Policy Analysis

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Cleaning Up New York State's Budget Mess

by Raymond J. Keating

Executive Summary

In recent years New York has faced large budget gaps as the state government has increased spending and the state economy has stagnated. The economic slowdown has created fiscal challenges for state policymakers, but Albany has too easily resorted to tax increases instead of pursuing needed spending reforms. Earlier this year, the legislature increased income and sales taxes and added to the state's already high debt load. State tax revenues will rise by an estimated $3.8 billion in fiscal year 2004, and spending will rise at least $4.0 billion. Last year legislators increased spending by $6.5 billion, or 7.7 percent, even though the budget faced a large deficit.

The state fiscal crunch will not be solved with tax increases, particularly if spending keeps growing by leaps and bounds. Higher taxes damage the economy and shrink the tax base as skilled workers and companies relocate to states with more hospitable tax climates. With some of the highest taxes in the nation, New York has been a net loser in domestic migration in recent years. New York should be cutting taxes to attract businesses and skilled workers, not increasing taxes.

Taxes can be cut and the deficit eliminated by restraining spending. For example, if spending growth had simply been held to the inflation rate since FY95, total state spending would be $77 billion in FY04 rather than the $95 billion currently projected, and there would be room to balance the budget and cut taxes. Looking forward, the state should launch a thorough review of the entire budget and cut unneeded programs. New York's per capita government spending on welfare, education, housing, and health care is far higher than that of other states and needs to be reined in.

This study looks at New York's recent budget trends and provides specific proposals to cut spending. Savings can be achieved by ending special interest programs such as business subsidies, contracting out state activities to the private sector, and privatizing services that could be better performed by businesses or charities. The New York government has tried to do too much for too long at the taxpayers' expense. If New York is to again become the beacon for economic opportunity and growth that it once was, the size and scope of the state government must be substantially rolled back.

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Introduction

As he was sworn in for his third term as New York's governor last January, George Pataki faced a large state budget deficit. The budget gap was estimated at $2 billion for the remainder of fiscal year 2003 (ending March 31, 2003) and about $9 billion for FY04.[1] Although many observers blamed the economic slowdown for the deficit, total state spending had risen from $73 billion in FY2000 to $91 billion by FY03, a stunning 25 percent increase in just three years (Figure 1).[2] Clearly, spending growth is the cause of the state's recent budget woes.

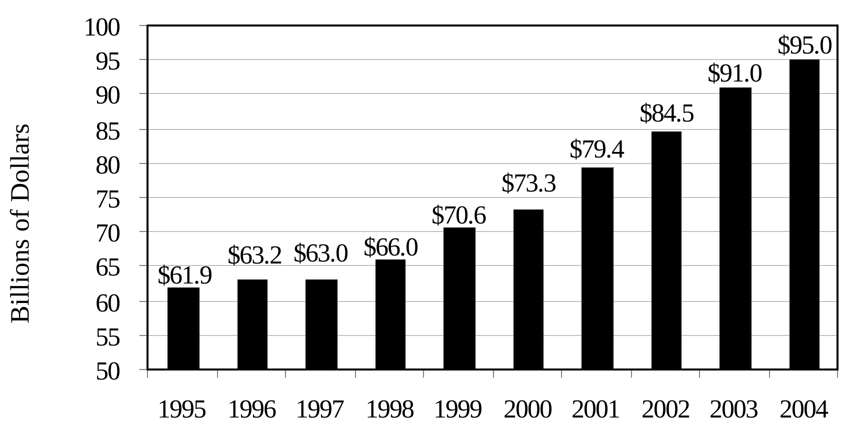
Even though spending is the obvious cause of current deficits, Governor Pataki proposed $1.4 billion in tax increases and more borrowing in his FY04 budget and proposed only modest trims to spending. The Republican-led state senate and the Democratic-led assembly pushed for spending increases and an even bigger tax increase. Pataki vetoed parts of the legislature's budget, but his vetoes were overridden.[3] Pataki's budget office estimates that total state spending will be $95 billion in FY04, up 4.4 percent from the prior year—a growth rate twice the inflation rate.[4] Worse, the final budget included tax increases of more than $3.8 billion for FY04—almost triple the amount Pataki had proposed.[5]

I first discuss how New York's high and rising taxes damage the state's economy in today's climate of interstate competition for investment and skilled workers. Next, I discuss the state's recent spending spree and detail spending cuts that should be pursued. Many state programs should be terminated, contracted out to private firms, or fully privatized and carried out by businesses or charities. New York needs to think more creatively about saving taxpayer money than it has in the past. Privatization and competitive sourcing have been implemented in many other state and local jurisdictions, and New York is ripe for similar reforms. I conclude that the state's current fiscal woes should be treated as an opportunity for state lawmakers to make tough spending cuts to put the state on a sustainable budget path and improve long-term growth in the state's economy.

Repeating Old Mistakes with Tax Increases

The government's failure to control the growth of state spending is having a negative impact on New York taxpayers and the state's economy. In 2003 the top personal income

Figure 1
New York State Total Spending under Governor Pataki, FY95 to FY04



Source: New York State Division of the Budget, www.budget.state.ny.us. FY04 is an estimate.

tax rate was increased from 6.85 percent to 7.7 percent, and the top state-plus-local rate in New York City increased to 12.15 percent (Table 1). The state sales tax rate was increased from 4.0 percent to 4.25 percent with local sales taxes added on top. In New York City the combined state and local sales tax rate is 8.625 percent. Other recent tax increases have included a hike in cigarette taxes, elimination of corporate deductions, a suspension of the $110 sales tax exemption for clothing and footwear, and various fee increases.[6] Some of those tax increases are supposed to be temporary, but high spending and continued deficits could give legislators an excuse to keep the higher tax rates. Table 2 shows that New York's tax rates are above rates in other states. New York City's add-on taxes make matters worse for state residents living in the city.

