential income. These results, shown in columns 3 and 4, show that over $2 billion, or about 10 percent, of 1975 revenues raised from own sources was the revenue "cost" of slow growth.

However crude, these estimates do suggest the importance of the poor performance of the economy for the fisc.

Income Taxation

The personal and business income taxes in New York together yielded $5.2 billion or 29 percent of total tax revenue collections in 1975. Revenues from these sources, however, grew erratically because of a series of discretionary changes and because of the performance of the state economy.

Personal Income Taxation

As may be seen from Table 3.9, personal income tax revenues tripled over the 1963–75 period. Wasylenko has carefully analyzed the income elasticity of the New York State personal income tax from 1959 through 1971.[11] After "cleaning" the revenue yield series of discretionary changes, he estimated an elasticity coefficient of 1.2. His estimates also show that the elasticity was relatively more influenced by effective rate than base increases—a benefit of the progressive rate structure.

In the more recent period during which the economy has declined, personal income tax revenues have risen largely because of discretionary changes but also because of the combined effects of inflation and a progressive rate structure.[12] There have been important discretionary adjustments in the tax since 1971. In 1972 the standard deduction was increased to 14 percent or a maximum of $2,000 and a minimum standard deduction was introduced. Also in 1972 the percent of taxable capital-gain income was raised from 50 to 60, and a new high-rate bracket (above $25,000) with a 15 percent marginal rate was added. Finally, a 2.5 percent surtax has been effective since 1972 (though suspended for 1973). The standard deduction was increased to 15 percent in 1973 and the life insurance premium deduction was dropped.

TABLE 3.9: Personal Income Tax Revenue Growth for New York State Government, 1963–76

Year	Revenue*	Taxable Income*	Personal Income*	Revenue as a Percent of Taxable Income	Taxable Income as a Percent of Personal Income
1976	4,012,808	–	–	–	–
1975	3,753,584	–	–	–	–
1974	3,346,670	58,324,812	83,326,317	5.7	70.0
1973	3,064,368	54,361,926	78,423,367	5.6	69.3
1972	2,882,596	50,169,041	73,473,058	5.7	68.2
1971	2,405,486	47,029,268	68,699,643	5.1	68.4
1970	2,244,922	45,189,413	65,304,304	4.9	69.1
1969	2,186,445	43,694,725	62,978,046	5.0	69.3
1968	2,091,485	41,183,534	59,273,282	5.0	69.4
1967	1,649,619	37,038,022	53,952,339	4.4	68.6
1966	1,391,696	32,716,411	48,753,611	4.2	67.1
1965	1,253,447	29,948,091	45,150,657	4.1	66.3
1964	1,092,275	27,197,613	41,760,179	4.0	65.1
1963	942,251	24,386,642	38,086,710	3.8	64.0

*In thousands of dollars.

Sources: New York State Department of Taxation and Finance, Bureau of Tax Statistics, *Analysis of 1963 (1964–1974) New York State Personal Income Tax Returns*; New York State Department of Taxation and Finance, Bureau of Tax Research and Statistics, *Statistical Supplement to the Annual Report of the New York State Tax Commission for the Fiscal Year, 1975–1976.*

TABLE 3.10: Estimated Revenue Increases Due to Discretionary Changes in the Personal Income Tax Structure, 1971–76

Year	Estimated Level (1)	Actual (2)	Discretionary Effects (3)
1971	2,381,623	2,405,486	+23,863
1972	2,601,241	2,882,591	+281,355
1973	3,110,063	3,064,368	–45,695
1974	3,288,710	3,346,670	+57,960
1975*	3,571,566	3,753,584	+182,018
1976	4,145,458	4,012,808	+132,650

*Estimated using the 1964/75 income growth rate.
Source: Compiled by the author.

A detailed study of discretionary versus automatic increases is beyond the scope of this preliminary study, but a rough estimate of the revenue effects of discretionary changes might be made from the Wasylenko analysis. If his income elasticity of 1.2 is assumed correct, estimated revenues are shown in column 1 of Table 3.10. (We calculate these estimates assuming a 1.2 percent elasticity *over each year's actual collections*.) The revenue effects of discretionary changes are shown in column 3. These rough estimates suggest that relatively little of the recent increase in state personal income tax revenues has been due to discretionary adjustments. Yet the surtax alone should have produced a substantial increase. This implies that the 1.2 elasticity coefficient may be relatively low for automatic increases.* In any case, these results would seem to imply a slow growth in personal income tax revenues. As income growth further slows, the role of the personal income tax in increasing revenues will diminish further. There was evidence of this in 1976 when the rate of increase was only half that in the preceding year.

Business Income Taxation

Business income tax revenues have continued to increase, even with employment decline. As may be seen from the data in Table 3.11, this is partly due to increases in the taxable income base, though increased tax rates in 1972 and 1975 had important revenue effects. Between 1970 and 1974, the yield of the tax, or even the base, did not respond significantly

*An income elasticity of 1.2 is low by comparison with other states.

