CITIZENS BUDGET COMMISSION

BLOG | STATE BUDGET

What to Look for in New York State's New Year

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The State enters a new Legislative session and a new gubernatorial term in less favorable fiscal condition than a year ago and with threatening economic headwinds.

Last year's budget added billions of dollars in one-time and recurring spending, driving spending to unsustainable levels. The State's unprecedented multi-year budget balance relied on non-recurring resources, with fiscal year 2027 balanced by $6 billion that will not be available the following year. Now, economic risks mount and updated projections have opened a $6 billion gap in fiscal year 2027, which when added to the non-recurring resources shows that the State has a $12 billion structural problem in its sights.

While the short-term fiscal outlook remains stable assuming no recession, now is the time for the State to address its significant structural imbalance. Actions taken this session may well chart the course that determines whether the State will remain stable and capable of providing for New Yorkers' critical needs, or fall off a fiscal cliff. The latter results in future wrenching cuts to services New Yorkers need or tax increases that damage our economic foundation by making New York a less competitive place to live or run a business.

Shoring up major programs is critical to the State's fiscal sustainability and New York's competitiveness. The State needs to bring the costs of Medicaid, education, transportation, housing, and environmental mitigation and sustainability in line with available revenues. It should focus on ensuring the programs use cost-effective interventions and are managed well. New Yorker's needs are too great to waste precious resources.

This also is an opportune time for the Governor and Legislature to build on recent improvements in transparency and accountability in the budget and fiscal management practices. Better information, standards and practices, and accountability will improve the State's fiscal outlook and ability to continue to serve New Yorkers well.

Ahead of the Governor's State of the State address this week and the Executive Budget release later this month, it is important to focus on:

The Financial Plan

- **The Path to Structural Budget Balance:** In July 2022, dimmed projections of economic growth led the State to reduce tax receipts projections by $3.4 billion annually in fiscal years 2025 and 2026, and $6 billion in fiscal year 2027, opening budget gaps of the same size. The short-term picture is still favorable—the budget is expected to finish this year balanced, with an extra $2 billion unallocated, and next year already nearly balanced. The fiscal year 2024 budget should restrain spending growth to help balance the budget in the out-years.

- **Spending Growth:** Last year's budget increased State Operating Funds (SOF) spending 12.8 percent in fiscal year 2023 and then at a rate of 3.3 percent annually through fiscal year 2027.[1] The largest programs (school aid and Medicaid) are projected to grow twice as fast as receipts, an unsustainable imbalance. Furthermore, proposals to increase spending more abound—on school aid, childcare, and child tax credits, as well as further suspension of the gas tax. Reducing SOF spending growth to 2 percent annually would eliminate the current 2027 budget gap and accommodate the loss of nonrecurring resources.

- **Expiration of Nonrecurring Resources:** The State has received billions of dollars in pandemic-related federal aid for schools ($13 billion), Medicaid (at least $10 billion), general fiscal relief ($13 billion), and more. These funds will be exhausted by the end of fiscal year 2025. In 2021, the State also enacted "temporary" tax increases: a three-year corporate tax hike and a seven-year personal income tax (PIT) hike. As the federal resources expire, the financial plan shows gaps opening. Still fiscal year 2027 relies on $3.8 billion of the last year of the PIT increase and $2.9 billion of nonrecurring funds from prior years. State spending restraint should accommodate the expiration of these resources beyond fiscal year 2027.

- **Changes to the Economic and Tax Receipts Outlook:** The financial plan assumes continued modest economic growth; forecasts for employment, personal income, and wages all increase over the financial plan period. However, an economic slowdown or downturn would reduce tax receipts and widen the existing budget gaps. In fact, some budget monitors are already projecting a short, shallow recession.[2] Because of the State's high reliance on the volatile PIT, even a small disruption could open multi-billion-dollar gaps. Thus, the updated economic forecast and tax receipts projections will be critical for evaluating the State's fiscal condition over the short and long term.

- **Extraordinary Budget Powers**: At the onset of the pandemic, the State enacted several extraordinary powers to transfer appropriations, sidestep the debt cap, and issue short-term debt. Pandemic-era budgets also included billions of dollars in dry lump sum appropriations to allow for emergency response spending. These extraordinary powers and broadly defined lump sum appropriations are not necessary now and, in fact, create fiscal and ethical risks by allowing the Executive unilateral, near-universal spending authorities. These powers have been proposed in each Executive Budget since 2020, should not be proposed this year, and should be rejected if they are.