The failure to control spending is also causing the government to increase the state's debt load. To close this year's budget gap, the state is selling $4.2 billion in bonds to be repaid from future tobacco company payments. This policy is a short-term Band-Aid that covers up a lack of spending restraint. Besides, the bonds are backed by the state's general fund in case the tobacco payments falter and may result in higher taxes down the road.[7] The state's high-debt policy is irresponsible because it pushes more costs onto future generations. In all, the FY04 budget uses $5.1 billion in "nonrecurring actions."[8] These are "smoke-and-mirror" provisions that allow legislators to evade tough spending decisions.

Tax and debt increases have not solved the state's budget problems. Indeed, the state comptroller projects that New York's budget deficits will be more than $5 billion in FY05 and more than $8 billion in FY06.[9] Looming deficits raise the threat of more tax increases, which would further reduce family incomes and slow state economic growth.

Tax increases damage economic growth in two primary ways. First, higher taxes shift resources from the more productive private sector to the less productive government sector. In the government sector, money is spent according to political and interest group preferences, not according to consumer demands and market signals that ensure efficient usage. In the government sector, failed programs or departments usually get additional resources to waste. In the private sector, failure results in resources being reallocated to more efficient enterprises. The government has a strong ten-

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Table 1
New York's Top Income Tax Rates

Income	2002	2003	2004	2005
New York State				
$100K–$500K	6.85%	7.50%	7.35%	7.25%
$500K +	6.85%	7.70%	7.70%	7.70%
New York City				
$100K–$500K	3.65%	4.25%	4.18%	4.05%
$500K +	3.65%	4.45%	4.45%	4.45%
Combined State and City				
$100K–$500K	10.50%	11.75%	11.53%	11.30%
$500K +	10.50%	12.15%	12.15%	12.15%

Source: Author's compilation based on data from New York Department of Taxation and Finance, www.tax.state.ny.us.

Table 2
Top Tax Rates: New York vs. U.S. State Average, 2003

Tax	New York State	New York State and City	U.S. State Average
Top individual income tax rate	7.7%	12.15%	5.3%
Top corporate income tax rate	8.775%	17.275%	6.7%
Gasoline tax (per gallon)	$0.33	$0.33	$0.23
Cigarette tax (per pack)	$1.50	$3.00	$0.71

Source: Author's calculations based on data from Small Business Survival Committee and Federation of Tax Administrators. State average includes Washington, DC.

dency to become less productive over time without a major shakeup, whereas the private sector steadily increases productivity and boosts the nation's living standards.

Second, higher taxes, particularly income taxes, diminish incentives for working, saving, investing, and entrepreneurship, which are the sources of economic growth. This year New York raised state tax rates on personal income, dividends, interest, and capital gains for individuals earning more than $100,000. That income group includes highly skilled people who can be quite tax sensitive and move out of the state when the government gets too greedy. To compound the problem, state lawmakers gave New York City approval to increase its personal income taxes. Recent increases have pushed the combined state and New York City top personal income tax rate to 12.15 percent—the highest in the nation.

High tax rates put New York at a disadvantage in the national and global competition to attract capital and skilled labor. Capital and labor in search of the best economic climate are increasingly mobile across state and international borders.[10] As a consequence, New York's government needs to become leaner so that tax rates do not get out of line with those of other jurisdictions. Tax increases will result in fewer businesses and slower economic growth, thus shrinking New York's tax base.

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Cross-state statistical studies have looked at the relationship between tax rates and economic growth. For example, a study by the congressional Joint Economic Committee looked at state taxes and personal income growth between 1960 and 1993 and found that low-tax states grew almost one-third faster than high-tax states.[11] A 1996 study by the Federal Reserve Bank of Atlanta looked at state and local taxes compared to state income growth from 1960 to 1992. The study found that high taxes were negatively related to economic growth, whether marginal tax rates or overall tax levels were considered.[12]

International investment flows into the United States also are affected by state-level taxes. For example, a study by Deborah Swenson of the University of California–Davis found that U.S. states that have higher taxes attract fewer new investments and plant expansions from foreign companies than do lower-tax states.[13]

High-tax states also lose out with regard to America's mobile workforce. A recent study by economist Richard Vedder looked at the impact of taxes on domestic migration by comparing the 25 highest-tax states with the 25 lowest-tax states.[14] From 1990 to 1999, the low-tax states gained 2.05 million people from other states, on net, while high-tax states lost 890,000. From 2000 to 2002, low-tax states gained 729,000, and high-tax states lost 371,000 people, on net.

New York has lost population because of domestic migration. From 1990 to 1999, it lost a net 1.9 million people to other states. From

2000 to 2002, it lost a further 373,000. Partly as a result, New York's economic growth has trailed that of other states. Between 1977 and 2001, real gross state product across the 50 states increased at an average annual rate of 3.1 percent—24 percent faster than the 2.5 percent growth rate in New York.[15]

New York has badly lagged the nation in overall population growth. From 1970 to 2000, New York's population grew just 3.8 percent, compared to 38 percent growth for the nation.[16] After 1990 New York performed somewhat better with a 5.6 percent population growth rate but still lagged the nation's population growth rate of 12.9 percent.[17]

New York also has underperformed the rest of the nation in job growth. While U.S. employment grew 71 percent from 1970 to 2002, New York's employment grew 24 percent.[18] From 1990 to 2002, New York's employment grew just 5 percent compared to 13 percent for the nation.[19]

The lack of job creation signals a lack of entrepreneurs willing to battle the state's taxes and regulations. That is unfortunate because between 60 and 80 percent of net new jobs are created by small businesses with fewer than 500 employees.[20] New York ranks poorly in an annual assessment of states' small business climates by the Small Business Survival Committee.[21] The latest SBSC Index for 2003 measured 21 different government-related costs and found that New York ranked 45th, thus having one of the worst climates in the nation for small business.