TABLE 3.11: Corporate and Unincorporated Business Net Income and State Income Tax Payments, 1967-76 (in thousands of dollars)

	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
Business income tax, total	631,875	609,669	858,593	962,912	870,620	1,146,891	1,283,016	1,299,736	1,456,303	1,698,996
Corporation income tax	357,131	357,131	465,827	529,321	433,787	601,357	693,948	706,174	763,269	877,190
Business net income	33,554,132	31,258,850	33,805,781	33,701,988	29,256,370	34,069,685	40,012,597	44,965,656	–	–
Corporate	31,819,836	29,275,342	32,084,129	32,076,070	27,521,805	32,382,828	38,369,742	45,360,666	–	–
Unincorporated	1,734,296	1,983,458	1,721,652	1,652,918	1,734,565	1,686,060	1,642,855	1,604,990	–	–
Number of businesses	220,227	220,285	177,691	178,245	194,569	205,138	213,527	209,975	–	–
Corporate	162,459	151,126	110,444	113,055	129,947	138,387	141,672	143,445	–	–
Unincorporated	57,768	69,159	67,247	65,190	64,622	66,751	71,855	66,530	–	–

Source: New York State Department of Taxation and Finance, Bureau of Tax Research and Statistics, *Statistical Supplements to the Annual Report of the New York State Tax Commission for the Fiscal Years, 1966-1976.*

TABLE 3.12: Distribution of Corporation Income Tax Payments by Sector, 1965-74 (in dollars)

	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974
Total	263,404,757	308,369,641	314,652,405	339,986,976	441,921,474	437,859,951	434,179,610	585,907,971	647,218,328	684,905,326
Manufacturing	140,112,112	165,392,371	167,176,894	166,505,493	230,191,810	214,601,852	187,644,826	265,115,749	299,100,031	331,100,583
Trade	50,494,464	59,622,163	60,931,392	70,189,462	84,474,917	92,468,395	97,847,760	128,674,924	138,832,324	164,391,022
Finance, insurance, and real estate	35,648,421	40,010,635	42,186,121	53,177,141	66,887,736	61,858,478	72,260,405	96,915,527	97,723,967	80,485,080
Services	18,810,767	21,621,033	23,327,571	27,614,980	33,186,835	36,930,502	40,924,910	49,542,361	49,866,595	52,674,092

Source: New York State Department of Taxation and Finance, Bureau of Tax Research and Statistics, *Statistical Supplement to the Annual Report of the New York State Tax Commission for the Fiscal Year 1966-67, 1967-68, 1968-69, 1969-70, 1970-71, 1971-72, 1972-73, 1973-74, 1974-75, 1975-76.*

TABLE 3.13: State Government Sales Tax Revenue Growth, 1963-76

Year	Revenue[a]	Taxable Retail Sales[a]	Taxable Retail Sales Per Dollar of Personal Income
1963	–	–	–
1964	–	–	–
1965	–	–	–
1966[b]	298,437	25,724,000[e]	52.7
1967[b]	604,327	30,215,000	55.8
1968[b]	630,912	31,545,000	53.2
1969[b]	698,759	34,940,000	55.4
1970[c]	1,012,036	33,733,000	51.6
1971[c]	1,715,898	39,197,000	57.0
1972[d]	1,532,795	40,021,000[f]	54.4
1973[d]	1,734,093	43,350,000	55.2
1974[d]	1,863,241	46,575,000	55.8
1975[d]	2,000,854	50,025,000	48.0
1976	2,148,945	53,723,625	48.1

[a]In thousands of dollars.
[b]New tax effective August 1965, rate of 2 percent, seven months collection for first fiscal year, 1966.
[c]Rate increased to 3 percent effective April 1, 1969.
[d]Rate increased to 4 percent effective June 1, 1971; base extended to receipts from sales of prepared food and drink of less than $1.00.
[e]Modified to reflect full year's sales.
[f]Modified by using 3.83 percent as average annual rate.
Sources: New York State Division of the Budget, *New York State Statistical Yearbook, 1966-1974*; U.S. Bureau of the Census, *State Government Finances, 1975* (Washington, D.C.: U.S. Government Printing Office), Table 7; New York State Department of Taxation and Finance, Bureau of Tax Research and Statistics, *Statistical Supplement to the Annual Report of the New York State Tax Commission for the Fiscal Year, 1975-1976.*

to the declining level of economic activity. Still, even with discretionary changes the percentage increase in tax revenue was about the same as the percentage increase in business income.

There have been important structural changes in the pattern of revenue yield since 1970 (see Table 3A.1). The average employee size of a taxpaying firm fell from 40 to 33 in 1974—a decline of nearly 20 percent. Over the same period, net income per taxpaying firm increased by only 13 percent, in current dollars. In terms of burden, the "average" firm paid about the same 2.8 percent of net income in business taxes in 1974 as in 1970.*

*This computation, of course, ignores the alternative tax bases which might be used.

TABLE 3.14: Local Government Finances in New York State, 1964–74

	1964	1965	1966	1967
Per capita full value of real property				
Total: all local units	4975	5137	5379	5593
New York City	4671	5178	5431	5515
New York City as a percent of total	93.88	100.79	100.96	98.60
Per capita revenues raised own sources				
Total: all local units	241	260	264	303
New York City	281	318	310	355
New York City as a percent of total	116.59	122.30	117.42	117.16
Per capita real property tax revenues				
Total: all local units	150	160	167	187
New York City	159	172	178	195
New York City as a percent of total	106.00	107.50	106.64	104.27
Effective property tax rate (percent)				
Total: all local units	3.01	3.11	3.10	3.34
New York City	3.40	3.32	3.27	3.53
New York City as a percent of total	112.95	106.75	105.48	105.68

If tax payments are related to employment, it may be seen that per employee business income tax payments rose by 36 percent between 1970 and 1974, and by 17 percent between 1974 and 1975.

This kind of change is significant in that it suggests that declining net business income may lie ahead. If the lack of employment growth is due to a combination of firms not expanding and others leaving the state, the taxable business income generated by the firms that remain will eventually show this pattern, unless employment decline simply signals productivity increases and/or capital-labor substitution. The same should hold for the alternative bases for computing tax.

When the corporate share of business income taxes is examined separately, a similar picture of revenue growth emerges with the manufacturing and trade sectors dominating both collections and the rate of increase in collections through 1974 (see Table 3.12). It is significant that these are two sectors of the state economy which have undergone significant decline.