- **Rainy Day Fund:** Last year, the State significantly increased the allowable size of deposits to, and the balance of, the Rainy Day Fund and proposed a plan to significantly increase reserves over time—two of the most positive fiscal planning steps the State has taken in years. These actions increased the reserves from just over $2 billion in fiscal year 2020 to $9 billion in fiscal year 2022, with a plan to exceed $19 billion by fiscal year 2025. (This includes $6.2 billion in the non-statutory Economic Uncertainties Reserve, which can be used.) Still, to weather a typical recession, roughly $40 billion would be needed to cover about three years' worth of tax receipts losses. Following through with the existing plan plus additional savings will be crucial going forward. The best proximate opportunity is to save the $2 billion in unallocated receipts for a rainy day.[3]

- **Budgeting and Fiscal Management Reform:** Over the past year, the State has taken steps to improve transparency and accountability by restoring oversight powers to the Comptroller, improving adherence to reporting deadlines, completing Quick Start budgeting, and bolstering the Rainy Day Fund. Still, problems in the budget and fiscal management processes persist. Some reforms to bolster fiscal stability, transparency, accountability, and oversight can be done immediately and administratively. For example, the budget should further increase funding for the Authorities Budget office, further bolster the Rainy Day Fund, and omit loosely defined lump sum appropriations. The budget should also include proposals for more structural reforms, such as establishment of an independent fiscal analyst's office, a transition to budgeting on a modified accrual basis, and implementation of a performance management system.

Major Programs

- **Medicaid Enrollment and Costs Pressures:** The State's Medicaid budget problems pre-date the pandemic. The Medicaid Redesign Team was reconvened to find billions of dollars in savings to make the program sustainable and a $1.7 billion State payment was delayed to keep the program "on budget." Costs are high and have grown rapidly in some areas, especially long-term care services, putting immense pressure on the Medicaid budget specifically and the State budget overall. The challenge of paying for Medicaid will be exacerbated this year by the expiration of pandemic-related enhanced federal aid and requirements on the program. Since 2020, the State has been receiving roughly $3.5 billion annually in extraordinary federal aid to offset State Medicaid costs, tied to a requirement to continuously enroll Medicaid beneficiaries during the pandemic. Next year, the continuous enrollment requirement and associated federal aid will be phased out. The State projects that the roughly one million enrollees who were added to the program since 2020—along with their costs—will move out of the Medicaid program over a one-year period. If enrollees remain in the program longer than projected, spending will be higher, increasing future budget gaps. The forthcoming budget proposal will update the Medicaid enrollment and cost projections.

- **School Aid Affordability and Equity:** The upcoming school year will be the final year of the phase-in of Foundation Aid increases. The State Education Department recently requested $1 million to study school aid formulas to "ensure state aid funding is allocated where it is most needed" beginning in school year 2024-2025.[4] This raises the question of whether a long-term strategy as CBC recommends for equitable and sustainable school aid spending will be proposed in this year's budget.

- **Metropolitan Transportation Authority (MTA) Budget: The** MTA has a $2.5 billion annual structural operating budget deficit. The MTA is seeking $600 million in aid to balance its 2023 budget, and many are calling for new, significant, and recurring revenue sources. The MTA has proposed some productivity savings to narrow its gaps, but stabilizing the MTA's operating budget should rely significantly more on efficiency savings.

- **Energy and Environment:** In the past two months, voters approved a $4.2 billion environmental bond act, and the State's Climate Action Council approved its Final Scoping Plan to achieve the State's climate goals. Implementation of these major new portfolios, and the State's existing extensive environmental conservation programs, will move into high gear. The State should identify the most cost-effective and achievable policies and projects from its menu of choices to begin making meaningful progress toward its climate goals. The Executive Budget will offer the first glimpse of how the State will take its first steps toward those goals.

Housing

- **Housing Production:** The Governor has said she will propose policies to boost housing production. Presumably, she again will propose policies to catalyze transit-oriented development, legalize accessory dwelling units, and increase allowable floor-area ratios. This year's proposals also may (and should) include policies to streamline environmental review. These and other changes are needed to address the housing production deficit Statewide, especially in and around New York City.

- **Replacement for 421-a:** Last year's Executive Budget proposed an alternative to the expiring 421-a housing production tax credit program, 485-w. A well-designed replacement for the now-expired 421-a would help spur affordable and market rate rental housing production and may return as part of this year's housing agenda.

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ENDNOTES

[1] These figures are calculated by CBC based on reported spending growth in the Financial Plan adjusted for timing of payments and one-time federal aids. Reported growth is 4.5 percent in fiscal year 2023 and 3.6 percent on average annually thereafter. CBC staff analysis of New York State Division of the Budget, *Midyear Update to the Fiscal Year 2023 Enacted Budget Financial Plan* (November 2022), www.budget.ny.gov/pubs/archive/fy23/en/fy23en-fp-myu.pdf.

[2] See New York State Division of the Budget, *2022 Joint Report on Receipts and Disbursements November 15, 2022* (November 2022), www.budget.ny.gov/pubs/press/2022/fy24-quickstart/report-fy24-quickstart.pdf.

[3] The State added $2.1 billion to the Transaction Risk Reserve in the midyear update, hedging against a deterioration of tax receipts in the second half of the year. See New York State Division of the Budget, *Midyear Update to the Fiscal Year 2023 Enacted Budget Financial Plan* (November 2022), www.budget.ny.gov/pubs/archive/fy23/en/fy23en-fp-myu.pdf.

[4] New York State Education Department, *2023-24 Regents Budget and Legislative Initiatives* (December 1, 2022), www.regents.nysed.gov/common/regents/files/1222saa2.pdf.