New York's poor economic performance will likely continue until it adopts a strategy of lower taxes and leaner government. Today individuals and businesses are responding more strongly than ever to the disincentives created by high taxes. For example, with recent city and state tax hikes, New York City now has the highest cigarette taxes in the country at $3.00 per pack. The city's recent tobacco tax increase, which pushed the tax from 8 cents per pack to $1.50, resulted in an estimated $127 million in lost profits for businesses and 10,000 lost jobs, and the city raised only about half the revenue expected because of tax avoidance and negative economic effects.[22] New York's history shows clearly that high cigarette taxes give rise to large black markets, which provide a funding source for terrorists and organized crime while fostering gang battles for control of illicit profits.[23] New Yorkers have been taxed to the max—it is time for political leaders to overhaul the spending side of the state budget rather than push for further damaging tax hikes.

The Real Problem Is Overspending

The fundamental fiscal problem in New York is that the state government is too large. The economic slowdown of recent years and the terrorist attacks in 2001 have slowed New York's tax revenue growth. But instead of cutting spending to deal with the leaner revenue picture, New York's leaders have continued to spend as if the state were still in the boom years of the late 1990s when its coffers overflowed.

George Pataki did not start out as a Mario Cuomo clone, but in recent years he has jettisoned the conservative fiscal approach he had when elected in 1994. After some restraint in the mid-1990s, total state spending increased from $63 billion in FY97 to $91 billion in FY03, an annual average increase of 6.3 percent. That far exceeded the inflation rate of 2.5 percent during the period. (These figures are based on the "all-funds," or total spending, measure in the state's budget, which is a broader measure than "general fund" spending.)[24]

Total state spending in New York far exceeds average levels across the 50 states. According to the U.S. Bureau of the Census, per capita total state expenditures in New York in FY01 of $5,586 exceeded the U.S. average of $4,159 by 34 percent.[25] Spending by both the state and local governments in New York shows a similar pattern. In FY2000 New York's state and local government spending was $9,057, which was 46 percent higher than the 50-state average of $6,208.[26] Figure 2 provides a state and local breakdown for FY2000.

New York's poor economic performance will likely continue until it adopts a strategy of lower taxes and leaner government.

New York had $4,212 in debt outstanding for every person in the state in FY01—more than twice the average state government debt of $2,024.

Comparing government spending to personal income levels also shows that New York's government is overgrown compared with governments of other states. In New York, state and local spending was 26 percent of personal income in 2000, which compared to 21 percent across the 50 states.[27] Thus, New York's government costs are 24 percent higher than those of the average state even taking into account New York's higher income levels.

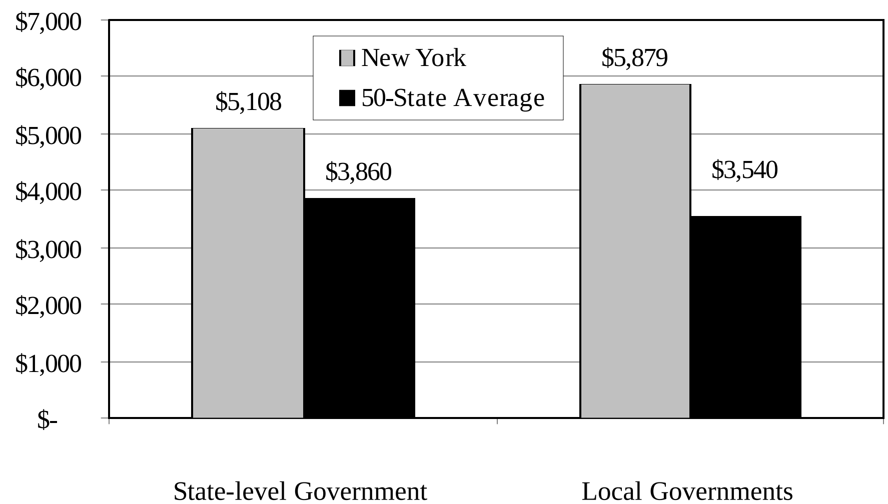
New York's excessively large government is also apparent when one looks at state employment data. New York State employs about 225,000 workers, measured in full-time equivalents.[28] Relative to the state's population, New York's state and local governments employ 15 percent more workers than the average for the 50 states.[29] Measured on a per capita basis, New York has a large number of excess government workers in welfare, heath care, trash disposal, housing and community development, and K-12 schools compared with other states.[30] Not only are there more government workers in New York, their average payroll cost is 21 percent higher than the average for the 50 states.[31]

Although the state payroll was reduced modestly during the first few years under Governor Pataki, his administration has yet to conduct a thorough review of state operations to identify ways of boosting productivity and cutting waste.[32] One study found that reducing the state payroll by 15,000 positions would save more than $700 million a year.[33] But the state legislature is very resistant to reform; in 2003 it rejected most of the proposals made by the governor to cut the state workforce by a modest 5,000 workers.[34]

New York's excessive spending over many years has pushed the state debt load to an exceptionally high level. U.S. Bureau of the Census data show that New York had $4,212 in debt outstanding for every person in the state in FY01—more than twice the average state government debt of $2,024.[35] New York's local governments are also much more indebted than local governments in other states, as shown in Figure 3 for FY2000. The buildup of debt is the result of excessive and irresponsible spending decisions made by the government in prior years. The cost of high current spending is pushed onto future taxpayers through higher debt. New York's high debt load has earned its general obligation bonds the poorest rating of those of any state from Moody's Investors Services.[36]