Sales Taxes

State sales tax revenues increased in 1969 and 1970 because of discretionary increases in the rate, hence there is no pre-1970 period from which

1968	1969	1970	1971	1972	1973	1974
7504	6216	6605	7224	7747	8708	9452
5586	6557	7163	7758	8191	9452	10010
97.93	105.48	108.44	107.39	105.73	108.54	105.90
327	368	407	449	517	557	602
368	404	445	484	572	608	646
112.53	109.78	109.33	107.79	110.63	109.15	107.30
200	216	244	270	298	322	349
201	213	242	265	280	313	337
100.50	98.61	99.18	98.14	93.95	97.20	96.56
3.50	3.47	3.69	3.73	3.84	3.69	3.69
3.59	3.24	3.37	3.41	3.41	3.31	3.36
102.57	93.37	91.32	91.42	88.80	89.70	91.05

Source: State of New York, *Special Report on Municipal Affairs by the State Comptroller*, for local fiscal years ending in 1974.

a "normal growth" might be estimated. However, from 1970 to 1974, taxable retail sales have grown at more than 7 percent or slightly faster than personal income. The revenue increase has been relatively stable (see Table 3.13). However, in the current fiscal year (1976/77), there is a considerable slacking in revenues from all forms of sales and excise taxes, reflecting a lower growth in consumption.

Property Taxes

The rate of growth in per capita property tax revenues between 1970 and 1974 was more rapid than that in personal income or in any state tax. And as may be seen from Table 3.14, this increase was due to the increase in the full value of property. The implication is an income-elastic property tax base, though these increases are in large part due to discretionary actions. Still, on a statewide basis, the effective property tax rate was about the same in 1974 as it was in 1970.

New York City clearly dominates local government financing in the state. However, this pattern shows a substantial change over the decade under study here. On a per capita basis, New York City raises about 3.5

percent less in property taxes than the average of the rest of the state but has a per capita full value about 6 percent higher than the rest of the state. However, while the effective property tax rate is lower in the city, all locally raised revenues per capita are about 7 percent higher.

EXPENDITURE GROWTH

State and local government current spending in New York increased by about $19 billion (362 percent) between 1963 and 1975. Of this, $6.2 billion was for education, $3.7 billion for welfare, and $2.5 billion for health and hospitals, that is, 65 percent of the increase was attributable to the social services. By comparison, expenditures in the rest of the nation grew by 321 percent, of which 66 percent was attributable to health, education, and welfare. These comparative growth rates are examined on an average annual basis as shown in Table 3.15. The results, on average, suggest a 1.94 percent increase in current expenditures for every 1 percent increase in personal income in New York State. The comparable elasticity for the rest of the country—where income grew 20 percent faster—was 1.48.*

Various explanations may be offered for this pattern of expenditure increase. On the one hand, since the increase is largely in the social services it may be argued that expenditure increase is a response to a set of demand considerations, for example an increase in the number of school-aged children, Aid to Families with Dependent Children (AFDC) recipients, and the poor in general. A second explanation relates to increases in the cost of providing public services. In this case, it might be argued that expenditures were rising relatively rapidly because of a combination of inflation and the effects of unionization on public employee wage rates which jointly have driven up the cost of providing any given level of services. Third, one might argue that expenditures have risen very rapidly because of low productivity in the public sector, financial mismanagement, and in general a costly bureaucracy which has expanded too much in the past few years.

The best explanation of the expenditure increase is likely some combination of these three, but some weighting of their relative importance in causing expenditures to rise is essential if one is to formulate a proper policy response to finance New York state and local govern-

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*These estimates are in current dollars. If income were deflated by the CPI for the nation and New York City, respectively, and if expenditures were deflated by the index presented in the table on p. 78, the expenditure-income elasticities would be 3.58 for New York and 2.078 for the nation.

TABLE 3.15: Growth Rate in Expenditures, State and Local Government

New York	Average Annual Percent Increase*
Total expenditures	0.12338
Total current expenditures	0.12993
Total personal income	0.06691
Rest of the Nation	
Total expenditures	0.10903
Total current expenditures	0.11962
Total personal income	0.08091

*Estimated from: $\ln E = \alpha + \beta t$,
where E = expenditures
t = time dummy

Source: U.S. Bureau of the Census, *Governmental Finances, 1963-1975* (Washington, D.C.: U.S. Government Printing Office), Series GF/No. 5, Tables 17 and 18.

ment operations. In general, if the demand explanation is correct there is some relief ahead for the state in the form of projected declines in school-aged children and welfare recipients. If the financial management issues are important, there is the implication that expenditures might somehow be controlled and therefore curbed. If the cost explanation is correct, the outlook is rising expenditures and little tax relief.

Demand Considerations

Consider first the possibility that New York state and local government expenditures have been primarily responses to the demand for increased levels of public service. Demand influences on expenditure levels are difficult to estimate since no good proxies for either public output or service demand are available. A cursory examination of the relationship between general indicators of demand and spending does not suggest a good fit. Between 1963 and 1975, population grew by less than 3 percent in total but expenditures increased in real terms by 86 percent and in current dollars by over 300 percent (see Table 3A.3).* Since 1970, while

*Expenditure data presented in real terms always implies the use of the deflator described above.

state population declined, per capita spending rose by 75 percent, as compared with an increase of 47 percent in the (New York City) consumer price index and 55 percent in the estimated index of state and local government prices.

In the case of education, a similar pattern emerges. Declines in enrollments since 1972 have been offset by increasing costs so that total expenditures have increased by 9.5 percent. Welfare expenditures have risen by 46 percent since 1971 though the number of recipients has fallen by about 50,000 or about 4 percent.

