Georgia State University

ScholarWorks @ Georgia State University

ECON Publications

Department of Economics

1983

Two Steps Forward, One Step Backwards, and Some Tough Decisions for the New Governor

Roy W. Bahl
Georgia State University, rbahl@gsu.edu

Larry Schroeder
Syracuse University, ldschroe@syr.edu

Follow this and additional works at: https://scholarworks.gsu.edu/econ_facpub

Part of the Economics Commons

Recommended Citation

Bahl, Roy W., and Larry Schroeder. "Two Steps Forward, One Step Backwards, and Some Tough Decisions for the New Governor. Empire State Report, January 1983, New York Legislative Institute.

This Article is brought to you for free and open access by the Department of Economics at ScholarWorks @ Georgia State University. It has been accepted for inclusion in ECON Publications by an authorized administrator of ScholarWorks @ Georgia State University. For more information, please contact scholarworks@gsu.edu.

Two Steps Forward One Step Backward And Some tough decisions for the new Governor

by Roy Bahl and Larry Schroeder

Hugh Carey came to Albany during the deepest nationwide recession since World War II. Ironically, he is leaving office during an even deeper recession. He is also leaving the state with a large budget deficit, a Standard and Poor's "credit watch," and a pending New York City fiscal problem. Carey's first administration salvaged what appeared to be a hopeless New York City and turned around a long-standing tradition of unbridled public sector growth. But Governor Cuomo is now faced with a Hobson's choice; he can continue the policy of restraint, in which case he will have to make serious budget cuts—the painful part of fiscal restraint that the Carey administration never really had to face or he can deal with the capital infrastructure problem and maintain current service levels, but only at a cost of reversing some of the tax reductions of the past eight years. In either case, the policies will be pursued in the context of a no-growth state economy, a poorly performing national economy, intense regional competition, a less income- and inflation-responsive state income tax, and federal aid reductions. In some ways, the setting for the new governor's fiscal programs will be even more unfavorable than that which confronted his predecessor.

In order to understand the current situation, it is important to understand what happened in the past eight years and to think specifically of three elements: (1) the economy, which the Carey administration could not control; (2) taxation, which it focused on through explicit policy changes; and (3) expenditures, which it dealt with indirectly through attrition, deferral and inflation.

New York's economic decline is well documented and, of course, is quite beyond the control of state policy makers. During the Carey years, the state lost 400,000 residents and, while there was some small growth in real per capital income, its relative income level slipped from 13 percent above the national average to 9 percent above. Thus, Carey came to office when New York State accounted for 8.5 percent of the national population and 9.5 percent of national income and is leaving office with the state accounting for 7.7 percent of national population and 8.4 percent of income.

New York has become a much less dominant force in the nation. It is not surprising, then, that New York's share of federal grants has fallen, from 10.6 to 10.2 percent during this period. Even so, the total growth in federal grants was so large that real per capita federal aid to New York state and local governments rose by 17 percent. from $167 to $196 between 1974 and 1980. The meaning of all this is that the resource base with which the state government had to work grew very little in real terms and actually declined relative to the rest of the country.

Tax policy, on the other hand, is a controllable; and tax reduction is the most notable feature of the Carey fiscal policies. Led by dramatic personal income tax reductions, New York's tax burden has fallen from 15.5 percent of personal income in 1974 to 14.2 percent in 1981. But while the tax burden has been falling in New York, it has been falling faster elsewhere in the country, leaving New York's competitive position unimproved. In 1974, New York state and local government taxes were 38 percent above the national average, while in 1981, they were 39 percent higher. Still, this is a notable achievement. If the Carey administration had not stopped the increase, leaving taxes at their 1974 level, New York taxes would have been 52 percent above the national average by 1981.

In fact, the New York state government's tax burden reductions were more than competitive with the rest of the country, but local government reductions were not. This points up a problem Governor Carey never found a way to deal with: how does the state government control the growth in the overall state plus local tax burden?

A different kind of retrenchment occurred on the expenditure side of the budget, i.e., there were no explicit policy changes to eliminate programs or dramatically reduce benefits. Instead, maintenance and capital investments were deferred and other expenditures were eroded by inflation. As a result, state government

Roy Bahl and *Larry Schroeder* work in the Metropolitan Studies Program at the Maxwell School at Syracuse University.

per capita real expenditures have fallen by about $100 during this period. Expenditures in other states have not fallen as fast, with the result that in 1981 New York State and local governments spent 36 percent more than the average state as compared to 56 percent more in 1974.