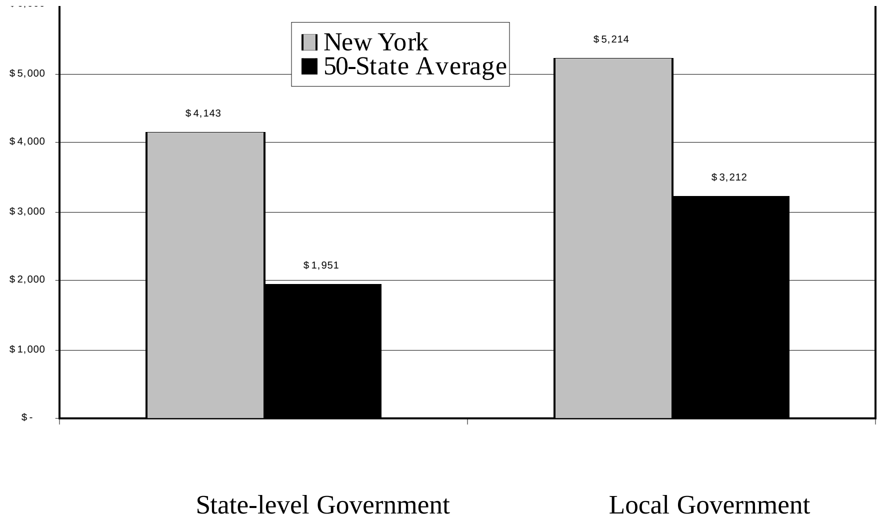
A reasonable amount of restraint in recent years would have averted today's budget

Figure 2
Per Capita Government Spending, New York vs. the 50-State Average, FY2000



Source: U.S. Bureau of the Census, www.census.gov/govs/www/estimate.html.

Figure 3
Per Capita Government Debt, New York vs. the 50-State Average, FY2000



Source: U.S. Bureau of the Census, http://www.census.gov/govs/www/estimate.html.

deficits and opened the door to needed tax relief. Consider that, if state spending increases had been kept to the inflation rate since FY95, overall spending would have been $77 billion in FY04, far less than the actual $95 billion projected. New York officials need to start reversing the damaging run-up in state spending by implementing the reforms proposed in the following sections.

Cutting Spending for a Better Government and a Stronger Economy

For decades New York officials have viewed government spending as a cure-all for society's ills and added programs here and there in shortsighted strategies to win votes. But that budget approach has left New Yorkers with high taxes and a bloated and ill-functioning bureaucracy with tentacles in many areas of the economy that should be left to the private sector. The current state budget crisis provides the governor and the legislature an opportunity to cut unneeded programs in order to balance the budget, provide tax relief, and boost the state's economy.

A reform goal for policymakers should be to cut New York's spending level to at least the average level in the other states. To cut the size of New York's state government to the 50-state average (as measured on a per capita basis) would require a 25 percent cut.[37] Legislators could begin by cutting the pure waste and pork-barrel spending in the budget. For example, millions of dollars are set aside in the state budget each year for "member items," or "lulus." This is money that legislators and the governor dole out to their favored special interest groups and pet projects. The state Division of the Budget estimates that such wasteful pork items will cost about $100 million in FY04.[38] Spending on such pork is irresponsible at any time, but it is particularly egregious with large deficits facing the state government.

New York's excessive spending is, however, a far broader issue than pork-barrel spending. The governor and the legislature need to begin identifying low-priority programs and departments in the budget and terminate or privatize them. Regarding each department and agency in state government, legislators should ask the following questions:

- Should government be undertaking the activity at all? Is there an actual market failure that justifies government action?

New York's excessive spending is a far broader issue than pork-barrel spending.

Medicaid payments per beneficiary in New York totaled $7,646 in 2000, vastly more than the U.S. average of $3,936.

- Should taxpayers be forced to pick up the tab for programs that may benefit only a narrow constituency or interest group?
- If government should be involved in an activity, would the responsibility be more efficiently handled by local governments than by the state government?
- Is government action actually solving the problem aimed at in a program? Is the program creating negative side effects that outweigh any benefits?
- Are private-sector firms or charities better equipped to perform a service with higher quality and lower cost?
- Is government action impeding entrepreneurs from pursuing their own plans that would provide the required service?

State spending programs might have a useful goal but could be better carried out by private firms or charities. Turning to the private sector can present large opportunities for savings and improvements in performance. Hundreds of billions of dollars worth of government assets have been sold to the private sector in this country and abroad in recent decades. But the Reason Foundation has estimated that states and cities still possess some $226 billion worth of assets that could be sold.[39] New York has many such assets. Privatization can not only cut budget deficits by reducing spending, but asset sales can raise money in the short-term to pay down accumulated state debt.

Short of full privatization, many state and local governments have saved taxpayer money by contracting out government functions to private bidders. A Reason Foundation survey found that 82 percent of cities were satisfied or very satisfied with their programs for opening city services to private competition.[40] The survey found that cost savings were as high as 60 percent and that substantial improvements in quality were typical. Contracting out expert William Eggers notes: "Private vendors are often able to produce savings through innovation, advanced technology, and a commitment to customer service. Once exposed to competition, public employees will also find ways to reduce their own costs. In Indianapolis, Mayor Stephen Goldsmith bid out more than 70 city services at an average savings of 20 percent."[41] New York needs to be just as innovative as other jurisdictions in providing state and local services.

The following sections describe areas in which the state government should cut spending, privatize programs, or contract out services to competitive private firms. It is not an exhaustive list of possible savings that New York policymakers should pursue but is designed to prompt officials to adopt new strategies to put the state budget on a leaner footing.

Medicaid

Medicaid is the 20-ton gorilla of the New York State budget, accounting for 28 percent of the state's total spending in FY03.[42] Medicaid is in severe financial crisis nationally with spending rising at 9.9 percent annually during the past five years and rapid growth expected to continue unless the states and the federal government cut costs.[43]

In New York Medicaid spending is even more out of kilter than in other states—with more beneficiaries than typical and more generous spending per beneficiary. According to the National Center for Health Statistics, Medicaid spending accounted for 31 percent of personal health care spending in New York in 1998, compared to 16 percent nationwide.[44] New York's excessive Medicaid spending is also evident from Medicaid payments per beneficiary. Payments per beneficiary in New York totaled $7,646 in 2000, vastly more than the U.S. average of $3,936.[45]

Medicaid funding is split half and half between federal and state taxpayers. Government programs with a shared federal-state structure typically breed fiscal irresponsibility as states expand programs far beyond what they would if the costs were borne solely by state taxpayers. But New York's Medicaid is far more expansive than that of the typical state; it provides many optional services not required by federal rules. Optional services that New York has elected to provide include eyeglasses, physical therapy, dental services, home health care, and subsidies to graduate medical education.