An alternative approach would assume that as the overall makeup of a population changes, so too will the demands it makes on the public sector. In a sense, this argues that as a community's characteristics change, its citizens jointly reveal a preference for a different level and composition of public services.[13]

In the New York case, we attempt only to relate current expenditures to income level and to the number of people served. To determine whether these results are somehow unique to New York, we have run the same regressions for all state and local governments in the country.

The results show a responsiveness of every class of expenditure to per capita income, but the responsiveness is generally higher in New York than the nation. The income elasticity of per capita current expenditures in the rest of the nation was 1.47 while New York was 1.84 over the 1963–75 period (estimated by linear least squares, with all data in current dollars).

Supply Considerations

Expenditure increases in the state may be better explained by cost increments. This hypothesis might be explored by studying trends in the composition of state expenditures by objects, that is, wages and salaries, retirement expenditures, supply costs, number of employees, and so on. Such an explanation of expenditure increase would hold that the composition of the population and the demands it makes are unimportant compared to inflation and unionization which increase the average level of employee compensation and nonlabor costs.

As is shown in Table 3A.4, average wages of New York state and local government employees rose by 79 percent from 1967 to 1975. The national consumer price index increased by 61 percent over that period, and the New York City index by 75 percent. At best, there was a 2 percent annual real increase in the average wage. Employment rose steadily through 1974, before declining in 1975. These very general trends would support an argument that government spending increases have been less influenced by demand than supply considerations.

TABLE 3.16: Average Annual Growth Rates in State and Local Government Employment and Average Compensation, 1963-75

	1963-69	1970-75	1963-75
Full-time equivalent employment			
New York State	4.7	0.6	3.3
United States	4.3	3.1	4.7
Full-time equivalent employment per capita			
New York State	4.0	0.7	3.1
United States	3.0	2.2	3.3
Average compensation			
New York State	6.2	6.8	9.3
United States	6.1	6.3	8.6
State Government			
Full-time equivalent employment			
New York State	5.3	0.3	3.5
United States	5.7	3.2	5.8
Average compensation			
New York State	7.0	5.7	9.3
United States	6.7	6.3	9.0
Local Government			
Full-time equivalent employment			
New York State	4.5	0.7	3.3
United States	3.8	3.1	4.3
Average compensation			
New York State	6.0	7.1	9.4
United States	5.8	6.3	8.4

Source: Compiled by the author.

Here it would seem useful to compare New York to the United States in terms of trends in compensation and employment. In terms of employment, the results show New York to be growing above the national average over the 1963–69 period; by as much as one-third faster if population is taken into account. During the past five years, however, the situation has reversed (see Table 3.16).

This change cannot be found, however, for average compensation. While the average wage in New York grew at about the national rate between 1963 and 1969, it increased to a more rapid rate between 1970 and 1975 and was substantially higher than the national rate.

When these trends are disaggregated by state versus local governments it may be seen that the largest compensation increases during the later period are attributable to local governments.

This pattern of higher compensation increase (in current dollars) may well be due to the more rapid cost increase in New York than in the nation. (Yet to use the deflator developed here would overstate the cost of living index since the New York City level is rising faster than that in the rest of the state.) Even so, these trends seem further evidence that governments in New York have not tied fiscal operations as closely to economic growth as have state and local governments in the rest of the country.

THE OUTLOOK

The fiscal outlook for New York state and local governments is grim. The public sector continued to expand in the 1970–74 period when it was clear the economic decline would not continue to support such expansion. This has only delayed the period of retrenchment, for such a period must come. There is some evidence in 1975 and 1976 budgets that it is already here.

The acute problems of some of the state's largest cities are well known. The state government's short-run financial problems are also serious. With respect to the latter, inadequate revenue growth resulted in a $447 million deficit in fiscal year 1976, financed primarily through the issuance of tax anticipation notes. It now appears that for fiscal year 1977 a continued decline of the state's economy has resulted in an overestimate of current revenues, and social-service costs are higher than had been anticipated. The result is a possible state deficit of $230 million. An even larger shortfall is more likely.

These short-term problems are symptomatic. The lower levels of current revenues are indicative of the effects of slow economic growth or actual decline on the state's tax bases. Expenditures, on the other hand, will respond to inflation and the collective bargaining process, regardless of what happens to private-sector economic growth. Meanwhile the problems of central cities and public authorities are all closely related to the state government's fiscal health and will impose a further drain on state finances.

Forecast Budgetary Balance

A careful forecast of the balance in the state-local sector lies ahead in this research effort and beyond the scope of this chapter. If properly done, such a forecast is a serious and time-consuming exercise. As an alternative, we might consider the outlook as forecast in existing projection exercises. One set of studies available gives projections for the whole state/local sector, aggregated for the nation.[14] These are useful and well done but cannot help in the forecast of an outlook for an individual state. These forecasts generally tell a story of fiscal health for the sector as a whole which is not descriptive of the situation in many states.

For the New York State government, the State Division of the Budget produces a five-year estimate of revenues and expenditures.[15] In general it appears to be a carefully done study and claims only to be a projection under one set of assumptions. It cautions properly about the projection variations which may result from even small changes in the underlying assumptions.

The projections of the Budget Division suggest a general fund surplus ("uncommitted income") of $1.1 billion by 1981. This is equivalent to about 9 percent of projected current revenues. Considering a possible 1977 deficit of $230 million and the current state of the economy, such a result would seem highly improbable. Rather, the Budget Division forecast might be better studied as the combination of underlying conditions necessary to bring the state government fisc to a healthy position. To the extent the conditions assumed are overoptimistic, the state will realize a less favorable budgetary position by 1981.

