

Balancing New York State's 2006-2007 Budget in an Economically Sensible Manner

January 2006

Fiscal Policy Institute

One Lear Jet Lane
Latham, New York 12110
518-786-3156

11 Park Place, Suite 701
New York, NY 10007
212-721-5624

www.fiscalpolicy.org

The Fiscal Policy Institute (FPI) wishes to thank the Ford and Charles Stewart Mott Foundations for their support of the state fiscal analysis work that makes this briefing book and the briefings at which it is being presented possible. FPI also wishes to thank the other foundations that support its work and the many organizations, including labor unions, religious congregations and other faith-based organizations, human services providers and advocates, and community and good government groups, that support FPI's work and/or disseminate the results of FPI's analysis. FPI also extends a special note of appreciation to CSEA for printing this briefing book.

Additional information on state fiscal and economic issues and copies of the Fiscal Policy Institute's publications are available on the FPI website at www.fiscalpolicy.org .

January 2006

Introduction and Overview

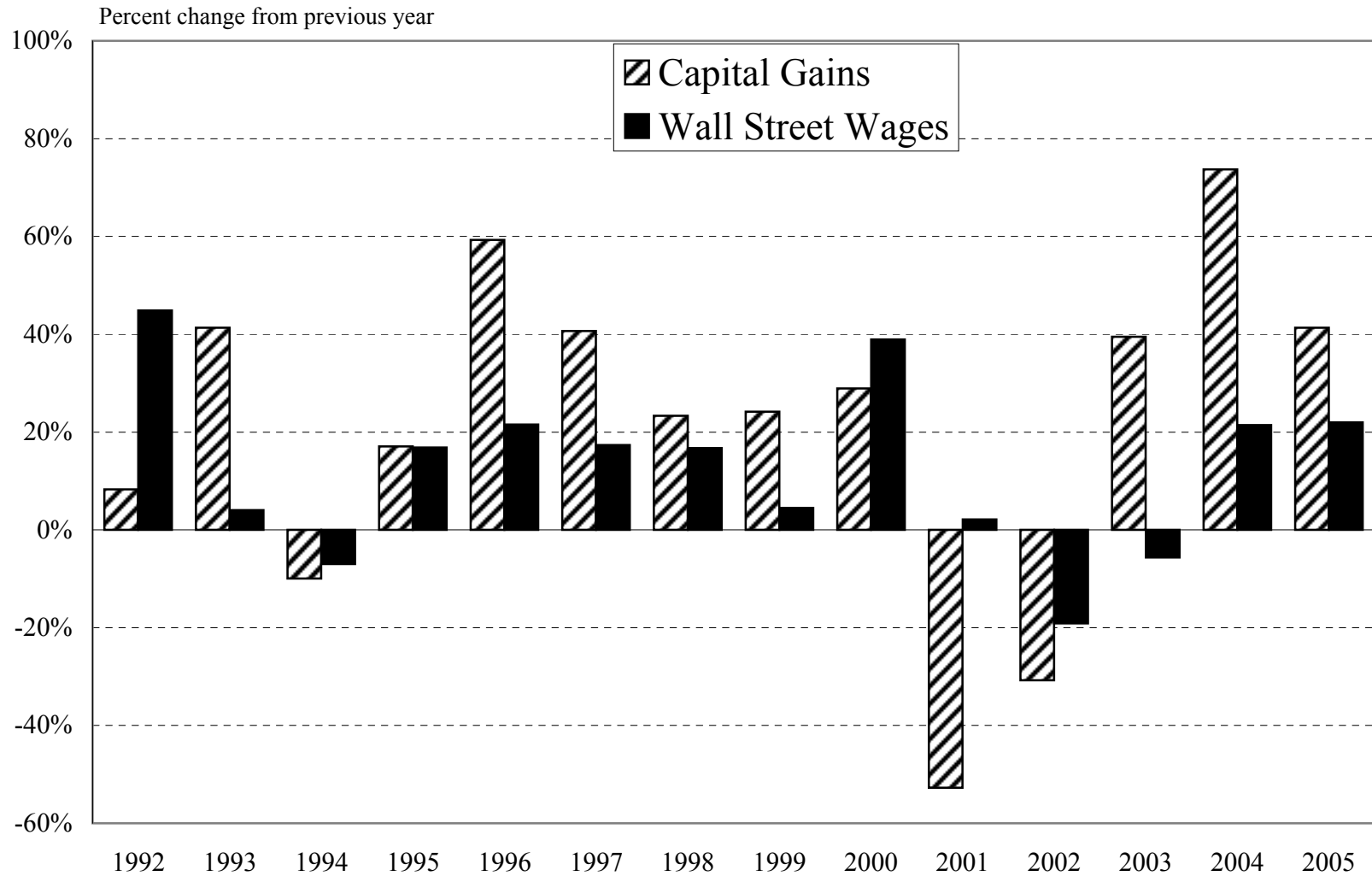
- The Fiscal Policy Institute (FPI) was established in early 1991 as an outgrowth of a broad-based Coalition for Economic Priorities that had come together two years earlier in response to the 1989-90 Executive Budget in which Governor Cuomo proposed to close a \$2.7 billion budget gap through deep cuts in important government services, increases in fees and regressive taxes, and shifts in responsibility to local governments. Governor Cuomo insisted that the budget be balanced without increases in the state's broad-based taxes.
- In 1989, the Governor and the Legislature, despite or perhaps because of the state's fiscal problems and its weakening economy, insisted on going forward with the third phase of the large, multi-year personal income tax cut that had been enacted in 1987. But contrary to the claims of tax cuts advocates, the large personal income tax cuts that were implemented in 1987, 1988 and 1989 did not inoculate New York from the emerging national recession. In fact, New York and the rest of the Northeast were hit particularly hard by that recession - and New York went from positive, but weakening, employment growth in 1989 to employment declines during the next three years. In the early 1990s, the Governor and the Legislature did defer the remaining steps of the 1987 tax cuts but they still chose to close the state's budget gaps during that period primarily through counterproductive cuts in services.
- Beginning in 2001, after seven years of good times, New York State was again confronted by significant economic problems and related fiscal challenges. In 2001 and 2002, New York avoided significant tax increases and service cuts through the use of one-shots and the various reserves that the state had accumulated during the earlier boom times. In early 2003, however, the state faced an unprecedented 15-month, \$11.5 billion deficit. After an extensive debate, the Legislature closed this gap in a much more balanced manner than New York State had pursued in closing its budget gaps during the early 1990s, and the state is now enjoying the benefits of those choices.

Origins of the New York State's Recent Budget Gaps

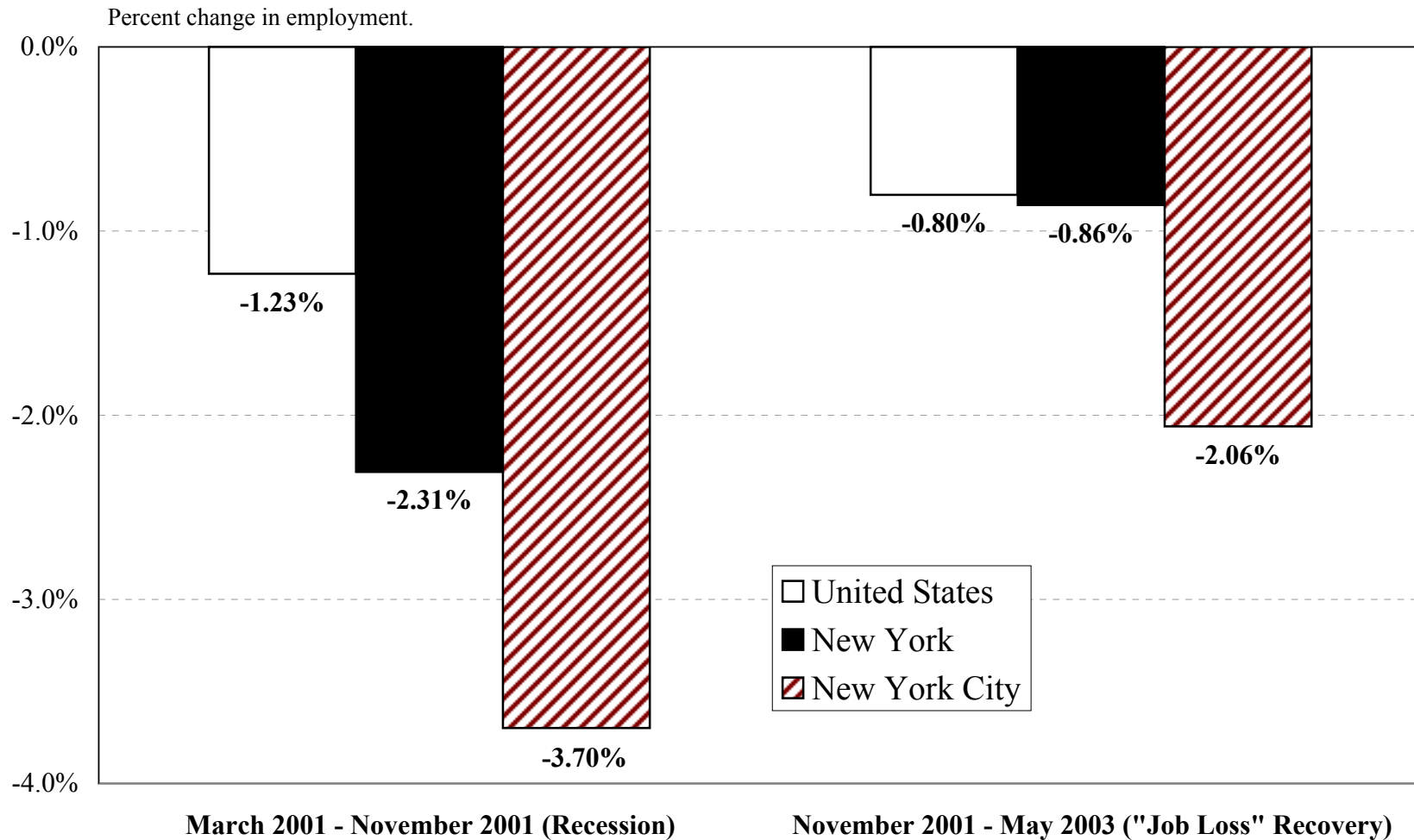
- **The bursting of the Wall Street and dot.com bubbles in 2000**
- **The national recession of March through November 2001 and the “job loss” recovery of November 2001 through May 2003.**
- **The September 11, 2001, attacks on the World Trade Center**
- **An overly ambitious multi-year tax reduction that could not be sustained through a downturn in the economy or a downturn on Wall Street. But we got both and September 11th as well.**

The bursting of the Wall Street and dot.com bubbles.

Capital gains and Wall Street wages accounted for two-fifths of the growth in New York's personal income tax base in the late 1990s, but declines in the early years of the current decade caused taxable income to fall.



**New York States's employment losses in the 2001-2003 recession and "job loss" recovery were greater than in the US as a whole.
New York City's job losses were particularly severe.**



Source: Bureau of Labor Statistics (BLS), New York State Dept. of Labor. NYS and NYC seasonal adjustment by FPI.

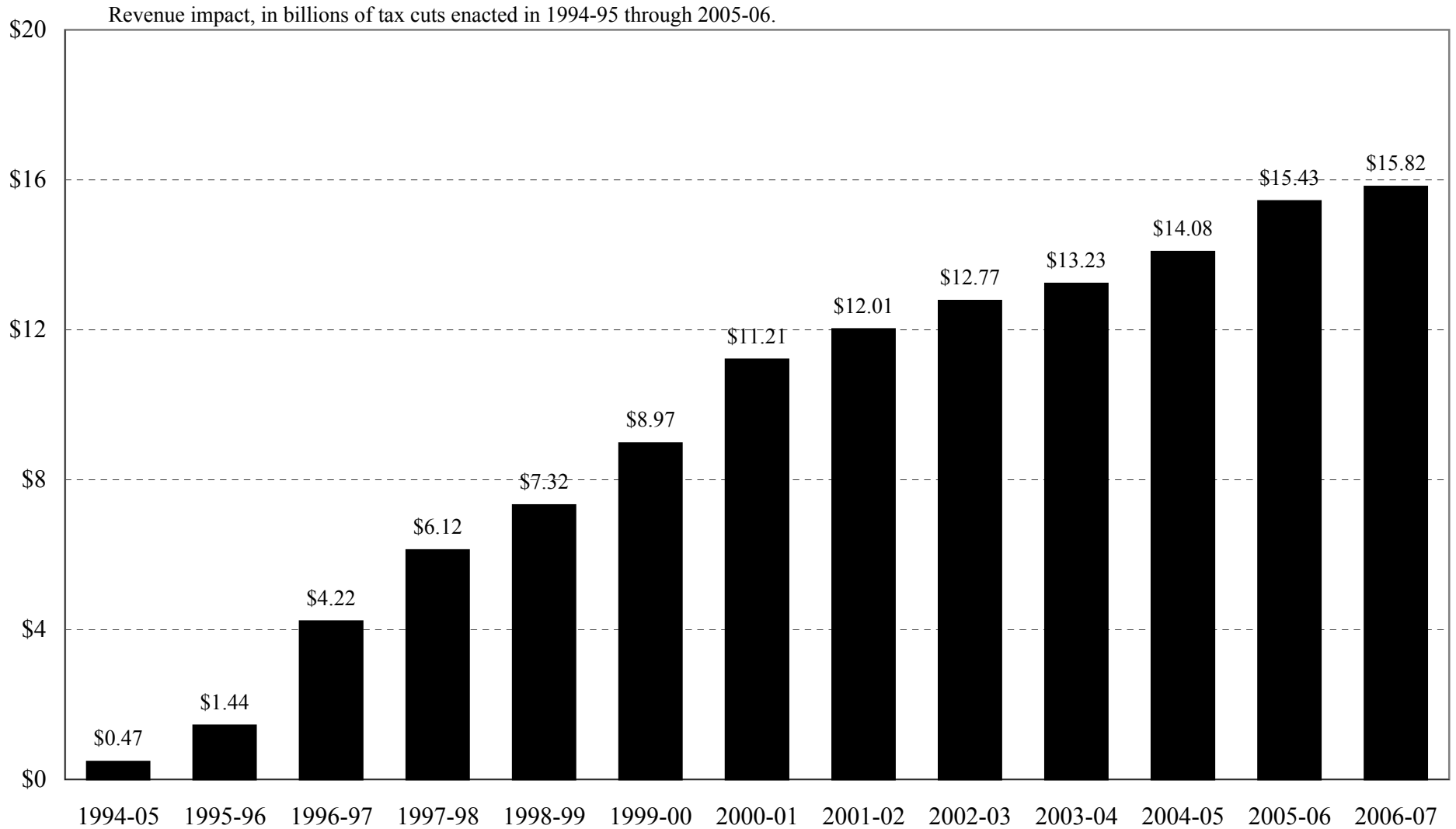
The September 11th disaster added to the problems that New York was facing because of the national recession and the bursting of the Wall Street and dot.com bubbles.