New York also has greatly expanded eligibility for Medicaid over the years. Eligibility has been expanded to families far above the poverty line and to immigrants, even though this coverage is not required by federal rules. The number of people eligible for New York Medicaid soared from 2.7 million to 3.4 million between 2000 and 2002, partly as a result of the state Family Health Plus program, which expanded eligibility to those with incomes that would otherwise be too high for the program. Another recent addition to New York Medicaid is a program for providing family planning services for families with incomes up to double the poverty line.

New York's Medicaid subsidies to hospitals, nursing homes, and home health care services have disproportionately higher costs than those of other states. Another problem that boosts costs is that the percentage of Medicaid recipients in managed care in New York is just 25 percent, which is well below the national average of 56 percent.[46]

Since Medicaid accounts for more than one-quarter of New York state spending, savings in the program would have a big effect on the state's financial health. Unfortunately, state politicians act as if they were the innocent victims of the uncontrollable cost increases. In fact, New York policymakers have exacerbated the Medicaid crisis with program expansions, and they do have the power to cut the program's costs. New York should also join with other states to pressure the federal government to pursue wide-ranging reforms in the program.

Beyond simply cracking down on waste and fraud in the system, New York needs to limit the number of medical services that are covered in order to get its program more in line with coverage in other states. It also needs to sharply limit the number of beneficiaries to only the truly needy below the poverty line. Working with other states and the federal government, New York needs to push for an overhaul of the basic structure of the program. A reform idea with promise is to shift Medicaid spending to a voucher program, under which recipients would choose among various health care options and competitive providers. That would move away from the current centrally planned program structure toward a less costly and more responsive consumer-driven program.

Education

K-12 Schools. New York legislators increased the state education department's budget from \$10.7 billion in FY95 to \$20.6 billion by FY03.[47] That 93 percent increase far outpaced the 21 percent inflation during the period. Per pupil spending on public education in New York jumped from \$9,156 in 1995 to \$11,871 in 2001—an increase of 30 percent.[48] According to the U.S. Department of Education, New York's per pupil expenditures ranked third highest of the 50 states and exceeded the U.S. average by 35 percent.[49]

New York also has greatly expanded eligibility for Medicaid over the years to families far above the poverty line

Part of New York's recent spending increase resulted from the School Tax Relief program, implemented in FY98, under which state tax dollars were supposed to be used to provide local property tax relief. However, without any caps on local budgets, the effect was that local school spending and school property taxes rose at an accelerated pace. In general, state education aid to localities merely enables public schools to continue to spend excessively without having to improve performance.

More spending is not the answer for New York's schools. Indeed, many statistical studies have examined the relationship between public school spending and educational achievement. For example, more than a decade ago education economist Eric Hanushek of the University of Rochester reviewed 65 studies of the relationship between education spending and student performance and concluded, "Expenditures are unrelated to school performance as schools are currently operated."[50] Similarly, John Chubb and Terry Moe of the Brookings Institution concluded: "The relationship between [money] and effective schools has been studied to death. The unanimous conclusion is that there is no connection between school funding and school performance."[51] More recent studies have continued to confirm those findings.[52]

A new study published by the Manhattan Institute found that New York's high school graduation rate ranked 42nd among the states and the District of Columbia.[53] The report also found that the college readiness rate in New York was lower than the national average. As the Public Policy Institute of New York has observed: "New York taxpayers support one of the most expensive public school systems in the world. . . . But it's not so clear that those additional billions are rewarding or driving improvements in student performance."[54]

Since throwing more money at the schools has not improved performance, New York should explore options for injecting more competition into the public school system. Competition would exert pressure on the government schools to make more efficient use of taxpayer money and to improve the quality of education. The state should follow the lead of other jurisdictions and implement a voucher system to offer students in failing schools better opportunities. Such a reform would also save money because per pupil school costs are typically lower at private schools than at government schools.

Since throwing more money at the schools has not improved performance, New York should explore options for injecting more competition into the public school system.

Consider a personal example. My local public school district on Long Island spent $15,329 per pupil in 2001.[55] This is typical for Nassau and Suffolk Counties, where per pupil spending averaged $14,722 and $14,886, respectively.[56] Meanwhile, my family pays $3,000 in annual tuition for our child in a local private religious elementary school.

State University of New York. The largest university system in the country is the State University of New York with 64 campuses.[57] SUNY's FY03 budget was $4.2 billion, of which more than $1 billion comes from taxpayers.[58] SUNY's daunting size should be vastly reduced, and ultimately the system should be privatized with direct grants and loans to needy students as a more efficient and cheaper method of subsidizing higher education.

In the short term, a much larger share of SUNY's costs should be shifted from taxpayers to students through higher tuition. After all, students are the main beneficiaries of their education, as they gain higher salaries and better jobs after graduation. Indeed, many young people leave New York and take their taxpayer-financed skills elsewhere. SUNY's resident tuition is just $4,350 annually for FY04, which is far lower than tuition at government schools in nearby states, such as Rutgers University ($5,770), the University of Connecticut ($5,260), the University of Massachusetts at Boston ($5,227), the University of Vermont ($8,696), and the University of Maryland ($5,734).[59]

City University of New York. The City University of New York is the third largest university system in the nation, with 11 senior colleges, a graduate school, a law school, and six community colleges.[60] In 1982 the state took financial responsibility from New York City for CUNY's senior colleges, while also supporting the community colleges. In FY03, CUNY received $859 million from state taxpayers.[61]

New York State should not be paying for New York City's university system, especially since the state has its own university system. Financial responsibility for CUNY should be returned to the city of New York. But both the state and city governments should plan to remove themselves from the business of running universities since private institutions have proven themselves superior educators in this country. If the state government is to support educational opportunities for low-income students, direct subsidies to students would be far more efficient than having the government operate an enormous higher education bureaucracy.

