Remarks by
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Before the New York Senate Select Committee on Budget & Tax Reform
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Good afternoon, Senators. Thank you for the invitation to speak to you about the urgent issue of the State's budget.

I am Carol O'Cleireacain, currently Senior Fellow (non-resident) at The Brookings Institution and an economic consultant. I speak today as someone who came here from London in 1976, at the depth of the City's fiscal crisis, became immersed in it as Victor Gotbaum's chief economist at AFSCME DC37, spent the early 1990's as Mayor David Dinkins' Finance Commissioner and Budget Director and the late 1990's steeped in the District of Columbia's fiscal crisis. I was Deputy Treasurer of the State of New Jersey during the first year of Governor Corzine's administration.

My experience has given me both a special interest and expertise on fiscally distressed governments. Unfortunately, there have been many. As different as they may seem, New York City's and Washington's stories were essentially the same: lenders eventually lost trust in their ability to pay their debts and so the credit markets closed on them. This happened in seemingly rich places. But, these governments behaved badly over an extended period of time – not least because they did not pay attention to the consequences of their actions. As a result, the governments which had earlier granted them home rule were forced to step in with cash and loans to save the day and with financial oversight and budget reform to ensure there would be no repeat.

This background has everything to do with the budget of the State of New York today.[1] For decades, regardless of the strength of the economy, recurring revenues have been insufficient to sustain ongoing spending. This is the definition of a **structural imbalance.** The imbalance is getting worse, since the combination of high spending and a volatile revenue structure has not been addressed. Instead, New York struggles to get one year's budget to balance, temporarily, through heavy dependence on one-shot actions,[2] making the next year's balancing even harder. Clearly, budget balance has not been sustainable in recent decades for the State of New York.

According to the Division of the Budget, the annual growth path for State spending averages about 7.5%/year, while revenues are growing at about 3.5%/year. The four percentage point annual difference between the growth of spending and the growth of revenue generates the large multi-billion dollar gaps that must be closed permanently to achieve a sustainable budget path. In addition, the State needs to build up some significant reserves to serve as a cushion over time.

It is not realistic that such an ongoing gap can be closed in one fell swoop. And, it will not be easy to change the learned behavior generating these persistent and growing gaps. There needs to be a new way of doing business in Albany when it comes to budgeting: the imposition of new rules and discipline, carrying with it the threat of shame and strong punishment for failure.

Let me list some of the changes that I believe will be necessary.

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1 For an excellent description of the current New York budget situation, see Robert Bifulco and William Duncombe, *Budget Deficits in the States: New York*. (Syracuse University, mimeo, 2009)

2 About $20-24 billion in the past ten years.

One is a **multi-year financial plan process**. I emphasize the word "process." In cities, this process has been initiated by statute and overseen and enforced by an independent control board until the standards, rules, procedures, documents and analyses have been internalized by the elected officials and staff. Once there is evidence that there is a new way of "doing business," it becomes realistic to expect that taxpayer and investor trust will be restored.

Essential to a multi-year financial plan is a budget balanced according to Generally Accepted Accounting Principles (GAAP). With GAAP budgeting, you cannot use next year's revenues to pay this year's expenses. And, you cannot roll expenses from this year to the next and claim that this year is balanced. Both, as you know, are common practices in Albany.

Another essential is a mandatory revenue estimate for the budget year.

An integral part of the process is mandatory quarterly revisions, requiring spending and revenue actions, by the executive and the legislature, to keep the annual budget in balance and to make explicit the implications of the changes for the out-years. The executive budget presentation is one of these quarterly revisions.

A multi-year financial plan counters the all too human preference for the "short-term" by making **visible and ongoing** the **consequences** of policy decisions: new programs; collective bargaining agreements; tax changes. Policy actions are examined through the lens of their ongoing (out-year) impact. Such a plan provides some incentive to pair one-time revenues with one-time spending actions. The process is designed to present the implications of a worsening situation in time to take actions to prevent disaster.

Finally, most New Yorkers are probably not aware that the Division of the Budget produces tables forecasting baseline spending and revenue for the following three years; their estimate of the "out-year" budget gaps approaches $20 billion dollars in FY13-14. For all the hard work they put into the effort, it receives scant recognition. These tables do not function as a four-year financial plan. They are not used in making budgets; there is no mechanism to act on them.

Adopting a multi-year financial plan process would provide you, as legislators, with the information and tools to break out of the constrained budgeting you have been doing. You would have a clear roadmap of the drivers generating the growing structural imbalance, which would present you with the opportunity to reshape significantly major programs.

In closing, I assure you that I know this State is not the same as a city verging on bankruptcy. You have the sovereignty; no one can impose a control board on you. If you are to adopt a multi-year financial plan process – with the budget and reporting discipline it involves – you will have to do it yourselves, because you are convinced you can no longer continue on the current path. You will have to live this discipline and accept serious penalties for failure. You would do it to change Albany's culture for the better.

The culture around cash accounting is one of fiscal manipulations as long as payments to creditors can be deferred and cash can be found somewhere. However, sometimes money runs out. The global financial crisis has shown us the catastrophic failures that occur when funding sources dry up. As a result, it has produced a move towards greater discipline, regulation and transparency in a wide range of our public and private institutions. New York State cannot risk being left behind. Capital markets are unforgiving in their judgments.

Thank you. I will be happy to take questions.