- New York State and New York City tax revenues were reduced by billions because of the loss of thousands of lives, the 26 million square feet of prime office space destroyed or damaged, and the indirect impact of the disaster on numerous industries from hotels to apparel manufacturing.
- The U. S. General Accounting Office (GAO) reviewed and validated the Pataki Administration's estimate that \$1.4 billion of the state's revenue losses during the 2001-02 state fiscal year were attributable to the September 11th attacks.
- The revenue impacts in subsequent fiscal years are probably less substantial but they are not insignificant.
- While the federal government provided aid for other disaster-related losses it did not provide any recompense for these revenue losses, even though the United States Constitution provides that "The United States shall guarantee to every State in this Union a Republican Form of Government, **and shall protect each of them against Invasion.**" (Article IV, Section 4).

The overly ambitious multi-year tax cuts enacted in the mid and late 1990s made it more difficult for the state to withstand the challenges of the 2001-2003 period.

- In retrospect, it is clear that the large multi-year tax cuts enacted in Governor Cuomo's last year in office and Governor Pataki's first six years were, when taken together, overly ambitious. The Division of the Budget estimates that these tax cuts are reducing state tax revenues by about \$15.4 billion this year and an estimated \$15.8 billion next year.
- Governor Pataki has described this effort as the largest multi-year tax reduction ever undertaken by any state. In terms of balancing this objective with prudent fiscal planning, a tax reduction plan half this size would have still been the largest state tax reduction in history but New York would have been much better positioned to weather the fiscal storms of the 2000 to 2003 period and to meet the state's priority investment needs.
- Analysts and commentators who concluded that these tax reduction plans could not be sustained in the event of a downturn in the economy or a downturn on Wall Street, without significant backtracking on either the revenue and/or the expenditure sides of the budget, were dismissed as "nay sayers." Unfortunately, during the first several years of this decade, New York had to deal with both of those development simultaneously and with the aftermath of September 11th as well.

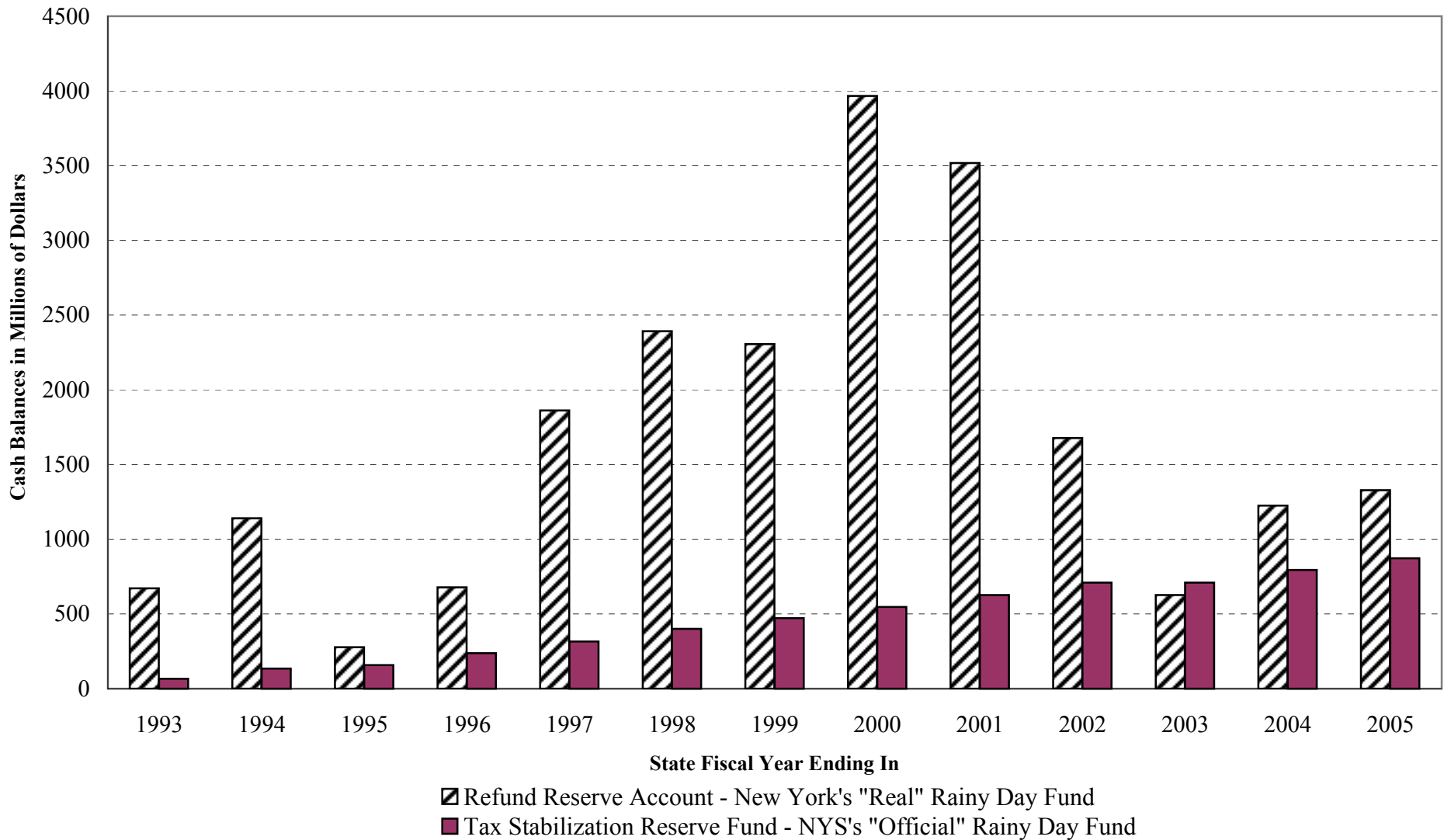
The tax cuts enacted since 1994 will reduce state revenues by almost \$16 billion during the 2006-2007 fiscal year.



Ostrich-Like Budgeting with a Little Help from the State's Reserves

- In 2001 and 2002, New York avoided significant tax increases and service cuts through the use of one-shots and the various reserves that the state had accumulated during the earlier boom times.
- In his 2002-03 Executive Budget, Governor Pataki estimated that New York State faced a \$6.8 billion budget gap - \$1.1 billion during the fiscal year that was then coming to an end and \$5.7 billion during 2002-03. To get through the year, the Governor proposed some modest tax and fee increases, the use of approximately \$2.6 billion in various reserves and other nonrecurring resources, freezes on spending for a wide variety of services and, in several areas, particularly in education and higher education, some pretty stiff budget cuts. The legislature restored many of the proposed cuts by tapping about \$1.4 billion more in nonrecurring resources.
- The official view at that time was that New York State was headed for a 2003-04 budget gap of at least \$4.2 billion IF revenue growth rebounded as projected by the Governor. But it did not. The result was the announcement in early 2003 of a budget gap of enormous proportions - \$11.5 billion. This gap consisted of an estimated \$2.2 billion shortfall for the 2002-03 fiscal year plus a projected budget gap of \$9.3 billion for 2003-04.

New York's "Real" Rainy Day Fund proved to be much more effective than its "Official" Rainy Day Fund in dealing with the rainy days of 2001 through 2003.



Closing the Budget Gap

- In January 2003, Governor Pataki proposed a multi-year plan for bringing the state's finances back into some semblance of structural balance. The Governor's multi-year strategy was not an illogical or inappropriate approach since implementing over \$9 billion in recurring service cuts and/or recurring revenue increases during a single fiscal year could very well cause substantial harm to the state's economy.
- Implicit in the Governor's multi-year approach were two kinds of budget balancing actions. **First**, the Governor was, in effect, proposing to reduce the projected budget gap to "manageable" proportions through one-shots (primarily the proposed tobacco securitization), additional federal aid, efficiencies and other actions that would not create an additional drag on the state's economy during what was then a "job-loss" recovery.
- **Second**, in addressing the remaining gap, the Governor leaned much more heavily toward service cuts than to revenue increases; **and** the revenue increases that he did propose consisted almost entirely of increases in regressive consumption taxes and fees.
- We said at the time and still believe that the Governor was correct in taking a multi-year approach to addressing the \$11.5 billion budget gap; and that he was correct in proposing to reduce the projected budget gap to manageable proportions before resorting to service cuts and/or tax increases since these latter actions would create an additional drag on the state's economy. **BUT**, when it came to the mix of service cuts and tax increases that he proposed for closing the remainder of the gap, it was clear that much better choices were possible. And the Legislature ended up making a series of such "better choices" in the changes that it made to the Governor's budget.

Reducing the Budget Gap to Manageable Proportions

- The use of nonrecurring resources to balance the 2003-04 budget was criticized by some observers as "simply putting off the problem."
- But, attempting to close all or most of a \$9.3 billion gap in a single year with ongoing service cuts and/or tax increases would have done significant damage to the state's economy.
- The argument that state policymakers should have "bitten the entire bullet" immediately was premised on the incorrect notion that the economy and Wall Street would not recover or that it would take many years for them to do so.
- On balance, the use of a mix of both recurring and nonrecurring actions to close the 2003-04 budget gap was not unwarranted even though uncertainty clearly existed at the time regarding the timing and strength of the anticipated recoveries in the economy and in the financial markets, and of their impact on state revenues.
- Under the Governor's 2003-04 Executive Budget, the proposed tobacco securitization would reduce the amount of the 2002-03 "close out" gap from \$2.2 billion to \$700 million, and the amount of the 2003-04 gap from \$9.3 billion to \$7 billion. Proposed debt restructuring and refinancing would further reduce the 2003-04 gap to be closed through spending cuts and revenue increases to a little less than \$6.5 billion.

The Governor's Approach to the Hard Choices

- Once the Governor got to the more difficult step of closing the remaining gap, he proposed to deal with the remaining \$700 million gap for 2002-03 entirely on the spending side of the ledger and to cover the remaining 2003-04 gap with \$5.2 billion in spending cuts and \$1.3 billion in revenue increases, or about \$4 of cuts (in state services and aid to localities) for every \$1 of revenue increases.
- The revenue increases that the Governor did propose were overwhelmingly increases in consumption and other regressive taxes and fees. The largest single revenue increase proposed by the Governor, for example, involved eliminating the State's relatively new \$110 clothing sales tax exemption and the replacing it with four one-week exempt periods.¹ Moreover, as the Governor's budget was reviewed by the Legislature and outside observers it became clear that many of the proposed cuts in aid to localities would have to be made up, at least in part, by property tax increases.
- The 2003-04 Executive Budget's \$5.2 billion in General Fund spending cuts included a \$1.27 billion cut in school aid, a \$1.02 billion cut in Medicaid, a \$1 billion cut in other local assistance programs, a \$1 billion cut in state government operations, and the use of over \$500 million of federal family assistance funds to cover portions of the cost of the Tuition Assistance Program and other programs that were traditionally funded with state revenues.
- At the time, the Governor attempted to justify these policy choices by (1) asserting a relationship among taxes, government spending and the economy that is inconsistent with basic economic principles, and (2) presenting an incorrect rendition of New York State's economic history.

¹ In the adopted budget, the Legislature made the repeal of the clothing tax exemption temporary rather than permanent as the Governor had proposed in the Executive Budget.