The Budget Division forecast assumes a growth in nominal personal income at 7 percent or better over the projection period. It also assumes nonagricultural employment to grow at about 1 percent per year. These projections are based on some national recovery (3.3 percent real growth) and "a change for the better in the trend of New York's participation in that national expansion."[16] As noted in the report, a projection discrepancy of as little as 1 percent on the low side could eliminate 40 percent of the excess income forecast for 1981. With this perspective, an annual increase in nominal personal income between 7 and 8 percent may be challenged as far above the growth rate that might reasonably be expected. Certainly a 1 percent annual increase in employment is a marked turnaround from the past trend. With relatively little real growth in the economy, and with the comparative disadvantages of the Northeast, such a change seems unlikely. In essence, what the Budget Office projections imply is that the state economy has bottomed out and will now enter a period of stable growth. These projections will obviously be heavily influenced by the degree of recovery of the national economy. If this is unlikely, the projections are overoptimistic. (Table 3A.2 shows trends in personal and business income taxes for the period 1965–75.)

Quite apart from these assumptions about the growth in the economy, the assumptions made about expenditure growth may be too conservative. On average, the projection is 4 percent per year between

1977 and 1981, or an expenditure-income elasticity of 0.5 as compared with an elasticity of nearly 2.0 for the state government over the 1963–75 period. If the expenditure elasticity remained at 1.8 (that observed for all state-local governments during the period) for the 1977–81 period, a deficit of $4.5 billion, equivalent to about 1/3 of current revenues, would result.

The revenue side is projected conservatively with no assumed discretionary increases and no apparent assumption of an increased federal share for the state. They project state government revenue effort to fall from 7.5 to 7.3 percent of personal income by 1981. This assumes a less-than-unitary income elasticity of revenue yield. Such a projection seems unduly conservative. Even with an annual growth rate of 5 percent in personal income, the state revenue system should yield about $13 billion in current revenues, or about $0.8 billion less than they project.

With these historical elasticities and a 5 percent increase in income, the deficit in 1981 for the state government could fall between $2 and $3 billion. To the extent local governments and public authorities further drain state government general revenues, the deficits could be larger.

However, the relationship between expenditure and revue growth and income growth may change substantially in the next few years. On the revenue side, there has been evidence of a slower growth in income and sales taxes. This is in part due to the slower real growth in income and taxable consumption and the decline in real business net income. Based on the performance in the past two years, a nominal revenue growth of 4 to 5 percent per year may be a reasonable expectation.

Expenditures have increased primarily because of increases in average compensation of public employees. A slower rate of inflation and/or conscious reductions in wage agreements together with a moratorium on hirings could slow the rate of expenditure increase. However, for the state government budget to be in balance at the beginning of the next decade, the rate of increase in expenditures would have to be at about 4 percent in nominal terms. If nominal personal income grows at only 5 percent, this target will not be easily achieved. Anyway, there are fixed commitments which will grow at high rates regardless of the rate of personal income increase. Considering the performance of the state fisc in recent years, a 4 percent expenditure growth seems unlikely.

The implication of this critique is that the state government will be fiscally pressed over the next five years. To the extent local government fiscal problems call for state actions, for example, assumption of financial responsibility for education or a transfer of other social services, this pressure will be multiplied.

A forecast of the budgetary position of all local governments in the state does not exist. If it did, however, it would probably show many of the larger central cities to face substantial deficits ahead. New York City tops the list with an economic base that continues to decline, and though spending has been reduced it is not realistic to expect that it can continue to support even its present level of activity in the future.

Remedial Public Policies

The heart of the New York fiscal problem is economic decline—the state's resource base can no longer support the quality of public services to which New York residents have become accustomed. There are five policy directions open: cut services, raise taxes, increase productivity, increase federal assistance, or improve the local economy. The first three are options for local action while the last two require federal action.

Local Options

Increased productivity in the public sector is a favorite policy recommendation in that it resolves fiscal problems without requiring governments either to raise taxes or cut services. While there is clearly room for improved management at the local government level, large savings (relative to projected deficits) from increased productivity in the public sector are not a realistic expectation.[17]

Revenues might be increased through further increase in the effective tax rate. The argument against this is the possible retarding effect on economic development. New York state and local government taxes, at over 10 percent of income, are already the highest in the nation and some 60 percent above the average of the states. Even when corrected for New York's higher per capita income (with a linear regression of the tax-income ratio on per capita income), the tax share of personal income is 44 percent above average and the highest in the nation. Through 1974 it was also rising faster than in any other state in the nation. In 1975 there was a decline in the revenue-income ratio, possibly reflecting the concern over relatively high taxes. Still, with the kind of deficits projected here, tax cuts are not likely and tax increases are probable. The question is whether some combination of inflation and real growth will allow absorbing these nominal increases without raising the effective tax rate.

Service-level reductions are the most likely result of New York's fiscal problems. While there will continue to be absolute cutbacks in some areas and reductions in the scope of some services, this will mostly take the form of services not expanding to accommodate increasing needs and increasing unit costs of provision. This does not mean that expenditures will decline. Increasing wages and benefits can drive up expenditures by a significant amount, without raising service levels.

There is another type of reform which is highly desirable but politically difficult. If the tax base in the suburbs could be tapped more fully so as to balance needs for services with capacity to finance, the fiscal situation in central cities could be markedly improved.

Federal Options

The federal government could increase the flow of aid to the state to prop up the public sector during this period of decline. A program of increased aid during a transition period in which the state sought to balance its long-term spending expectations with its likely future economic growth would be a sane program. Alternatively, federal grants to maintain an overdeveloped public sector would only prolong the period of continuing annual fiscal crisis. (Table 3A.5 shows recent trends in selected components of federal aid to New York State.)

A similar position might be taken with respect to regional development subsidies. They only prolong the period of transition to a lower, but stable, level of activity. The longer the period of this transition, the greater the uncertainty with respect to business investment, and the greater the chance for a snowballing effect of the decline.[18]

CONCLUSION

New York State's fiscal problem is that its public sector is overdeveloped. The state resource base will no longer support the high level of public services provided in the state unless tax rates are continuously increased. While shifts in population and economic activity are tending toward equalizing income across the country, the state has retained its dominance and relative national role in state-local fiscal activity. This can no longer be done. A period of downward transition must be recognized, and policy should center on selecting priorities in the adjustment of public service levels.