Other Higher Education Subsidies. To save taxpayer money and balance the state budget, the state can reduce other higher education subsidies. For example, the state will provide $61 million in aid to SUNY and CUNY community colleges in FY04, which amounts to $2,300 per full-time-equivalent student.[62] That aid should be eliminated. Another program to eliminate is Bundy Aid, which pays independent colleges and universities for each undergraduate and graduate degree awarded. Governor Pataki called for eliminating Bundy Aid for graduate degrees, but the state legislature provided $44 million for this program in FY04.[63]

Business Subsidies

New York State hands out hundreds of millions of dollars of taxpayer cash each year to favored businesses. Despite decades of trying, federal and state politicians cannot generate economic development and outperform the market economy with business subsidies that target particular industries and businesses. Economic growth comes from working, saving, investing, and entrepreneurship in the private sector. Governments can help by providing a sound legal framework, a light regulatory touch, and low taxes, and these are the areas where New York falls far short.

Economic Development Activities. The Department of Economic Development is supposed to advise the governor and legislators on economic development, develop economic strategies, coordinate efforts among governmental entities, and provide technical and funding assistance to businesses.[64] This department, which had a $41 million budget in FY03, should be eliminated.[65] The department mainly serves the political function of allowing state politicians to sprinkle taxpayer money to favored special interests. Economically, the department misallocates resources by removing money from the private sector to spend on less productive government projects.

Similarly, the Empire State Development Corporation, which engages in real estate schemes, economic development, state facility financing, housing portfolio maintenance, and other activities, should be eliminated.[66] (Its useful privatization efforts could be transferred to another agency.) This overgrown entity had an FY03 budget of $109 million.[67]

The governor's Empire Opportunity Fund should also be terminated to save taxpayers $100 million over five years. This initiative is supposed to "help create thousands of new jobs by supporting major economic development projects across New York State," according to the governor's office.[68] But if the state creates a $50,000 job with a handout, it must have extracted $50,000 from the private sector where it would have created private-sector jobs. The idea that the government can "create jobs" is a costly and damaging myth.

Energy Research and Development Authority. Mirroring the federal government's failed efforts to control and guide energy markets, New York State has had an Energy Research and Development Authority since 1975. The authority, which had a $28 million budget in FY03, is supposed "to develop and implement new energy technologies, focusing on renewable energy sources and energy conservation."[69] After paying for this state government agency for three decades, taxpayers have a right to ask when the government plans to actually discover a viable renewable energy source. As another unneeded intrusion into the marketplace, this authority provides subsidies to investor-owned utilities in the form of tax-exempt bonds for capital investments. The Energy Research and Development Authority should be eliminated because a state agency cannot improve on private markets in creating a secure energy future for New York.

Department of Agriculture and Markets. This department is another unneeded business subsidy agency. The Department of Agriculture and Markets, with an FY03 budget of $93 million, aims to promote the agricultural economy of the state.[70] But farmers and farm organizations should be responsible for promoting their products themselves, as are businesspeople in nearly every other industry. This department performs many tasks that could be easily privatized, such as running the huge New York State Fair and Fairgrounds.

Grow New York Food and Agriculture Industry Development Program. This program

New York State hands out hundreds of millions of dollars of taxpayer cash each year to favored businesses.

New York should be trying to attract more private capital by reducing its tax rates and creating a good climate for business start-ups, rather than engaging in speculation with taxpayer money.

is a specific example of agriculture subsidies that should be cut.[71] The program spent $500,000 on giveaways for activities, such as marketing, that farmers should undertake for themselves. The money was paid, for example, in grants to the Cornell Cooperative Extension to "assess the feasibility of developing a producer-owned, value-added meat processing and marketing system" ($51,570); Hopkinson Farms to "identify proper kitchen uses for common varieties of New York–grown potatoes, market varieties by best use, and create a premium brand image for New York potatoes" ($49,000); Cornell Cooperative Extension to "develop and distribute a marketing guide for New York producers of agroforestry products" ($4,810); Militello Farms to "refine software that will enable a prototype robotic grape pruner" ($28,000); and Regional Farm and Food Project to "organize and develop a statewide association of small, mostly on-farm cheesemakers" ($26,462).

Olympic Regional Development Authority. The state owns two ski resorts, Whiteface Mountain and Gore Mountain, through the Olympic Regional Development Authority. The authority, which was established after the 1980 Lake Placid Winter Olympics, also operates an ice-skating center, a speed-skating oval, bobsled and luge runs, ski trails, a biathlon range, a ski-jumping complex, and the U.S. Olympic Training Center. State taxpayer subsidies for these efforts were more than $7 million in FY03.[72] These facilities should be privatized, and the state government should get out of the winter sports business.

Office of Science, Technology, and Academic Research. This office is yet another misguided state effort, which is duplicative of private-sector activities, to stimulate the economy. The FY03 budget for this agency was $60 million, which flows to a variety of technology and economic development endeavors, such as venture capital efforts, the creation of business plans, aid to manufacturers, and semiconductor research.[73] But taxpayer money is not needed for these purposes because the United States has huge pools of private money available to fund scientific and industrial research and development. For example, the U.S. venture capital industry funded new technology firms with $21 billion in 2002.[74] At the peak of the last boom in 2000, U.S. venture capital investment was $100 billion. New York should be trying to attract more of this private capital pool by reducing its tax rates and creating a good climate for business start-ups, rather than engaging in speculation with taxpayer money.

The governor's five-year $283 million Centers for Excellence program is a similar duplication of private efforts. The program is supposed to allow the state to "effectively target its high-tech investments and rapidly respond to ever-changing technologies and business opportunities."[75] But it is ridiculous to think that a state bureaucracy could stay ahead of private markets in "targeting" technology. This program should be canceled.