Closing the Budget Gap: The Legislature's Alternative and the Governor's Critique

- In May 2003, the legislature adopted significant changes in the Governor budget bills. By that time, the 2-year budget gap had grown to \$12.6 billion, due to revenue and spending re-estimates. Despite the growth in the size of the gap, the Legislature adopted a much more balanced approach to balancing the state budget relying more heavily on revenue increases than the Governor had originally recommended and reducing many of the spending cuts that had been recommended by the Governor.
- Ten days after the original legislative passage of its budget package, the Governor vetoed the Legislature's bill to raise state taxes, authorize transitional borrowing and allocate school aid and line-item vetoed 118 spending additions. Within 20 hours, the Legislature overrode every one of the Governor's vetoes on a bipartisan basis.
- The Governor originally argued that the revenue increases enacted by the legislature would not cover all of its spending restorations. But, shortly thereafter, the Congress adopted a significant but temporary “state fiscal relief package.” With this infusion of federal “budget balancing” aid, the Governor concluded that the 2003-04 state budget, as adopted, was credibly balanced.
- The Governor also argued that the Legislature’s approach to balancing the state budget would have terrible economic consequences. On May 6, 2003, for example, the Governor issued a press release with the following lead paragraph: “Governor George E. Pataki today announced that the fiscally irresponsible budget passed by the State Legislature will harm New Yorkers by imposing the largest tax increase in the history of the State -- a tax increase that will lead to massive job losses and a projected \$13 billion budget shortfall in the upcoming two years.”

Rhetoric vs. Reality

- As we now know, the Legislature's approach to closing the unprecedented \$11.5 billion budget gap has proven to be much more economically sensible than either the approach taken by the state during the early 1990s or the approach (which would have been, in large part, a re-run of the choices of the early 1990s) recommended by Governor Pataki in early 2003.
- By January 2005, it was clear that the multi-year approach that the Governor had recommended that the state use to address the \$11.5 billion budget gap was working. The overwhelming majority of the budget gap faced by the state in 2005-06 budget (\$3.5 billion out of \$4.2 billion) was the result of the loss of a series of one-time actions that were used to balance the 2003-04 and 2004-05 budgets. In the budget presented for 2005-06, it was clear that underlying revenue growth was once again sufficient to cover underlying expenditure growth. But the projected revenue at that time was not sufficient to replace the one time revenue and expenditure actions that were used to balance the previous two year's budgets.
- But during the course of the 2005-06 fiscal year, economic and revenue growth accelerated to the point that the state is now projected to end the fiscal year with a surplus of at least \$2 billion. In discussing the current budget surplus, the Governor has said that "This is a dramatic turnaround from last year when we were looking at a \$4 billion deficit. It just shows that good government policies like reforming and controlling the cost of Medicaid and putting in place economic policies where our economy is expanding and growing have led to higher revenues and lower costs." In listing the policies that contributed to the surplus, the Governor leaves out the most tangible factor - the temporary tax increases that were enacted in 2003, over his veto. These tax increases not only contributed to the state's fiscal stabilization but they prevented counterproductive service cuts and they clearly did not have the negative economic consequences that the Governor predicted in 2003.

The 2003 tax increases prevented the need for more counterproductive service cuts and contributed to the state's recovery and current budget surpluses.

Cash impact of significant recent tax increases.

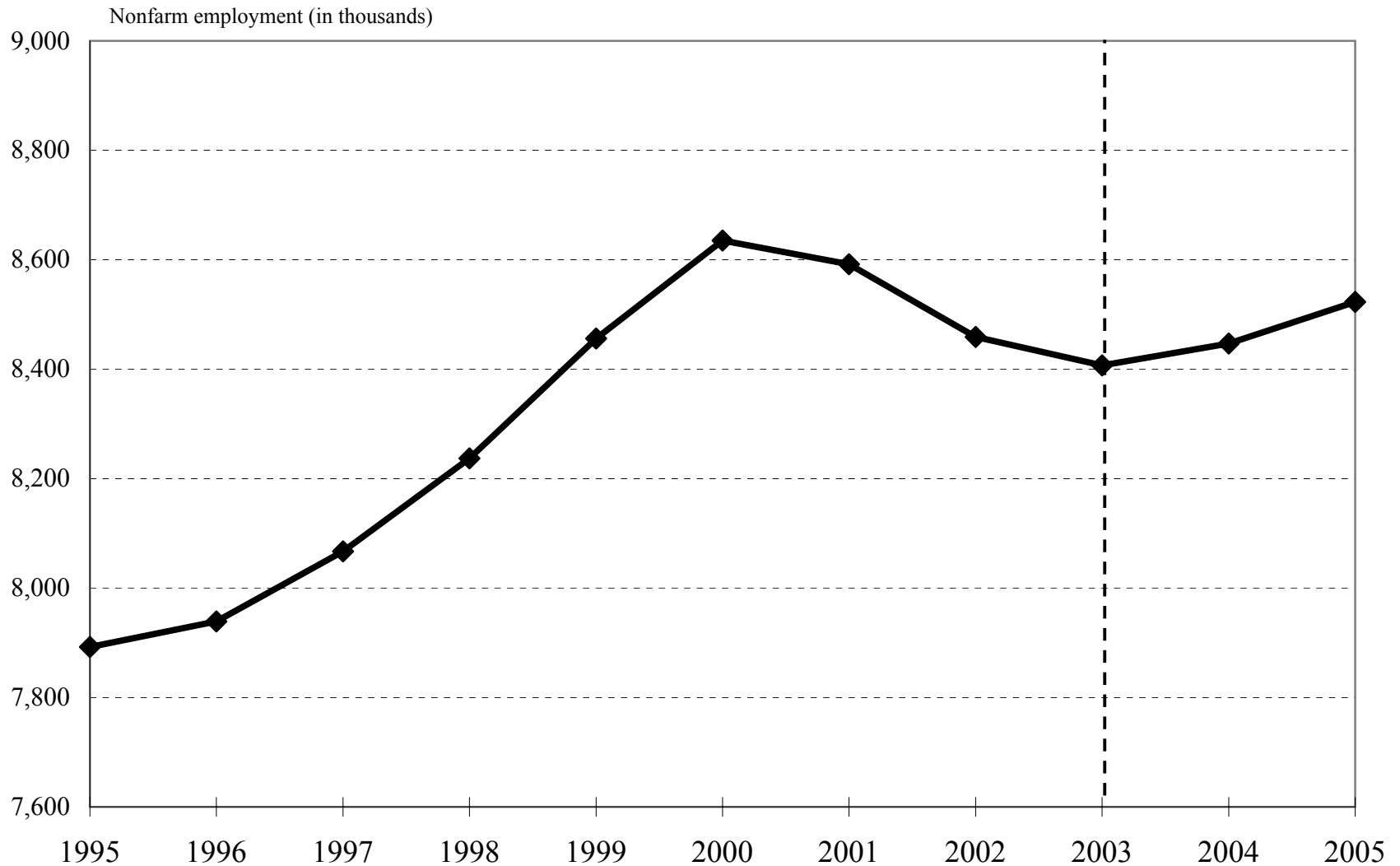
(by state fiscal year, millions of dollars)

<u>Tax Increase</u>	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06</u>	<u>3-Year Total</u>	<u>2006-07</u>	<u>4-Year Total</u>
Income Tax - temporary rate increase	1,155	1,496	1,444	4,095	425	4,520
Sales Tax - temporary 1/4 percent rate increase	445	584	129	1,158	0	1,158
Sales Tax - temporary suspension of clothing exemption	441	586	583	1,610	605	2,215
Total	2,041	2,666	2,156	6,863	1,030	7,893

Why was the 2003 approach to budget balancing better than the approach taken during the early 1990s?

- Neither tax increases nor service cuts are desirable during a recession. Both take demand out of the economy - making recessions longer and deeper, and making recovery more difficult.
- But New York, like most other states, is required to balance its budget in both good times and bad. The resulting dilemma is trying to figure out what mix of spending cuts and tax increases will do the least harm. Ideally, during such periods, the federal government, which is not required to run balanced budgets and which is responsible in our governmental system for overall macroeconomic management, will assist the states with some form of counter-cyclical financial assistance.
- But what are the states to do during economic downturns absent sufficient federal aid to avoid spending cuts and/or tax increases? Joseph Stiglitz, winner of the 2001 Nobel Prize in Economics, and Peter Orszag of the Brookings Institution, in their paper, *Budget Cuts vs. Tax Increases at the State Level: Is One More Counter-Productive than the Other During a Recession?*, use basic economic reasoning to explain why a temporary increase in the tax on the portions of income over some relatively high level is the least damaging mechanism for balancing state budgets during recessions. They conclude that reductions in government spending on goods and services that are produced locally (like education and healthcare) and reductions in transfer payments to lower-income families are most damaging to the economy since they come closest to taking dollar for dollar out of the local economy. Increases in consumption taxes and fees will take more demand out of the economy than tax increases on the portion of income over some relatively high level but less demand than cuts in locally-produced goods and services or transfer payments to lower-income families.

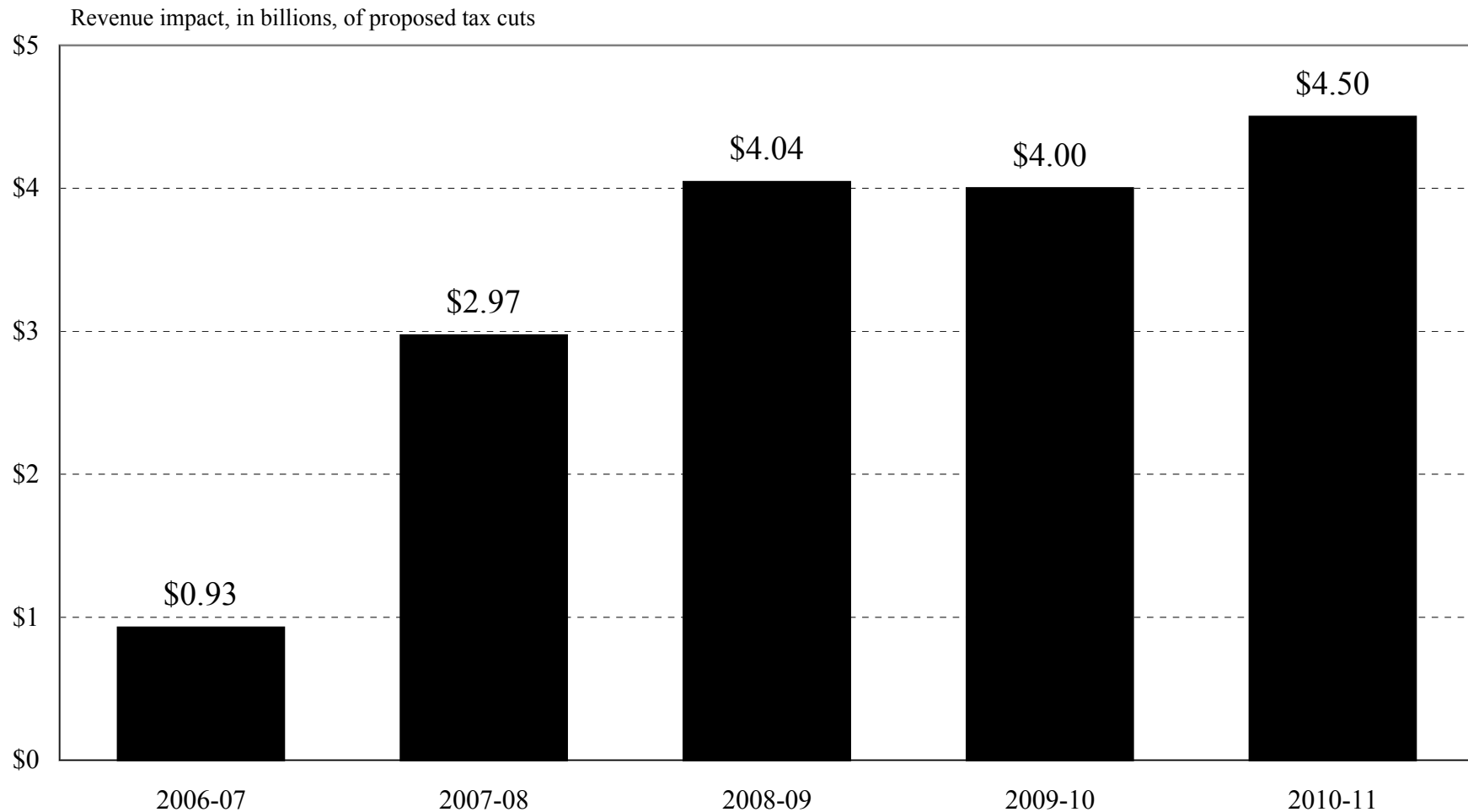
The 2003 Tax Increases Did Not Have the Negative Economic Effects that Governor Pataki Predicted.