With appropriate federal aid, this need not mean severe service cutbacks in all areas, but rather a slow growth in services provided while the rest of the nation catches up.

NOTES

1. David Puryear and Roy Bahl, *Economic Problems of a Mature Economy*, Occasional Paper No. 27, Metropolitan Studies Program, The Maxwell School, Syracuse University, April 1976; William H. Miernyk, "The Northeast Isn't What It Used To Be," in *Balanced Growth for the Northeast*, New York State Senate, 1975; and Christopher Carlaw, *Boston and the Flight to the Sunbelt* (Boston: Boston Redevelopment Authority, October 1976).

2. Material in this section is drawn from Puryear and Bahl, op. cit.; Roy Bahl, Alan Campbell, David Greytak, and David Puryear, *Public Policy Implications of Regional Shifts in Economic Activity*, prepared for Northeastern Congressional Coalition by the Metropolitan Studies Program, The Maxwell School, Syracuse University, October 1976. A good presentation of the extensiveness of state decline may be found in Benjamin Chinitz, "Manufacturing Employment in New York State: The Anatomy of Decline," Chapter 2 of this volume.

3. A more careful analysis of the problem is in David Greytak and Bernard Jump, *The Effects of Inflation on State and Local Government Finances, 1967*–1974, Occasional Paper No. 25, Metropolitan Studies Program, The Maxwell School, Syracuse University, 1975; and David Greytak and Bernard Jump, *The Impact of Inflation on the Expenditures and Revenues of Six Local Governments, 1971–1979*, Monograph Series, Metropolitan Studies Program, The Maxwell School, Syracuse University, revised December 1975.

4. *The Financial Outlook for State and Local Government to 1980* (New York: Tax Foundation, Publication New Series No. 28, 1973); and David J. Ott, Attiat F. Ott, James A. Maxwell, and J. Richard Aronson, *State-Local Finances in the Last Half of the 1970's*, prepared for American Enterprise Institute for Public Policy, Domestic Affairs Studies, April 1975.

5. Charles Warden, "Growth Prospects," in *Balanced Growth for the Northeast*, op. cit.

6. *State of New York Five-Year Projection of Income and Expenditures General and Fiscal Years 1976–77 through 1980–81*, prepared for Governor Hugh L. Carey and Director of the Budget Peter C. Goldmark, Jr. (Albany, N.Y., February 1976).

7. Roy W. Bahl, Alan Campbell, and David Greytak, *Taxes, Expenditures and the Economic Base: Case Study of New York City* (New York: Praeger, 1974).

8. A discussion of intergovernmental arrangement by state is contained in *Federal Grants: Their Effects on State/Local Expenditures, Employment Levels, Wage Rates*, Advisory Commission on Intergovernmental Relations (Washington, D.C., 1977), Chapter 2.

9. Bernard Jump, Jr., *Financing Public Employee Retirement Programs in New York City: Trends Since 1965 and Projections to 1980*, Occasional Paper No. 16, Metropolitan Studies Program, The Maxwell School, Syracuse University, January 1975; and Bernard Jump, Jr., *State and Local Employee Pension Plans: Watching for Problems*, prepared for the Academy for Contemporary Problems, Public Finance Series No. 1, Columbus, Ohio, October 1976.

10. We have attempted to specify precisely and estimate the nature of the relationship between taxation and employment in New York City in Roy Bahl and David Greytak, "The Responses of City Government Revenues to Changes in Employment Structure," *Land Economics*, forthcoming.

11. Michael J. Wasylenko, *An Estimate of the Elasticity of the New York State Personal Income Tax*, Occasional Paper No. 13, Metropolitan Studies Program, The Maxwell School, Syracuse University, March 1975; and Michael J. Wasylenko, "Estimating the Elasticity of State Personal Income Taxes," *National Tax Journal*, June 1975.

12. The effects of inflation on state and local government tax bases are explained in David Greytak and Bernard Jump, *The Effects of Inflation on State and Local Government Finances, 1967–1974*, op. cit.

13. An early example of this approach is Harvey Brazer, *City Expenditure in the United States* (New York: National Bureau of Economic Research, 1959).

14. *The Financial Outlook for State and Local Government to 1980*, op. cit.; and Ott et al., op. cit.

15. *State of New York Five-Year Projection of Income and Expenditures General and Fiscal Years 1976–77 through 1980–81*, op. cit.

16. Ibid., p. 45.

17. A review of the issues surrounding productivity measurement and improvement is presented in Jesse Burkhead and John P. Ross, *Productivity in the Local Government Sector* (Lexington, Mass.: D.C. Heath, 1974).

18. Our position on a federal transition program in general regional subsidies in particular is outlined in the *Northeastern Congressional Coalition*.