State Funding of Local Activities

An examination of press releases on Governor Pataki's webpage makes it appear that the governor and his staff spend much of their time buying votes by sprinkling taxpayer money throughout the state for local projects such as road improvements.[76] The practice of the state government assuming greater fiscal power over local activities creates unfairness and inefficiency because taxpayer cash gets channeled through the political machine and bureaucracy in Albany. There is no economic reason to fund local activities through the state budget. The practice appears meant to simply provide photo opportunities for state politicians.

The following are some examples taken from the governor's press releases. Some of these activities are pure waste, some should be carried out by local governments, and some should be carried out by private companies and charities.

- $400,000 to help reconstruct and convert an old Woolworth store in Glens Falls into a theater

- $2.7 million to seven communities in the capital region for housing rehabilitation and home ownership projects
- $350,000 in "technical assistance" to localities for "use in developing a strategic plan to identify steps to achieve specific community development goals and objectives"
- $2 million grant to the Palace Theater in Albany for a new marquee and electrical work
- 65 grants totaling $771,907 to organizations in New York City and Westchester County to "encourage community involvement in environmental protection and education"; this money went, for example, to Staten Island's Blue Herron Park for environmental education classes; Audubon's "For the Birds" program in public schools; the Cherry Tree Association for "education of youth and their parents about the existence of the waterfront and its possibilities for public enjoyment"; the East Village Parks Conservancy to implement "an integrated, comprehensive community outreach and education initiative that fosters community involvement and recruits and trains volunteers"; Friends of Brook Park Nature Preserve to create a "Harmony Grove Peace Walk Labyrinth"; and Theodore Gordon Flyfishers to produce an instructional video for teachers participating in the "Trout in the Classroom" program

New York State will pay $562 million to local governments in general purpose aid in FY04 and an additional $47 million in "emergency" local assistance.[77] Intergovernmental funding should be phased out because it breeds wasteful spending as communities demand excessive services when the costs are borne by citizens in other parts of the state.

At the same time, New York's local governments rightly complain that the state imposes costly mandates on them. Albany needs to conduct a detailed review and cost analysis to reduce such mandates, which have the effect of driving up local taxes. A 1999 report on state-imposed mandates on localities estimated that reforms in various areas, such as Medicaid, education, construction, and liability laws, could save local taxpayers $5 billion annually.[78]

Wasteful "Feel-Good" Programs

Council on Children and Families. This $1.9 million state agency is a good example of the bureaucratic morass of New York government. The agency is supposed to "improve and strengthen services to children and families . . . accomplished through better coordination between and among service providers and supervisory agencies . . . and useful mechanisms to resolve interagency conflicts regarding the provision of services."[79] The agency admits that it "does not have direct responsibility for the operation of programs" but "is able to carry out its mission with the support of the commissioners or directors of the State's 13 health, education and human services agencies which make up its membership."[80] The council publishes glossy annual reports with pictures of happy families and vacuous rhetoric such as "New York loves its children." New York taxpayers cannot afford such feel-good agencies and they should be shut down.

Division for Women. Another unneeded feel-good agency is the state's Division for Women.[81] This organization publishes brochures and webpage discussions that duplicate information on women's issues that can be found in any bookstore. The agency says it "serves as an advocate for women's issues." But surely it is the role of private organizations, not an arm of the government, to "advocate" particular policies in a free society.

Office of Aging. This agency, which targets an important voting constituency, has 59 local offices scattered around the state and a budget of $169 million.[82] Like the Division for Women, the agency produces glossy brochures and information that is easily available from other sources. The Office of Aging's website, for example, offers detailed tips for eating well and getting exercise. The

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Extracting additional money from highly taxed New Yorkers to fund entertainment activities chosen by a political elite is unneeded and unfair.

agency's website even has a number of pages devoted to teaching the best warm-up exercises for golf!

Council on the Arts. The New York Council on the Arts uses taxpayer money to fund orchestras, dance groups, theaters, and other leisure activities. From FY95 to FY03, the council's budget grew from $36 million to $52 million, an increase of 44 percent.[83] Government funding of leisure and entertainment activities should be eliminated, and New Yorkers should be free to support arts of their own choosing. After all, New York has a huge consumer demand for the arts and great amounts of private wealth and charity available to fund worthy arts groups. Extracting additional money from highly taxed New Yorkers to fund entertainment activities chosen by a political elite is unneeded and unfair. By contrast, purely private funding of the arts would better ensure that resources were directed toward the actual preferences of New Yorkers, rather than the preferences of the subsidy-driven arts establishment.

Other Agencies and Programs

Governor's Office and State Legislature. To set a new frugal tone for state government, policymakers should cut spending on the governor's office and state legislature. The budget for the legislature was $209 million in FY03, or $980,000 per member, which leaves plenty of room for cuts. In 2002 the legislature had a staff of 3,805, the largest of any state. A staff reduction of 40 percent, which would save $73 million annually, should be pursued.[84]

Department of Environmental Conservation. In recent years New York's state and local governments have increased efforts to buy land for preservation. But such undertakings are often driven, not by sober, scientific analyses, but by hype created by special interests. These purchases have been costly for taxpayers, and some have trampled on private property rights. The government should reverse course and look into opportunities for privatizing government-owned land and unneeded facilities.

The Department of Environmental Conservation, with a budget of $826 million in FY03, manages more than four million acres of state land—about 13 percent of the state's entire land area.[85] An analysis should be carried out to identify holdings that could be privatized.

Also ripe for privatization are the hundreds of essentially private business activities in the state managed by the environment department. These include 12 fish hatcheries, a game farm, 328 boat launching and fishing access sites, 52 campgrounds, and the Belleayre Mountain Ski Center.[86] Proceeds from state asset privatization could be used to pay down the state debt and put the state's finances on a sounder footing.