The Governor's Key 2006-07 Budget Proposals and Their Impact on the State's Future

- The centerpiece of the 2006-07 Executive Budget is a return to the idea of enacting large multi-year, backloaded tax cuts that put a substantial lien on future year resources and greatly limit the ability of the state to balance competing priorities in future years.
- The Governor's plan calls for the enactment this year of a series of tax cuts that he estimates would reduce state revenue this year by \$927 million and by \$4.5 billion in 2010-11. The proposed tax cut package would grow in cost because many of the tax cuts would take effect in steps over the next several years. Moreover, the fully-implemented cost of some of the proposed tax cuts, particularly the proposed repeal of the state estate tax, would not be realized until after 2010-11.
- The 2006-07 Executive Budget documents and statements by the Governor and his representatives are also attempting to convince New Yorkers that wealthy New Yorkers carry an inordinate share of the tax burden.
- The magnitude of the tax cut package is such that (in what would otherwise be a period of budget stability), the Governor is proposing (a) large service reductions (growing from \$1.98 billion in 2006-07 to \$3.14 billion in 2007-08) , and (b) the planned use of over \$1 billion of the state's accumulated reserves in each of the two succeeding fiscal years (2007-08 and 2008-09) rather than protecting those resources for use in the event of an economic downturn or, at worst, using them for important non-recurring purposes.

The Governor's new set of back loaded tax cuts would put a substantial lien on future year resources and greatly limit the ability of the state to balance competing priorities in future years.



The Governor's claims that wealthy New Yorkers pay an inordinate share of taxes ignores both (a) their share of income, and (b) taxes other than the personal income tax.

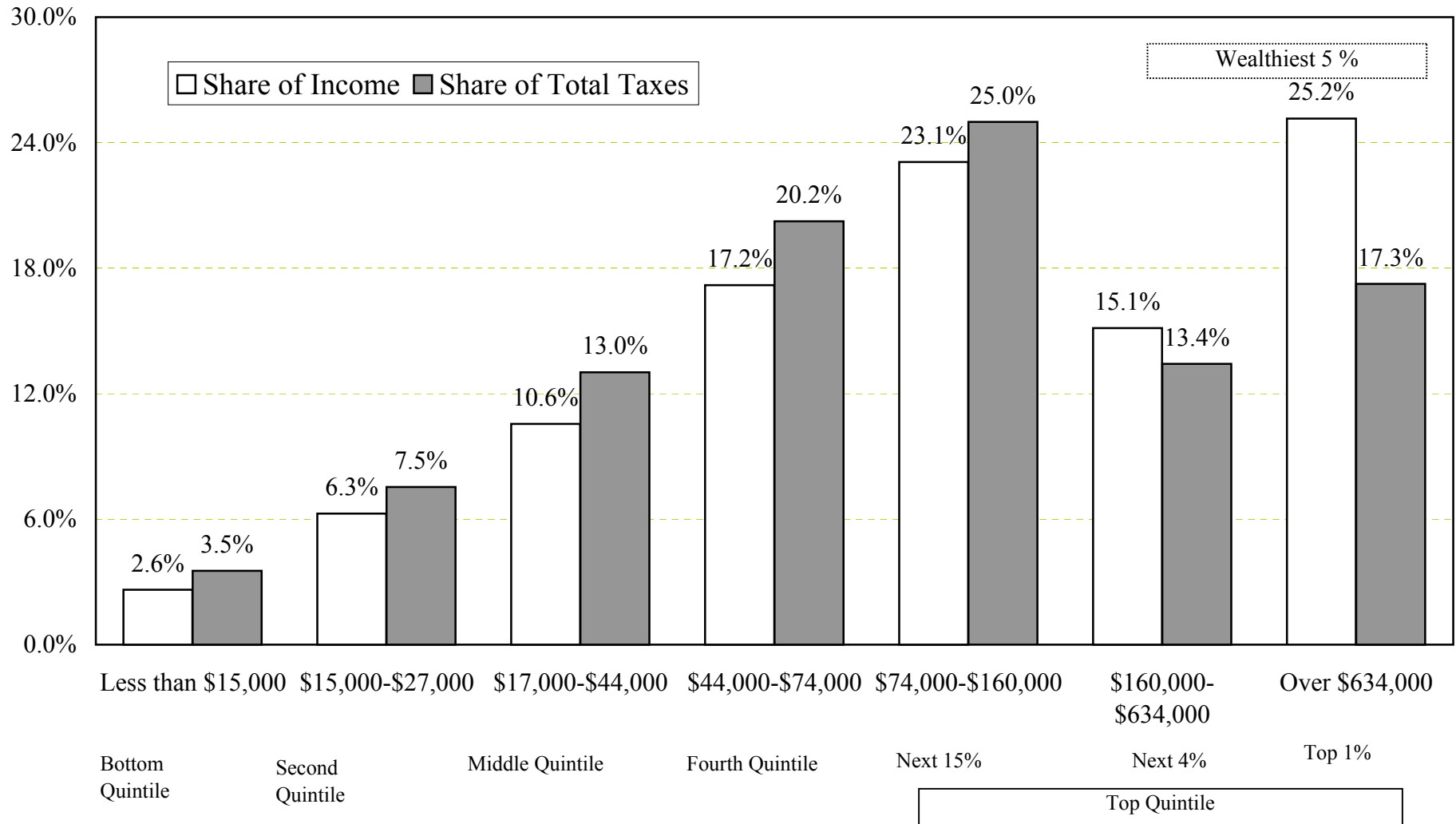
New York State and Local Taxes Paid by Non-Elderly Families

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	Top 1%
Income Range	Less than \$15,000	\$15,000-\$27,000	\$27,000-\$44,000	\$44,000-\$74,000	\$74,000-\$160,000	\$160,000-\$634,000	Over \$634,000
Average Income	\$8,700	\$20,700	\$34,900	\$56,800	\$101,700	\$250,200	\$1,663,000
Share of All Income	2.6%	6.3%	10.6%	17.2%	23.1%	15.1%	25.2%
Share of Family Incomes Above \$27,000	0.0%	0.0%	3.6%	13.5%	25.4%	20.3%	37.2%
Share of Sales & Excise Taxes	7.2%	13.4%	17.3%	22.1%	22.3%	9.5%	8.3%
Share of Property Taxes on Families	4.0%	6.6%	12.9%	21.6%	31.7%	15.9%	7.3%
Share of Personal Income Taxes	-0.8%	1.2%	6.6%	14.9%	24.5%	18.2%	35.4%
Share of Total Taxes	3.0%	6.5%	11.4%	18.6%	25.1%	14.6%	20.8%
Share of Total Taxes After Federal Offset	3.5%	7.5%	13.0%	20.2%	25.0%	13.4%	17.3%

Note: Table shows 2002 tax law at 2000 income levels.

Source: Fiscal Policy Institute analysis of incidence data presented in Institute on Taxation and Economic Policy, Who Pays?, January 2003.

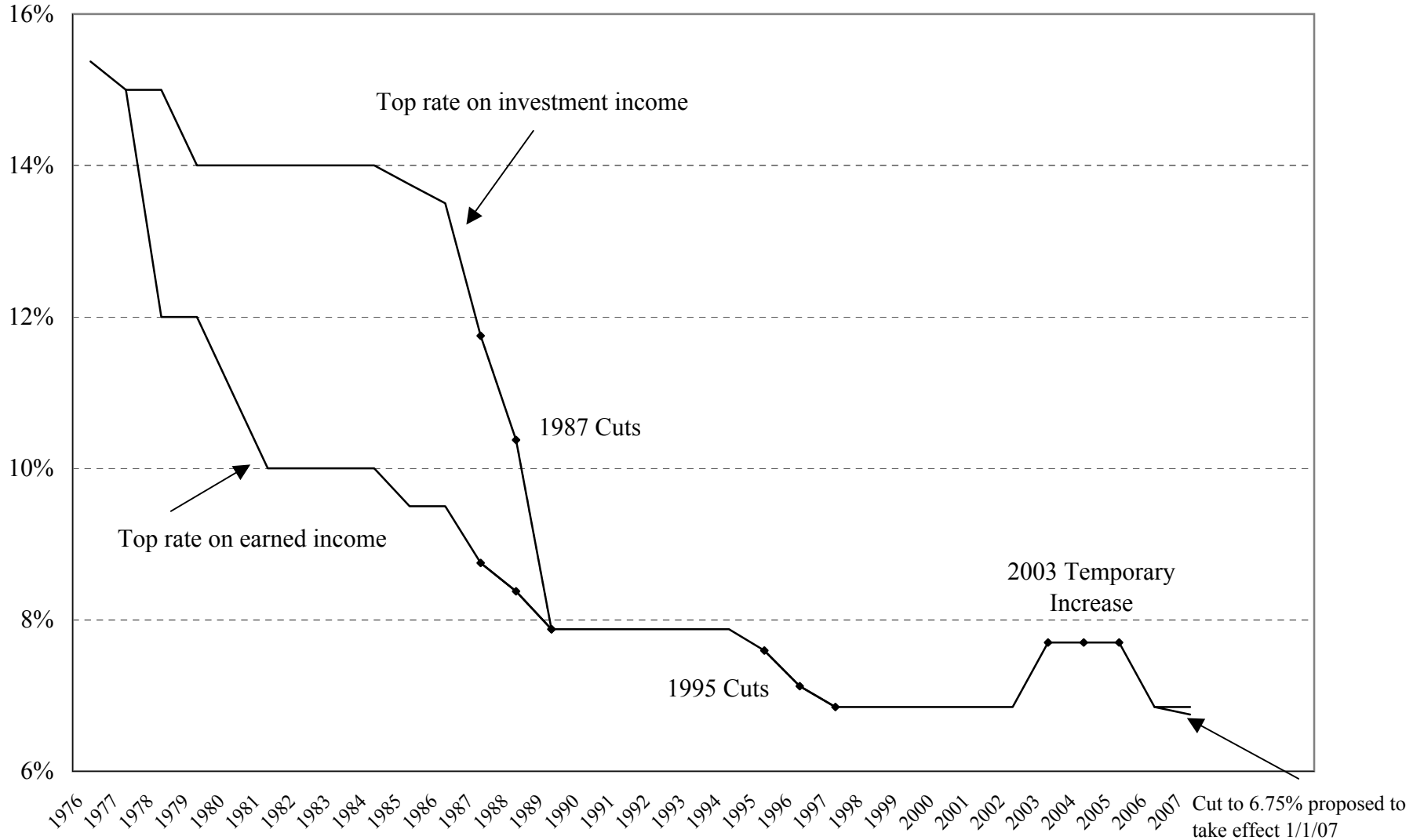
Taking federal deductibility into consideration, the wealthiest 5% of New York families have over 40% of the income but less than 31% of the tax burden.



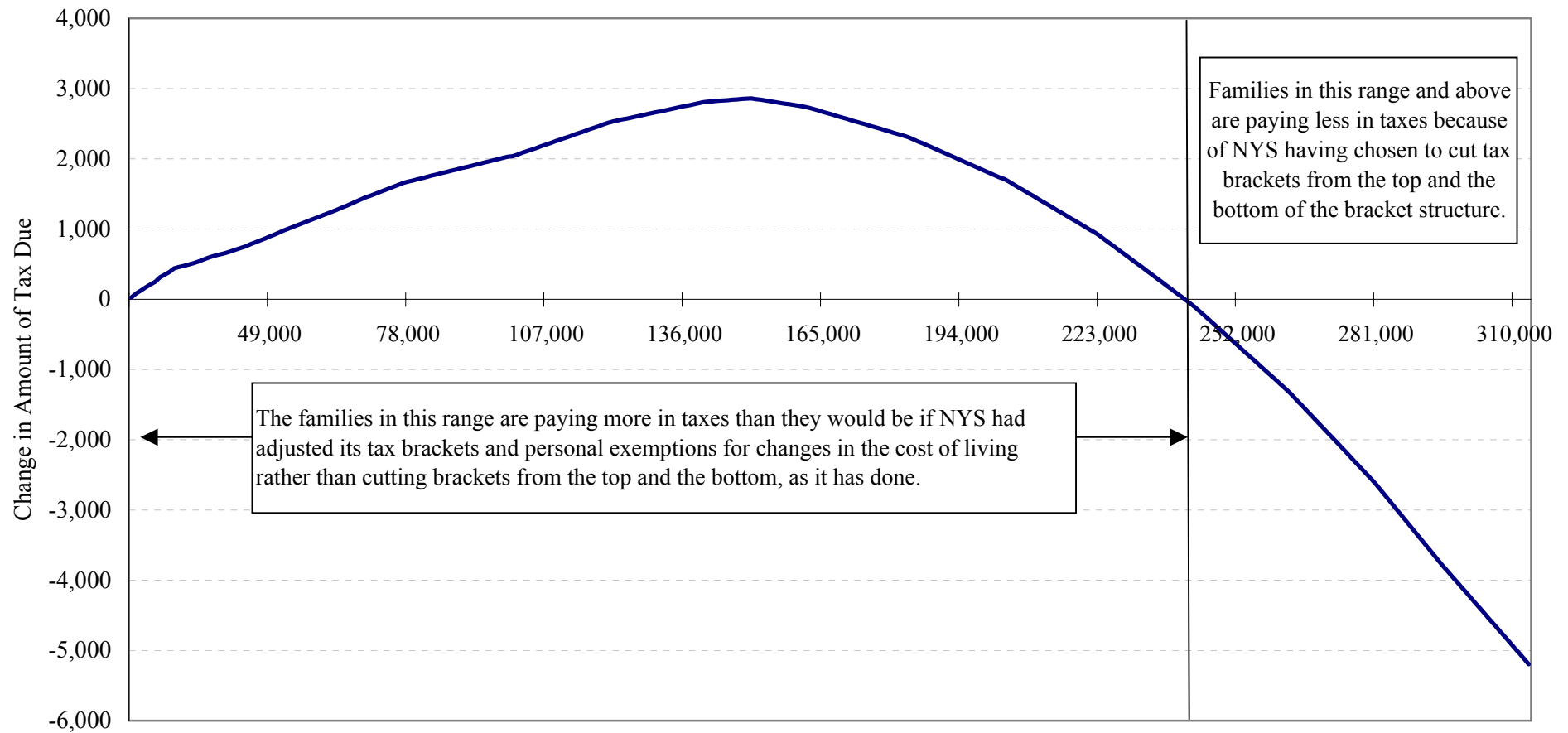
Source: Institute for Taxation & Economic Policy, 2003. Table shows 2002 tax law at 2000 income levels for nonelderly taxpayers, after federal offset. The percentages for the seven income groups add to 100%.