APPENDIX

TABLE 3A.1: Trends in State and Local Government Tax Revenues in New York, 1963–76

Year	Personal Income[a]	Business Income[a]	Sales and Use[a]	Property (Local Govern-ment)[c]	Other[a]	Total New York State Taxes[b]	Total Taxes of All Other State Gov-ernments[b]
1963	942,251	–	–	–	–	2,506.3	19,610.4
1964	1,092,275	–	–	268,575	–	2,712.9	21,529.8
1965	1,253,447	–	–	289,200	–	2,862.3	23,263.8
1966	1,391,696	–	298,437	359,682	–	3,415.7	25,964.1
1967	1,649,619	631,875	604,327	342,883	1,172,300	4,056.3	27,869.8
1968	2,091,485	609,669	630,912	362,260	1,116,300	4,447.2	31,953.0
1969	2,186,445	858,593	698,759	390,237	1,587,800	5,329.8	36,600.8
1970	2,244,922	962,912	1,012,036	445,080	1,897,600	6,116.5	41,845.5
1971	2,405,486	870,620	1,715,898	496,557	1,257,300	6,248.1	45,293.1
1972	2,882,596	1,146,891	1,532,795	547,306	1,457,300	7,018.5	52,851.9
1973	3,064,368	1,283,016	1,734,093	588,133	2,089,000	8,170.0	59,899.3
1974	3,346,670	1,299,736	1,863,241	637,448	2,007,100	8,516.4	65,690.9
1975	3,753,584	1,456,303	2,000,854		1,728,600	8,939.2	71,215.7
1976	4,012,808	1,698,996	2,148,945		1,041,400	8,902.0	–

	Percent Increases						
Year	Personal Income	Business Income	Sales and Use	Property (Local)	Other	Total New York State Taxes	Total Taxes of All Other State Governments
1963	—	—	—	—	—	—	—
1964	15.9	—	—	—	—	8.2	9.7
1965	14.7	—	—	7.6	—	5.5	8.0
1966	11.0	—	—	24.3	—	19.3	11.6
1967	18.5	—	102.5	-4.6	—	18.7	7.3
1968	26.7	-3.5	4.3	5.6	-4.7	9.6	14.6
1969	4.5	40.8	10.7	7.7	42.2	19.8	14.5
1970	2.6	12.1	44.8	14.0	19.5	14.7	14.3
1971	7.1	-9.5	69.5	11.5	-33.7	2.1	8.2
1972	19.8	31.7	-10.6	10.2	15.9	12.3	16.6
1973	6.3	11.8	13.1	7.4	43.3	16.4	13.3
1974	9.2	1.3	7.4	8.3	-3.9	4.2	9.6
1975	12.1	12.0	7.3	—	-13.8	4.9	8.4
1976	6.9	16.6	7.4	—	-39.7	-.4	—

[a]In thousands of dollars. [b]In millions of dollars. [c]In tens of thousands of dollars.

Sources: New York State Department of Taxation and Finance, Bureau of Tax Statistics, *Analysis of 1963 (1964-1974), New York State Personal Income Tax Returns*; New York State Department of Taxation and Finance, Bureau of Tax Research and Statistics, *Statistical Supplement to the Annual Report of the New York State Tax Commission for the Fiscal Year, 1975-76*; State of New York, *Special Report on Municipal Affairs by the State Comptroller* for local fiscal years in 1974; U.S. Bureau of the Census, *Governmental Finances, 1963-1975* (Washington, D.C.: U.S. Government Printing Office), Table 17.

TABLE 3A.2: Personal and Business Income Tax Trends, 1965–75

			Percent of Taxpayers in:		
	Personal Income Tax				
Year	Number of Taxpayers	Taxable Income per Tax payer	Less than $5,000 Income Brackets	Greater than $20,000 Income Brackets	Tax Payments Per Employed Worker in the State
1965	5,783,473	5,178.2	36.3	3.5	192.2
1966	6,066,781	5,392.7	34.9	3.7	207.4
1967	6,371,465	5,813.1	33.2	4.3	240.5
1968	6,636,446	6,205.6	32.6	4.8	298.7
1969	6,834,942	6,392.8	28.9	5.1	304.4
1970	6,653,425	6,791.9	24.4	5.9	313.7
1971	6,637,820	7,085.0	22.5	6.9	343.3
1972	6,649,074	7,545.2	19.0	8.0	410.0
1973	6,878,122	7,903.6	19.2	9.2	430.1
1974	7,010,670	8,319.4	18.5	10.5	472.3
1975	–	–	–	–	552.7

	Business Income Tax				
Year	Average Number of Employed Per Business	Net Income Per Business	Tax Payments Per Business	Business Income Per Employed Worker	Tax Payments Per Employed Worker
1965	–	–	–	–	–
1966	–	–	–	–	–
1967	31	152,360.9	2,869.1	4,892.4	92.1
1968	32	141,897.9	2,767.6	4,464.3	87.0
1969	40	190,245.9	4,831.9	4,706.9	119.5
1970	40	189,071.2	5,402.1	4,710.4	134.5
1971	36	150,363.1	4,474.6	4,176.3	124.2
1972	34	166,078.4	5,590.8	4,846.1	163.1
1973	33	187,386.1	6,008.6	5,616.1	180.0
1974	33	214,147.6	6,189.9	6,346.7	183.4
1975	–	–	–	–	214.4

Sources: New York State Department of Taxation and Finance, Bureau of Tax Statistics, *Analysis of 1963 (1964-1974), New York State Personal Income Tax Returns*; New York Department of Taxation and Finance, Bureau of Tax Research and Statistics, *Statistical Supplement to the Annual Report of the New York State Tax Commission for the Fiscal Year, 1975-1976*; U.S. Department of Labor, Bureau of Labor Statistics, *Employment and Earnings, States and Areas, 1939-1974* (Washington, D.C.: U.S. Government Printing Office). Data for 1975 provided by Bureau of Labor Statistics Regional Office, New York, N.Y.