Office of Parks, Recreation and Historic Preservation. Another agency that should pursue privatization and competitive contracting is the Office of Parks, Recreation and Historic Preservation, which had an FY03 budget of $209 million.[87] The office operates 35 historic sites, 167 parks, 27 golf courses, 53 swimming pools, 76 beaches, 27 marinas, 40 boat-launching sites, 774 cabins, and 8,320 campsites.[88] Many of these facilities, including the golf courses and marinas, could be operated by private-sector entities or sold off completely. State subsidies to such recreational activities are often welfare for the well-to-do and outside the proper responsibility of government.

Division of Housing and Community Renewal. The surest way to meet the housing needs of New Yorkers is to deregulate housing markets and allow entrepreneurs to provide housing for people at all income levels. After all, private competitive businesses provide food, clothing, and thousands of other products for Americans of every income level and every taste. But decades of government interference in the housing market through rent controls, excessive zoning regulations, and other rules have distorted markets and created the types of housing problems that this division is supposed to address. With an FY03 budget of $234 million, this agency regulates the state's public and publicly assisted rental housing, administers rent control regulations, and runs housing development and community programs.[89] A free competitive market in housing would make the entire agency redundant, saving taxpayers hundreds of millions of dollars annually.

Department of Correctional Services. New York State operates the fourth largest correctional system in the nation, with 70 facilities, more than 30,000 employees, and an FY03 budget of $2 billion. This is another area for which competitive sourcing options should be considered. In fact, three-fifths of U.S. states host private prisons.[90] Studies have found that savings from contracting out prison services to the private sector range from 5 percent to 20 percent.[91]

Public Authorities. New York has greatly expanded the size of its government by creating many off-budget public authorities. There are dozens of these government authorities, which had revenues in excess of $22 billion and more than $100 billion in debt in 2002.[92] Public authorities increase the size of state government and expand the state's debt load, but their existence and powers are not subject to the same visibility and democratic control as the rest of state government.

The big attraction of public authorities for politicians is that they do not require voter approval of issuance of long-term debt—a constitutional requirement for most New York government debt. Elected officials are able to avoid the drudgery of explaining their actions to voters by creating public authorities, which incur debt and spend money without approval from the public. Former governor Nelson Rockefeller greatly expanded the use of authorities, and New York has had a large but shadowy authority government ever since.

The state editor of the *New York Post*, Fredric Dicker, wonders how corrupt the Pataki administration is; Dicker cites scandals at the Thruway Authority, the Metropolitan Transit Authority, the Bridge Authority, the Long Island Power Authority, the state Power Authority, the Port Authority, the Dormitory Authority, the School Construction Authority, and other agencies.[93] The latest authority scandal involves a contract steered to a favored developer from the state Canal Corporation, a subsidiary of the state Thruway Authority. With so many authority scandals, it is no surprise that a recent Quinnipiac University poll found that 72 percent of New Yorkers believe that the state government is corrupt.[94]

However, the problem is not a single governor or administration; it is the vast size of the state government and the lack of transparency in a system of obscure and unaccountable agencies. New York State Comptroller Alan G. Hevesi is promising to tackle the corruption in the authorities and noted in a recent press release: "My Office has found serious problems at every single public authority we have examined, including the MTA, LIPA, NYRA, the Canal Corporation and the Dormitory Authority. New York State has about 55 public authorities and it is clear that there is not sufficient accountability and oversight."[95] Hevesi promises that he will draft reform legislation to be introduced next year to increase authority oversight and merge some authorities with existing state agencies. But the state needs to go further and privatize most of the authorities.

In the marketplace, private businesses are disciplined through open entry of competitor businesses. For government, the disciplining forces are open information and financial disclosure combined with political competition at the ballot box. But when government becomes as large as the New York government and has hidden off-budget authorities, few people have the time to examine the government's workings and cast fully informed votes. The existence of off-budget public authorities should be ended, and the state constitutional mandate requiring voter approval of all long-term debt should be honored. Special privileges for authorities should be rescinded, and most authorities should be privatized.

Special privileges for authorities should be rescinded, and most authorities should be privatized.

Conclusion

New York once served as a beacon of economic opportunity for the entire world.

The problem in Albany is not that the state has run large budget deficits but that both taxes and spending are too high.

However, the continual expansion of state government has reduced economic opportunity and dimmed this beacon in recent decades. Today far more Americans are leaving New York to seek a better life elsewhere than are coming to the state. New York's economic growth has lagged that of the rest of the nation.

The problem in Albany is not that the state has run large budget deficits but that both taxes and spending are too high. As the overall level of spending continues to rise, ever more resources are siphoned out of the private sector into the less productive government sector. The state's large budget deficit is not the core problem, but it is a warning signal that the government has grown too large and is spending too much.

Tax increases are not the solution to fiscal problems because they drive economic activity out of the state. Increased state borrowing simply pushes costs onto tomorrow's taxpayers. Higher taxes and more debt in New York have, unfortunately, allowed state policymakers to evade the tough spending tradeoffs that citizens elect them to make.

Spending cuts are needed to move the state back toward the lean government that New Yorkers deserve. Each state agency and program should be examined to see whether it is a candidate for termination, contracting out, or privatization. In addition, legal restraints should be placed on overall annual budget growth to protect taxpayers from further unneeded tax hikes. A tax limitation amendment to the state's constitution requiring a two-thirds legislative majority to raise or impose taxes or fees would be an effective restraint. In addition, a requirement for voter approval of any tax or fee increase would improve transparency and accountability in state fiscal decisions. Such broad-based budget restraints have been successfully implemented in other states, including Colorado and Washington.[96]

New York State can no longer afford business as usual in Albany since investment capital and skilled labor are more mobile than ever. New York needs to work harder to attract these vital resources to build the industries that will provide new growth in the state's economy. There is no room for bloated government and excessive tax rates in today's dynamic and competitive economy. The size of government needs to be reduced, not only to balance the budget, but to reduce the tax burden on families, investors, and entrepreneurs so that New York can lead the nation in economic opportunity once again.

Notes

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