New York State has cut its top personal income tax rate by more than 50% over the last 30 years - from 15.375% to 6.85%

Top marginal
tax rate



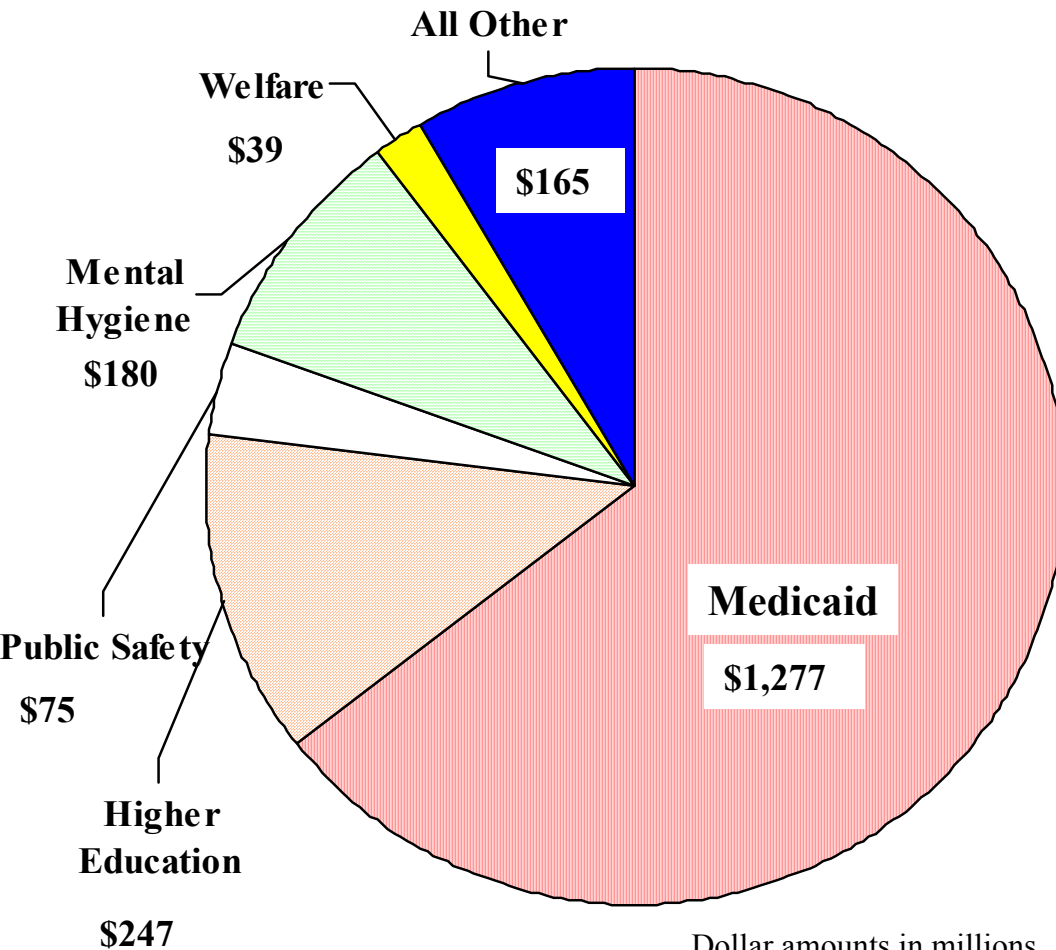
Over the past 30 years, NYS has shifted the tax burden by cutting personal income tax rates from the top and bottom rather than adjusting the state's tax brackets and the personal exemption amounts for inflation.



New York Adjusted Gross Income, from \$20,000 to \$313,000, of Families of 4 - weighted average of standard vs. itemized deductions - includes Household Credit

The Governor's backloaded tax cuts require \$1.98 billion of service cuts this year and \$3.146 billion in cuts next year.

Governor Pataki's Proposed Funding Cuts: 2006-2007



Medicaid

- Limited Part D wrap-around
- Anti-fraud
- Cost containment

Higher Education

- Flexible cost reductions
- TAP Performance-based criteria

Public Safety:

- Prison closure
- Operations management

Mental Hygiene:

- Patient Income
- Audits

Welfare

- Full family sanctions
- Work incentives

Since 1990, New York State's expenditures for employee wages and salaries have declined in real terms by over \$800 million, more than 7%.

Personal Service expenditures in millions of SFY 2005 dollars

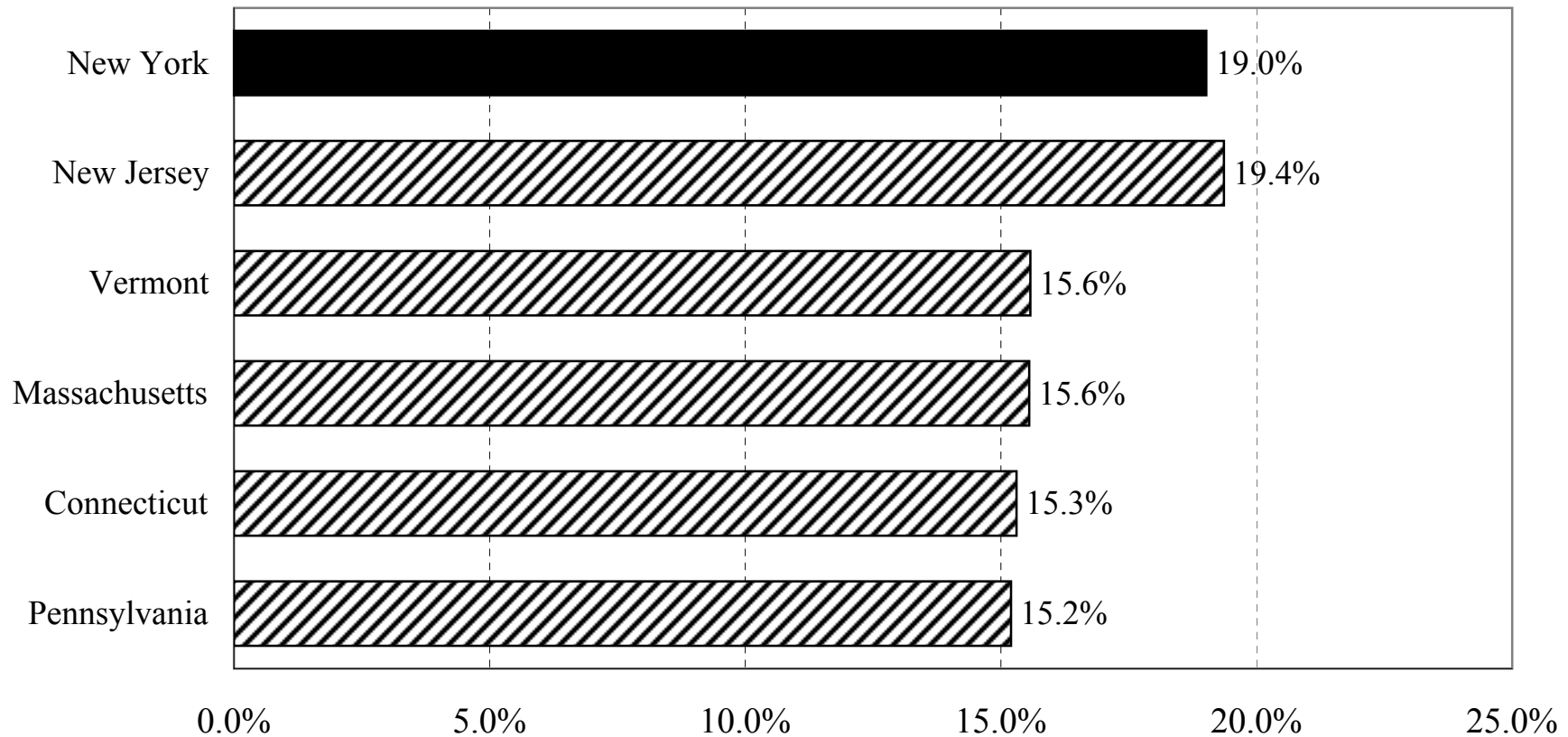
	General Fund	Special Revenue Funds	Total
State FY 1989-90	\$7,235.6	\$4,136.8	\$11,372.4
State FY 1994-95	\$5,806.3	\$4,846.8	\$10,653.1
State FY 2004-05	\$5,552.8	\$4,957.8	\$10,510.6
<u>Average Annual Change</u>			
1989-90 to 1994-95	-\$285.9	\$142.0	-\$143.9
1994-95 to 2004-05	-\$28.2	\$12.3	-\$15.8
<u>Average Annual Percent Change</u>			
1989-90 to 1994-95	-4.31%	3.22%	-1.30%
1994-95 to 2004-05	-0.49%	0.25%	-0.15%
<u>Total 15 -Year Change</u>			
Amount	-\$1,682.8	\$821.0	-\$861.8
Percent	-23.26%	19.85%	-7.58%

The Governor's proposed Medicaid cuts will hurt the health care system.

- Of the Governor's proposed \$1.983 billion in recommended "spending restraint," \$1.3 billion of the cuts would come from the Medicaid budget. Since each state and local dollar spent on Medicaid services generates a dollar in federal assistance, the Governor's proposal would syphon at least \$2.6 billion dollars from the state's health care system.
- One third of the Medicaid cuts involve freezing or cutting hospital, nursing home and pharmacy reimbursement rates, despite the fact that New York's hospitals have suffered seven consecutive years of bottom line losses and more than half of New York's nursing homes and certified home health agencies are losing money. According to the Hospital Association of New York State (HANYs), hospitals statewide lost \$127 million in 2004, which increased cumulative losses to \$2.3 billion since 1998.
- The state's "wrap-around" prescription coverage for the 570,000 people eligible for both Medicaid and Medicare would be discontinued after June 30. Currently the "wraparound" plan covers any drugs those eligible for both Medicaid and Medicare are unable to obtain through their new federal drug plans.
- Once again the Governor is proposing limits on eligibility for long-term care such as extending the look-back period for asset transfers from three to five years; requiring spouses of nursing home residents to impoverish themselves before the institutionalized spouse is eligible for Medicaid; and applying the asset transfer rules for nursing homes to home care eligibility.
- Family Health Plus changes proposed include: the exclusion from eligibility of individuals employed by companies with more than 100 employees; an increase in the co-payment for inappropriate use of emergency room services from \$3 to \$25 per visit; denial of services if an FHPlus beneficiary is unable to pay the required co-payment; and elimination of the six-month guaranteed eligibility for individuals enrolled in FHPlus.

New York and New Jersey have much higher percentages of their nonelderly adult population without health insurance than other neighboring states.

Percentage of nonelderly adult population with no insurance coverage for 2004.



Source: U.S. Census

The Governor's education proposals are inadequate to maintain current services without large property tax increases.

- The New York State Educational Conference Board estimates that, on average, school districts will need to spend about 5.6% more in 2006-2007 than in 2005-06 to simply maintain current programs and services given the increases in energy costs, health insurance premiums, pension contributions, salaries and other components of school budgets.
- Applying these growth rates, the Conference Board concluded that school districts statewide would have to spend \$2.2 billion more in school year 2006-2007 just to maintain the current level of services.
- To avoid shifting an increasing share of these school costs onto the local property tax base, the state would have to provide an increase in aid of at least \$1 billion - a far cry from the \$259 million increase in "regular" state aid proposed in the Executive Budget.

The Governor's budget fails to address the Court of Appeals decision in the Campaign for Fiscal Equity case.