TABLE 3A.3: Education, Welfare, and Health Expenditures of New York State and Local Governments, 1963–75

Year	Education*			Welfare		
	Total Expenditures (000)	Number of Students	Expenditures Per Student	Total Expenditures (000)	Number of AFDC Recipients	Average Payment Per Recipient
1963	2,547,299	2,960,568	860.4	541,900	436,164	41.23
1964	2,718,687	3,051,006	891.1	636,200	489,383	39.48
1965	3,094,266	3,121,717	991.2	729,400	539,279	41.64
1966	3,386,757	3,176,574	1,066.2	843,900	571,870	50.83
1967	3,816,388	3,248,879	1,174.7	1,087,100	710,000	54.30
1968	4,247,799	3,325,477	1,277.4	1,728,700	874,000	71.00
1969	4,801,526	3,397,413	1,413.3	2,206,900	1,007,000	63.70
1970	5,314,653	3,442,809	1,543.7	2,459,000	1,122,000	69.90
1971	6,183,772	3,489,245	1,772.2	2,858,700	1,264,006	75.83
1972	6,611,498	3,503,873	1,886.9	3,319,500	1,286,819	82.11
1973	6,677,402	3,474,687	1,921.7	3,673,500	1,221,065	81.32
1974	7,316,135	3,428,291	2,134.0	3,860,900	1,169,449	90.83
1975	n.a.	n.a.	–	4,197,000	1,215,476	91.83

Year	Health		Total Expenditures		
	Total Expenditures	Per Capita	Amount	Population	Per Capita
1963	680,500	38.45	6,968,800	17,696,000	393.8
1964	820,300	45.78	8,208,300	17,915,000	458.2
1965	878,600	48.60	8,673,100	18,075,000	479.8
1966	990,500	54.25	9,678,800	18,258,000	530.1
1967	1,128,100	61,52	11,269,700	18,336,000	614.6
1968	1,353,500	74.72	12,749,500	18,113,000	703.8
1969	1,541,400	84.13	14,954,100	18,321,000	816.2
1970	1,765,500	96.78	16,770,100	18,241,255	919.3
1971	2,160,500	117.47	19,779,500	18,391,000	1,075.4
1972	2,566,700	139.56	22,750,300	18,366,000	1,238.7
1973	2,497,100	136.71	24,099,100	18,265,000	1,319.4
1974	2,955,400	163.18	26,228,400	18,111,000	1,448.2
1975	3,469,500	191.47	29,193,800	18,120,000	1,611.1

*Excluding higher education.

n.a. = data not available.

Sources: State of New York Department of Audit and Control, Division of Municipal Affairs, *Financial Data for School Districts*, Fiscal Year Ended June 30, 1974, Tables B, C, and E; *Financial Data for School Districts*, Fiscal Year Ended June 30, 1972, Tables B, C, and E for 1963 (Cols. 1, 2); U.S. Bureau of the Census, *Governmental Finances in 1963–75* (Washington, D.C.: U.S. Government Printing Office), Tables 17 and 18 (Cols. 4, 7, 9, and 10); U.S. Department of Health, Education, and Welfare, Social Security Administration, *Social Security Bulletin*, (As of July 1975), (Cols. 5, 6).

TABLE 3A.4: Trends in State and Local Government Expenditures in New York State, by Object, 1963–75

Year	Total Current Expenditures[a]	Number of Employees	Average Wages[b]	Retirement System Expenditures: Total[c]	Retirement System Expenditures: Per Employee	Wages and Retirement System Expenditure as a Percent of Total Current Expenditures
1963	5,330.8	675,839	513.0	–	–	–
1964	6,424.7	699,500	541.4	–	–	–
1965	6,895.6	734,082	563.3	–	–	–
1966	7,646.7	781,952	597.9	–	–	–
1967	9,074.8	816,806	634.4	–	–	–
1968	10,470.6	857,630	698.6	–	–	–
1969	12,257.1	895,688	734.1	–	–	–
1970	13,882.6	934,564	806.6	–	–	–
1971	16,161.8	945,209	857.2	–	–	–
1972	18,669.2	956,640	925.6	–	–	–
1973	19,901.2	987,080	1,006.2	1,521,013	1,540.9	67.5
1974	21,797.1	1,002,764	1,065.2	1,891,440	1,886.2	67.4
1975	24,641.5	969,237	1,136.0	2,054,201	2,119.4	61.9

[a]In millions of dollars.
[b]October average wages.
[c]In thousands of dollars.

Sources: U.S. Bureau of the Census, *Governmental Finances in 1963* (Washington, D.C.: U.S. Government Printing Office), Tables 17 and 18 (Col. 1); U.S. Bureau of the Census, *Public Employment in 1965–75* (Washington, D.C.: U.S. Government Printing Office); U.S. Bureau of the Census, *State Distribution of Public Employment 1963, 1964* (Cols. 2, 3) (Washington, D.C.: U.S. Government Printing Office).

TABLE 3A.5: Selected Components of Federal Aid to State and Local Governments, 1968–74 (millions of dollars)

	New York State				United States				New York as a Percent of United States			
Year	Total	General Revenue Sharing	Public Assistance	Education	Total	General Revenue Sharing	Public Assistance	Education	Total	General Revenue Sharing	Public Assistance	Education
1968	1,824	–	931	159	17,807	–	5,286	2,694	10.2	–	17.6	5.9
1969	2,045	–	1,105	148	19,552	–	6,280	2,706	10.4	–	17.5	5.4
1970	2,364	–	1,121	225	23,358	–	7,430	2,973	10.1	–	15.0	8.5
1971	3,284	–	1,500	350	29,221	–	9,640	3,540	11.2	–	15.5	9.8
1972	4,398	–	2,583	381	35,208	–	13,090	4,283	12.4	–	19.7	8.8
1973	4,794	2,137	2,137	737	42,647	6,636	11,825	6,636	11.2	32.2	18.0	11.1
1974	5,217	678	2,236	395	46,040	6,106	12,607	6,106	11.3	11.1	17.7	6.4

Source: U.S. Bureau of the Census, *Statistical Abstract of the United States: 1969 (1970-1975)*, *Federal Grants to State and Local Governments. By Purpose, States and Other Areas* (Washington, D.C.: U.S. Government Printing Office).