The structure of expenditures within New York State has not changed markedly during the Carey years. The proportions spent on health, education, welfare and state aid remain about the same—the cuts have been distributed evenly. The number of state employees for each one thousand residents has actually grown, but the real average compensation for these employees has declined by about 20 percent.

How did the administration get away without making major programmatic cuts on the expenditure side? And why was so much attention focused on Carey's tax policies when the expenditure reduction, relative to the rest off the nation, were far more dramatic? The answer is that the expenditure cuts became relatively invisible thanks to unexpected assists from the national economy, the federal government, and, ironically, from the New York City crisis. First, there was a sustained national economic recovery between 1975 and 1979, which boosted state revenues. Second, the high rate of inflation during the Carey years helped maintain a high rate of state tax revenue growth, even in the face of statutory rate reductions, and enabled real expenditure reductions to go virtually unnoticed. For example, the 25 percent increase in compensation received by the average state government employee between 1974 and 1980 was actually a 20 percent reduction in real terms. Third, there was substantial increases in the flow of federal grants-in-aid to the state, particularly in the early years of the Carey administration. Finally, the caution that characterized the aftermath of the New York City financial crisis made it easier for the administration to sell a program of slower public sector growth than had historically occurred in New York State.

What is in store for the next administration? The economic outlook is still uncontrollable, and there is little evidence that New York has now gained a competitive advantage in attracting industry. Even if the state grows as fast as the rest of the country, as the performance during the last year would suggest, a slow rate of economic growth may be expected because of sluggish national growth. This implies that the state's real taxable capacity will continue to grow as slowly over the next four years as it did during the last eight.

The near future holds other problems. The reported one-half billion dollar deficit has the new administration in trouble at the outset, without the benefits of a high rate of inflation and a progressive state income tax structure responsive to that inflation. Prospects are for continued reductions in the amount of federal aid flowing to state and local governments in general and to states such as New York in particular. Moreover, fading memories of the New York City crisis, past deferrals of expenditures to renovate the state's infrastructure, urban problems, and the pent-up demand for new "programs" will make it increasingly difficult to sell an austerity program. Furthermore, New York City again finds itself in fiscal distress and may again plead its case to Albany, thus adding more pressure to these spending side demands.

What is a realistic expectation for the next four fiscal years? If the strategy is to continue reducing the tax burden, then continued deferrals and more expenditure reductions lie ahead. It is inevitable that these reductions will be concentrated in the social service area. On the other hand, even modest increases in state government expenditures, for example, to deal with accumulated capital obsolescence problems or to compensate for federal aid reductions, will almost surely mean a need to increase taxes. Only a reduction in social service expenditures or local assistance, or a fast-growing New York State economy that produces large fiscal dividends, can forestall this outcome. Cuomo will have to decide whether the latter is simply wishful thinking or enough of a realistic expectation to use it as the basis of public policy. ■

The Carey Record

The Uncontrollables	**1974**	**1981**
State Population (1,000s)	18,073	17,602
New York's Share of National Income	9.5%	8.4%
Real Per Capita Personal Income (1967 dollars)	$4,156	$4,209
Per Capita Personal Income as Percent of the Nation Average	113%	109%
Real Per Capita Federal Aid to New York State and Local Governments (1967 dollars)	$167	$196*
Taxes		
Marginal Rate on Top Personal Income Tax Bracket	15%	10%
New York State and Local Government Tax Burden (taxes as a percent of personal income)	15.5%	14.2%
New York Tax Burden as a Percent of National Average	138%	139%
Expenditures and Debt		
Real Per Capita State Government Expenditures (1967 dollars)	$983	$886
New York Per Capita State and Local Government Expenditures as a Percent of National Average	156%	136%
Percent of New York State Budget Allocated to		
Health	8.1%	7.8%*
Education	10.1%	10.2%*
State Aid and Welfare	56.5%	55.5%*
State Government Employees per 1000 Population	10.4	12.3*
Real Average Compensation per State Government Employee	$8,385	$6,963*

*1980 data.