- The Court of Appeals decision in the Campaign for Fiscal Equity (CFE) case deals specifically with New York City but both the Governor and the legislative leaders have all indicated that they want a statewide solution to this decision. But in his 2006-07 Executive Budget, the Governor hasn't even offered the proposal that he presented to the courts as the state's "plan."
- Instead, the Governor is proposing to increase so-called Sound Basic Education (SBE) aid from \$325 million this year to \$700 million in 2006-07, with the \$325 million to be distributed using the same formula that is currently giving every district, regardless of need, at least \$25,000. The Governor proposes to set aside the additional \$375 million in a reserve fund to be distributed "pursuant to an allocation plan approved by the director of the budget." At this pace, New York State would not meet its reasonable share of the costs of a Sound Basic Education for all the state's children until sometime around 2022.
- The Governor is also proposing an "efficiency improvement incentive award" that would give a school district a 2% increase in Flex Aid (the current name for the state's major operating aid program) if it holds spending increases below the lower of 4% or 120% of the average national CPI. Not only would this proposal, if successful, increase the disparities between low wealth and high wealth school districts, but it is also inconsistent with the "plan" that the Governor presented to the referees in the CFE case. That "plan" acknowledges that many school districts in New York need to increase spending much more than this in order to provide their students with the opportunity for a sound basic education.

The Governor's higher education proposals will make it harder for New Yorkers to move up the socioeconomic ladder.

- Once again the Governor is proposing changes in the Tuition Assistance Program (TAP) that will hurt the neediest students. In light of the tuition increases of recent years and the possibility of further increases, New York should be increasing rather than decreasing its investment in TAP. The glossy Executive Budget Overview lists the following as one of the "Governor's Accomplishments" - "The most generous financial aid in the nation, providing nearly \$800 million in assistance to nearly 370,000 students in pursuit of a college degree." What this Overview volume does not ballyhoo is that the projected level of spending for tuition assistance (\$783 million) in 2006-07 under the Governor's proposal would be down from \$928 million in 2004-05 and an estimated \$889 million in the current fiscal year.
- State General Fund disbursements in support of the state-operated SUNY campuses is projected to increase by less than 1% from \$1.04 billion this year to \$1.046 billion next year and State General Fund aid to CUNY is projected to decrease from \$942 million this year to \$912 million next year.
- While the Governor is proposing an increase in funding for the Science and Technology Entry Program (STEP) and the Collegiate-Science and Technology Entry Program (C-STEP), he is proposing flat funding for New York State's highly successful opportunity programs which over the years have made it possible for thousands of New Yorkers from disadvantaged backgrounds to obtain college degrees. These programs, the Educational Opportunity Program (EOP) at SUNY, the Higher Education Opportunity Program (HEOP) at private colleges and universities in the state, and Search for Education, Elevation and Knowledge (SEEK) at CUNY, are still operating at or below their 1994-95 funding levels.

The Governor’s public assistance proposals will hurt needy New Yorkers.

- **Changes to the Earned Income Disregard:** Once again the Governor proposes to increase the Earned Income Disregard to 50% for recipients on welfare less than five years and reduce the disregard percentage to 25% for recipients on welfare more than five years. This proposal penalizes families who are doing the “right” thing — working long, hard hours — merely because they are stuck in low paying jobs that do not enable them to earn enough to support their families without public help.
- **Full Family Sanctions:** Currently, if an adult in a family fails to comply with work or procedural requirements, public assistance benefits are withheld only for the person who is out of compliance. The Executive Budget proposes the elimination of public assistance benefits to the entire household if an adult member does not comply with work requirements. Full family sanctions will punish children for the actions or inactions of their parents despite the fact that research has found that states with full family sanctions have not been any more successful in moving families from welfare to work than states (California and New York) which do not currently exercise this option. Sanctionable offenses can be as minor as being late for an appointment or not filing paperwork with the right office. A 2004 Mathematica Policy Research paper notes that “fully sanctioned recipients are more likely to return to TANF than non sanctioned leavers.”
- **Reducing Benefits to Households with Severely Disabled Family Members:** This proposed statutory change would reduce the public assistance provided to approximately 26,700 households with children where one or more person in financial need meets the federal definition of severe disability, receives SSI and lives with one or more non-disabled household members who receive Temporary Assistance. The families who would be affected by this statutory change are already coping with often-extraordinary additional expenses. And for many families, the severe disability of a child or adult in the household prevents the parent from working outside the home.

Counties will need to devote more resources to child care and employment programs to comply with the new TANF work participation requirements but the proposed expansion of the Flexible Fund for Family Services actually reduces resources available for these purposes.

- **Shrinking Resources:** Governor Pataki is once again proposing that almost all Temporary Assistance for Needy Families (TANF) - funded programs except cash assistance, the earned income tax credit and the child and dependent care credit be folded into the Flexible Fund for Family Services (FFFS. Last year the Governor proposed that \$1 billion be allocated to the FFFS but the legislature reduced the amount to \$600 million and renewed stand alone funding for child care and other critical programs. This year's budget proposes last year's \$1 billion FFFS plus an additional \$25 million for a total of \$1.025 billion. This represents a \$52 million dollar cut in funding for the programs being folded into the FFFS.
- **Expanding Work Requirements:** TANF Reauthorization which passed the House of Representatives on February 1, 2006 will require more stringent work requirements by changing the caseload reduction credit. Under the new law that takes effect October 1, 2006, the "caseload credit" would count only reductions in caseload since 2005. This would mean that New York would have an effective required work participation rate very close to 50%. (Between October 2004 and October 2005, New York's federally funded family assistance caseload fell from 140,314 to 136,191, a decline of just under 3%.) New York's 2004 work participation rate was 37.8%. Unfortunately, the federal budget reconciliation bill provides only a scant \$200 million per year in additional child care funding, less than is needed just to ensure that current child care funding keeps pace with inflation and far less than Congressional Budget Office estimates states will need to meet the new work requirements by increasing participation in work activities.

The Expanded Flexible Fund for Family Services would Cut Funding for Critical Programs and Supports by more than \$50 million

Proposed 2006-2007 Flexible Fund for Family Services		\$1,025,000,000
FFFS 2005-2006		\$600,000,000
Child Care Funds - 2005-2006		\$379,000,000
Remaining FFFS Resources		\$46,000,000
Total 2005-2006 Funding for Programs Moved to the FFFS		\$98,003,000
Reduction in Funding	Amount:	(\$52,003,000)
	Percentage Decrease:	-53%

2005-2006 Enacted Budget Funding Levels for Programs Moved to the FFFS

Youth Employment	\$25,000,000	Language Immersion/English Training/ESL	\$2,000,000
Preventive Services Initiative	\$15,000,000	Basic Education	\$2,000,000
EDGE/BRIDGE	\$9,553,000	VESID/LIVES	\$1,500,000
Technology Training	\$8,500,000	Caretaker Relative	\$1,150,000
Transportation	\$8,400,000	Adult and Family Literacy	\$1,000,000
YEETP	\$4,000,000	ACCESS - Welfare to Careers	\$1,000,000
Wage Subsidy Program	\$4,000,000	Emergency Homeless	\$1,000,000
Supplemental Homeless Intervention	\$4,000,000	DAP	\$500,000
DV Screening	\$3,000,000	Build NY	\$1,000,000
Supportive Housing for Families	\$2,500,000	Workforce Development Institute	\$600,000
Displaced Homemakers	\$2,300,000		

Governor Pataki's budget addresses neither the critical child care funding shortfall that New York social services districts are already facing nor the new resources that will be necessary to increase work participation rates.

- According to the Child Care that Works Campaign, to assure quality child care for more low income children, New York State must increase available subsidy funding in SFY 2006-07 by \$140 million to fund 22,000 additional slots..
- Although funding for child care increased dramatically over the last decade from \$279 million in 1995 to \$929 million in 2004, in FY 2005-06, child care funding shrank by \$80 million as New York's federal share of the CCDBG decreased (\$12 million) and TANF reserve dollars were exhausted. Forty million in general funds was added to offset a portion of the cut, but unable to address unmet need in their areas, many counties chose to lower their eligibility levels and/or increase parent co-payments during this last year.
- The Governor proposes redirecting into the Flexible Fund for Family Services (FFFS) the \$379 million in TANF surplus funds previously dedicated to child care. Under this proposal, the money could be used for any TANF-eligible purpose and would not be restricted to child care. While social services districts were able to transfer some of their FFFS resources to be used for child care last year, less than \$10 million was actually transferred from the FFFS to child care and more than half of this amount (\$5.5 million) was transferred by New York City. In the rest of the state, only 15 other districts transferred money to the child care block grant.

The Flexible Fund for Family Services should be thoroughly evaluated before approving any expansion of this mechanism.

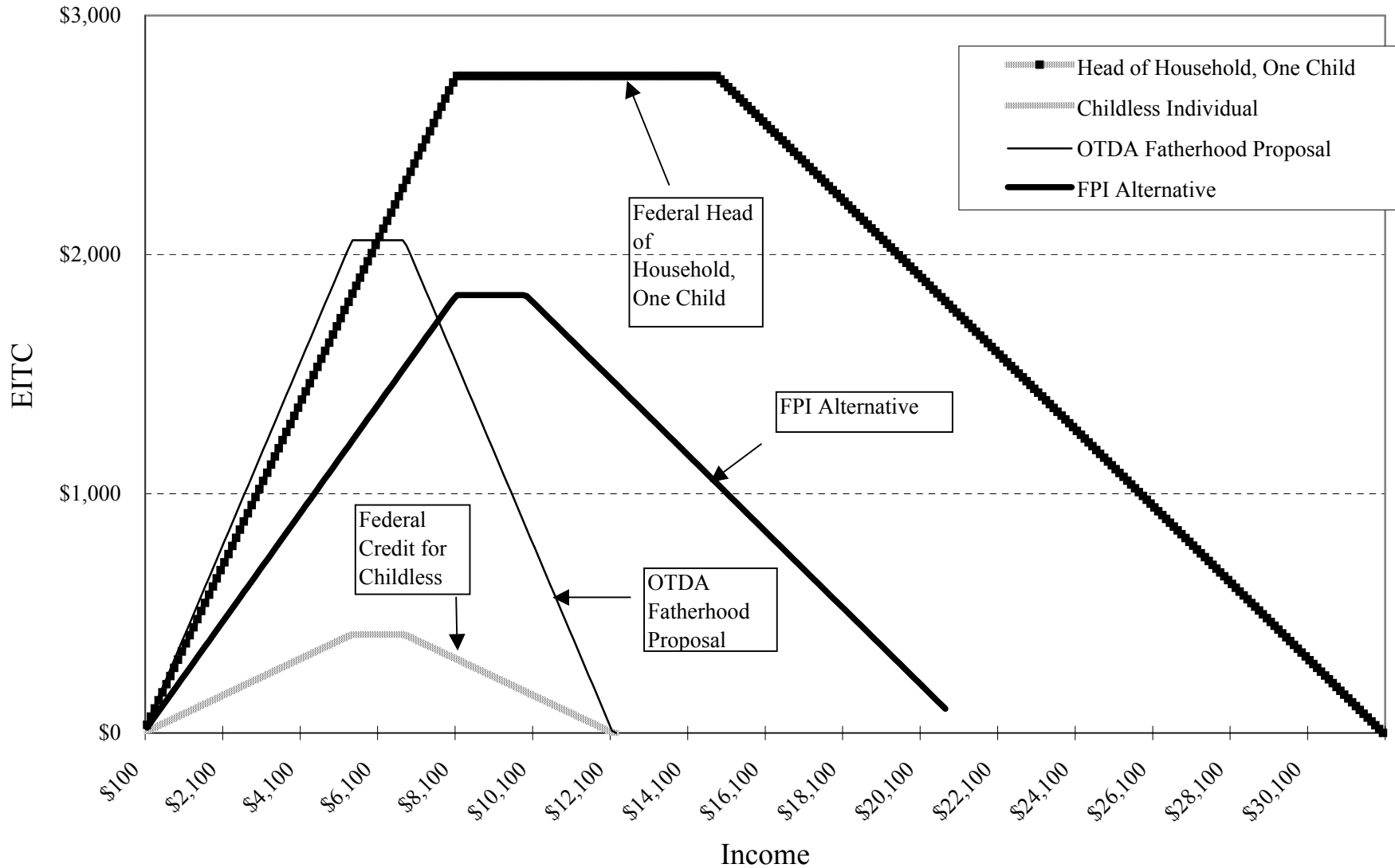
This is not the right time to cut back on critical employment, training and services programs for low-income New Yorkers.

- Last year Social Services districts spent only \$122 million of the \$600 million FFFS for TANF services and employment services. While New York City took advantage of the flexibility afforded by the FFFS and tripled its spending for these purposes from \$22 million in 2004-2005 to \$91 million in 2005-2006, outside New York City the increase in spending for these purposes was only \$6 million. Four counties (Chautauqua, Delaware, Monroe, Tompkins) did not allocate any FFFS resources to these critical services.
- The FFFS has no mechanism for public involvement in the development of local plans nor sufficient oversight mechanisms to ensure that counties do not use their flexibility to fill other county budget gaps rather than provide services to low-income families and children. New York has not yet had the opportunity to assess the effectiveness of the Flexible Fund for Family Services and therefore the Governor's proposal to expand the fund to incorporate child care and other programs currently funding at the state level should be rejected.

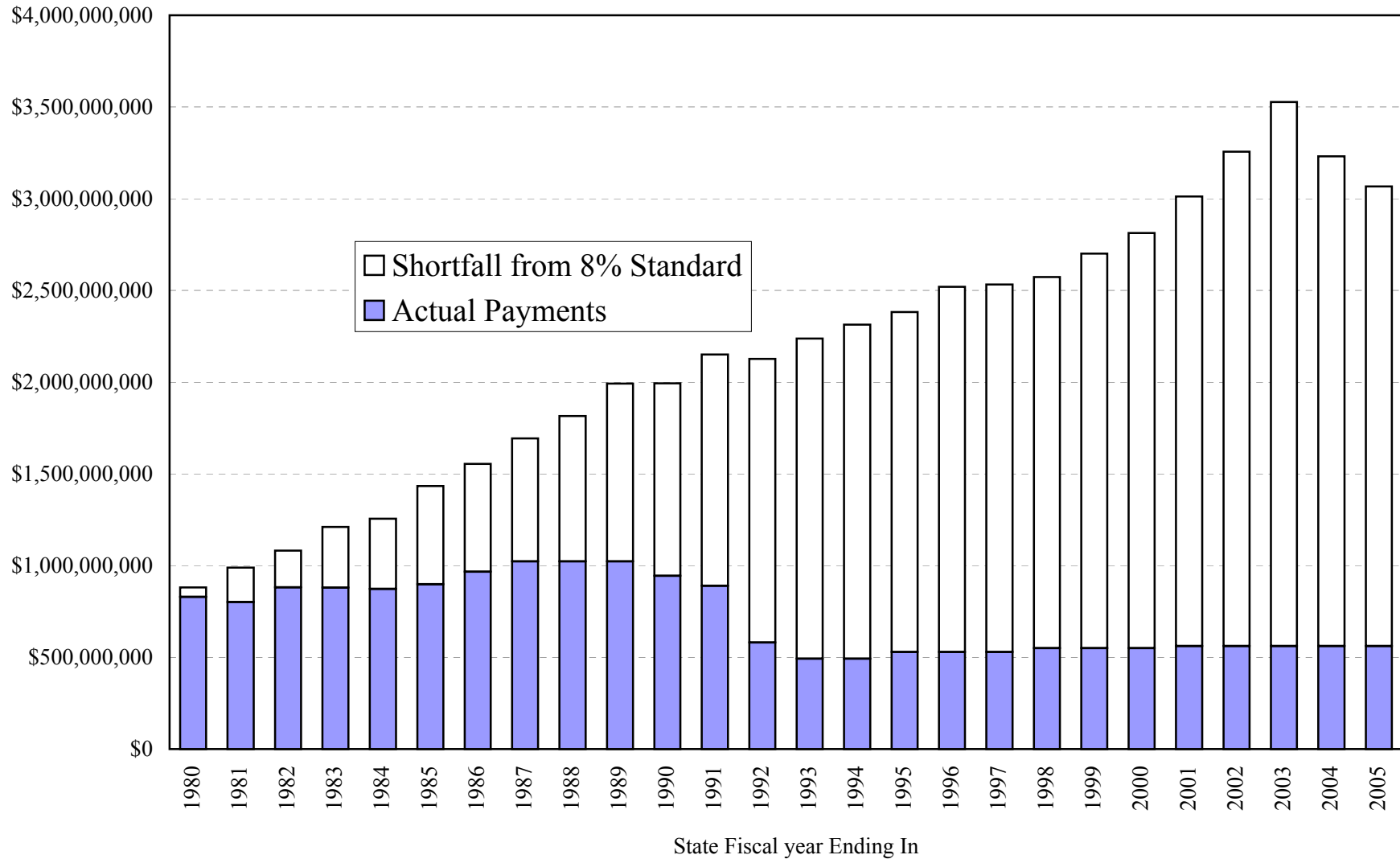
The proposed increase in the state Earned Income Tax Credit for noncustodial parents should be redesigned.

- Governor Pataki proposes a special NYS Earned Income Tax Credit supplement for noncustodial single parents between the ages of 18 and 35 who are current on their child support payments equal to four times the federal Earned Income Tax credit. While the benefit amount will vary, the maximum combined Federal and State EITC could be as high as \$1,995.
- Unfortunately, basing the credit on the inadequate federal EITC for childless workers means that workers earning more than \$12,120 per year would receive no credit — a parent working full time, year round at the NYS minimum wage would earn too much to qualify for the credit. Since the size of the credit would start to decline when income exceeds \$6,740 (annual earnings for full year employment for 19 hours per week at the minimum wage), the credit may even create a perverse incentive for noncustodial parents working full time to cut back on their work effort.
- Last year the Governor proposed this credit for 18 to 30 year olds. The expansion up to age 35 this year is an improvement but there is still no rationale for not providing this benefit to all low-income noncustodial parents, regardless of age. In fact, limiting the credit to noncustodial parents of a certain age misses the opportunity to mitigate the extremely high marginal “tax and benefit loss” rate faced by all low-income childless workers.
- A better design for the credit would base the enhanced NYS credit for all childless households on the federal credit for heads of households with one child providing a credit based on two thirds the phase-in and income limits for heads of households for all childless households. This credit would provide income support to workers making up to about \$21,300 a year. A worker earning between \$8,000 and \$9,800 per year would be eligible for the maximum federal credit of about \$1,830.

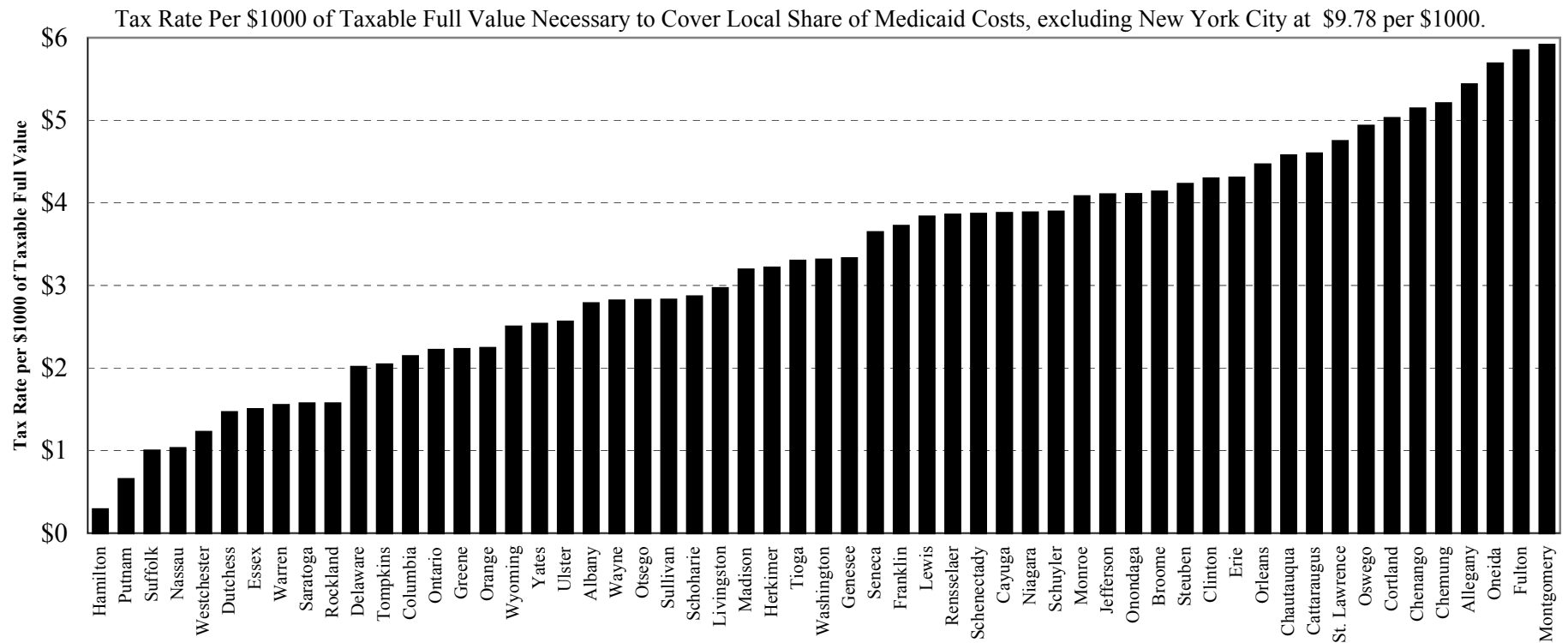
Alternative Proposal for a NYS EITC Supplement with Strong Work Incentives for Childless Households



Cutting and freezing revenue sharing puts pressure on the local property tax base - particularly hurting Upstate cities.



Basing the local share of Medicaid costs on the kinds of services provided rather than on the basis of "ability to pay" places great pressure on communities with weak tax bases relative to their concentrations of needy individuals. Capping the growth in the local share of Medicaid costs institutionalizes that inequity.



Sources: Medicaid Expenditures from NYS Department of Health. Full value from Office of State Comptroller.

Local tax revenue per capita is much higher in the New York City Metro Area than in the rest of the state. Within the New York City Metro Area, the suburbs rely more heavily on the property tax than does New York City.

Area	Local Government revenue Per Capita						
	General Sales Tax	Selective Excise and Gross Receipts Taxes	Property Taxes	Individual Income Tax	Corporate Income Tax	Other taxes	Total
New York City	\$421	\$138	\$1,111	\$578	\$352	\$177	\$2,777
All Local Governments in the 5 NYC Metro Area Suburban Counties	\$531	\$22	\$2,461	\$2	\$0	\$71	\$3,086
All Local Governments in the 52 Counties Outside the New York City Metro Area	\$361	\$22	\$1,149	\$0	\$0	\$38	\$1,571

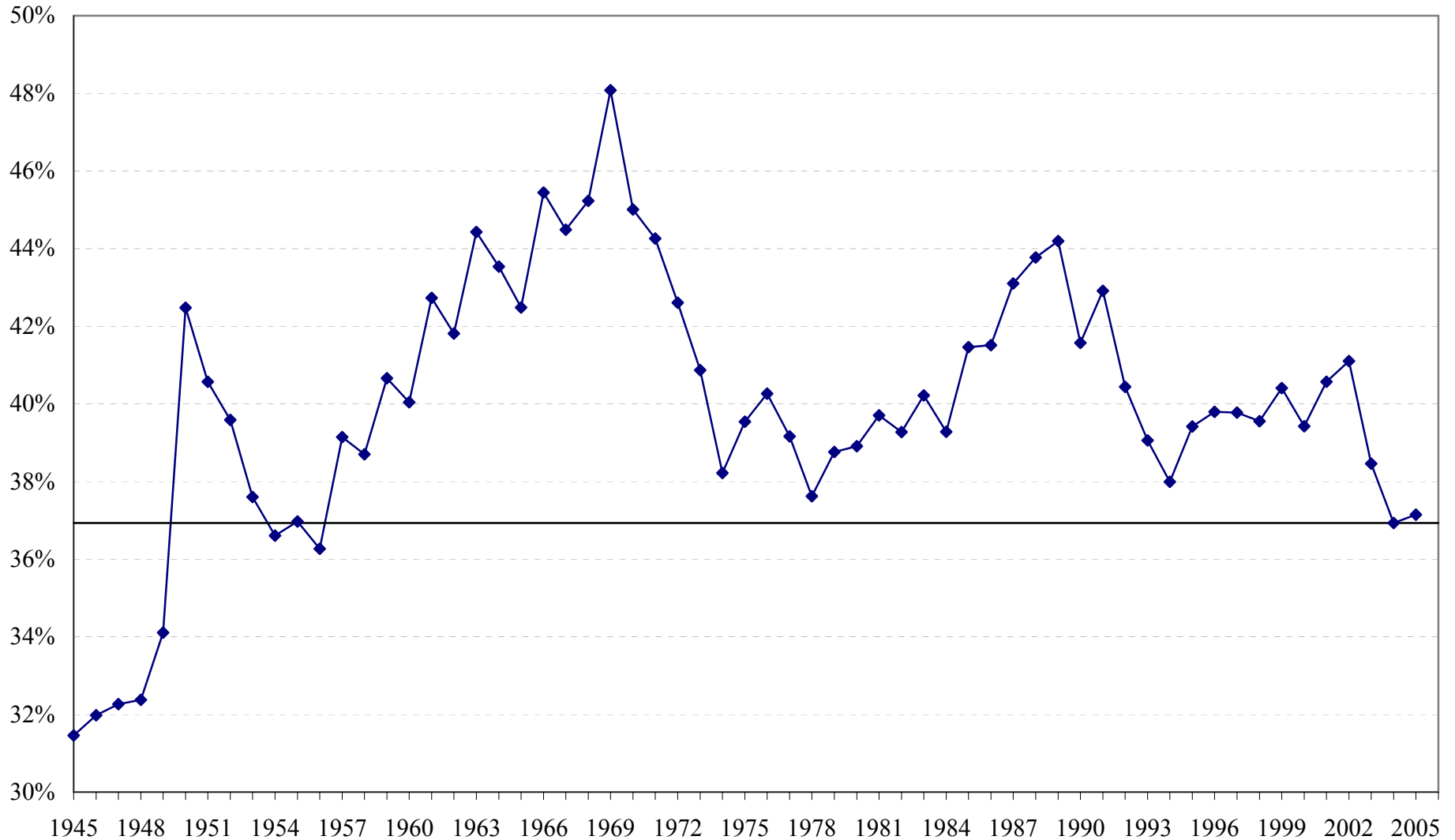
Source: Fiscal Policy Institute analysis of data from the U.S. Bureau of the Census, 2002 Census of Governments.

Property taxes are much lower in New York City than in the New York City suburbs since New York City has a much more diverse tax system.

	Percent Distribution of Local Tax Revenue by Source						
Area	General Sales Tax	Selective Excise and Gross Receipts Taxes	Property Taxes	Individual Income Tax	Corporate Income Tax	Other taxes	Total
New York City	15.2%	5.0%	40.0%	20.8%	12.7%	6.4%	100%
All Local Governments in the 5 NYC Metro Area Suburban Counties	17.2%	0.7%	79.7%	0.1%	0.0%	2.3%	100%
All Local Governments in the 52 Counties Outside the New York City Metro Area	23.0%	1.4%	73.2%	0.0%	0.0%	2.5%	100%

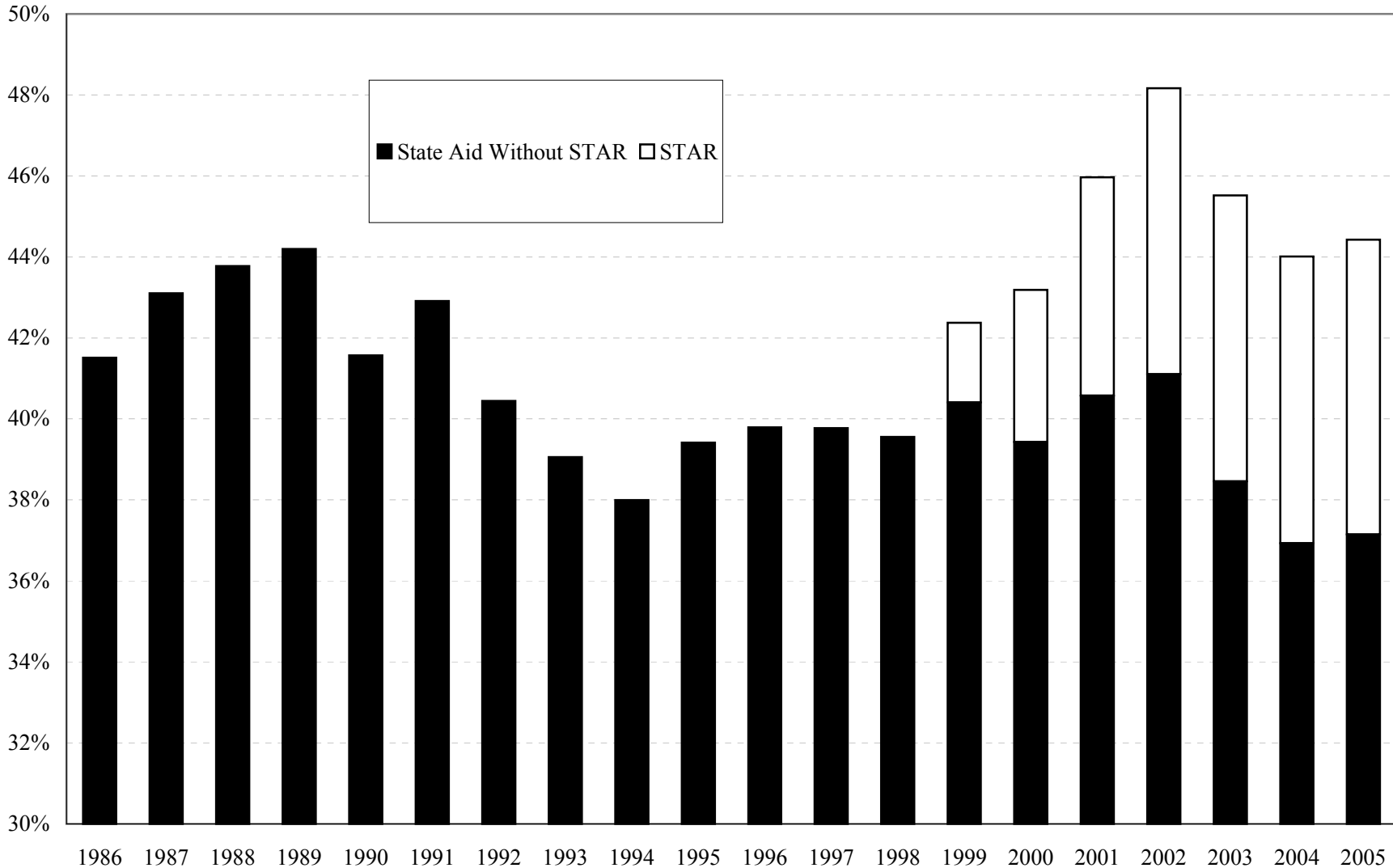
Source: Fiscal Policy Institute analysis of data from the U.S. Bureau of the Census, 2002 Census of Governments.

During the last several years, State Aid as a percent of public school budgets has been at a 50-year low.



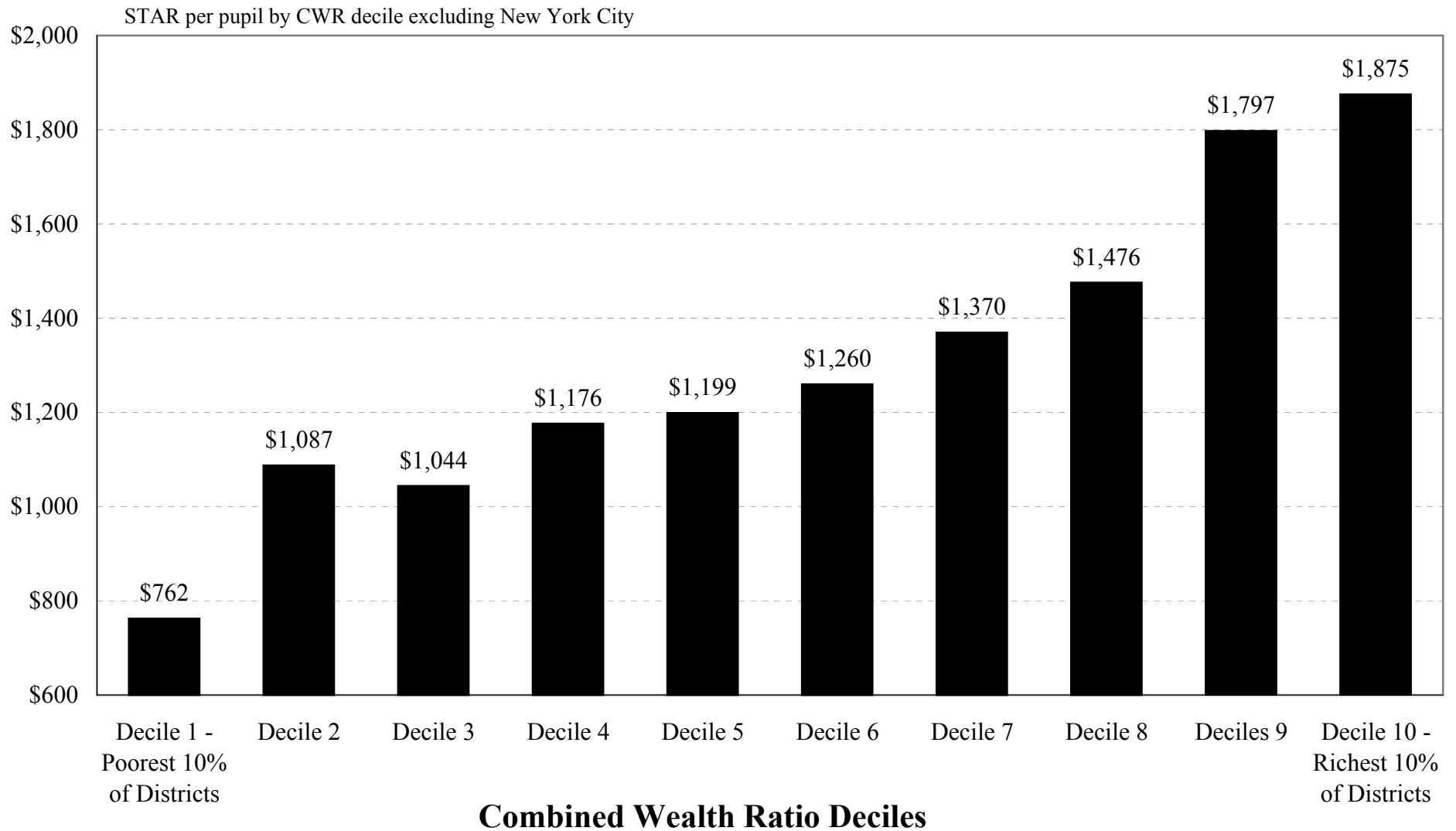
Source: State Education Department, Analysis of School District Finances in NYS School Districts, December 2004.

When STAR is taken into consideration, the State covers a larger share of public school budgets.



Source: State Education Department, Analysis of School District Finances in NYS School Districts, December 2004.

But STAR is distributed in a very different manner than other state aid to public schools.



STAR: New York's Flawed Property Tax Relief Mechanism

- Under STAR, all owner-occupied residential dwellings in the state are eligible for a state-funded homestead exemption of at least \$30,000. In counties in which the median home value is greater than the statewide median home value, the value of this exemption is prorated upward by the ratio of the county median home value to the statewide median home value. In Westchester County, the county with the highest median home value, this “sales price differential factor” was 2.8833 making the value of the exemption about \$86,500 and, according to the Division of the Budget’s website, it is estimated to be \$90,000 next year.
- Homeowners aged 65 and over, with incomes below \$60,000 adjusted upward for changes in the cost of living since 2003 (for the 2006-07 school year this income threshold is \$66,050) are eligible for an "enhanced" STAR exemption of \$50,000. This exemption is also prorated up in counties with median home values above the statewide median. In this year’s Executive Budget, the Governor has proposed to increase the enhanced exemption from \$50,000 to \$56,800 to reflect increases in the cost of living since 2001.
- In the 2001-2002 school year, the first year in which STAR was fully phased-in, the NYS Office of Real Property Services reported that there were nearly 640,000 "enhanced" STAR exemptions and more than 2.2 million "basic" STAR exemptions representing \$118.9 billion in exempt value. It is estimated that in the current school year, these numbers have increased to about 652,000 “enhanced” STAR exemptions and 2.77 million “basic” STAR exemptions.

STAR disadvantages renters and the needy school districts in which the state's renters are concentrated.

- Because STAR provides reimbursements to school districts only for the property taxes on owner-occupied dwellings, it substantially disadvantages those communities (primarily cities) with large numbers of renters.
- State reimbursements to school districts, during 2005-06, for these STAR property tax exemptions are estimated to be about \$2.52 billion with about \$163 million (or 6.46%) of that total going to New York City. New York City's low share of the property tax reimbursements is attributable to two factors - its relatively high percentage of renter-occupied dwellings and the special calculations of STAR benefits established for the Big 5 cities. In recognition of the limited benefits that would accrue to New York City under the STAR property tax exemption, the initial STAR legislation established a special New York City STAR Supplement which provides for a state-funded reduction in the NYC resident income tax. This element of the program is providing NYC residents with an estimated \$595 million in income tax relief in 2005-06 with the state reimbursing the city that amount, bringing the estimated total cost of the STAR program this year to \$3.1 billion with 24% of the benefits going to New York City.
- With STAR representing 40% of the increases in state revenue to school districts since its creation, this serves to undercut the effectiveness of the state aid system in addressing fiscal disparities among school districts. While New York City is treated unfairly by STAR, other school districts with large percentages of renters are treated even worse since they do not benefit from anything like the NYC STAR Supplement.

The STAR program, as currently structured, is not effectively targeted - thus costing much more than it needs to for the amount of relief that it gives to taxpayers who are overburdened by high property taxes.

- One of the basic flaws of the STAR program is that, with the exception of the “enhanced” STAR available to seniors with income below the \$60,000 (adjusted for inflation) cutoff, it provides the same benefit to all homeowners in a particular school district (or in a municipal segment of a school district that is located in more than one municipality) regardless of their income levels, or their property tax bills, or more importantly, the relationship between their income levels and their property tax bills. This creates two significant problems.
 - First, it prevents the program from delivering on its rhetorical premise - that it is designed to protect New Yorkers from being “forced from their homes because of escalating school property taxes.”
 - Second, it provides a significant amount of relief to a significant number of homeowners for whom property taxes represent only a relatively small percentage of their income.
- The combined result of these two shortcomings is that STAR, as currently structured, costs much more than it needs to for the amount of relief that it actually provides to homeowners who are truly overburdened by their property taxes. Similarly, a reformed STAR program could provide much more relief to those who need it at a greatly reduced cost.

The STAR program provides different benefits to taxpayers with the same incomes and the same property tax bills - depending on where they live.

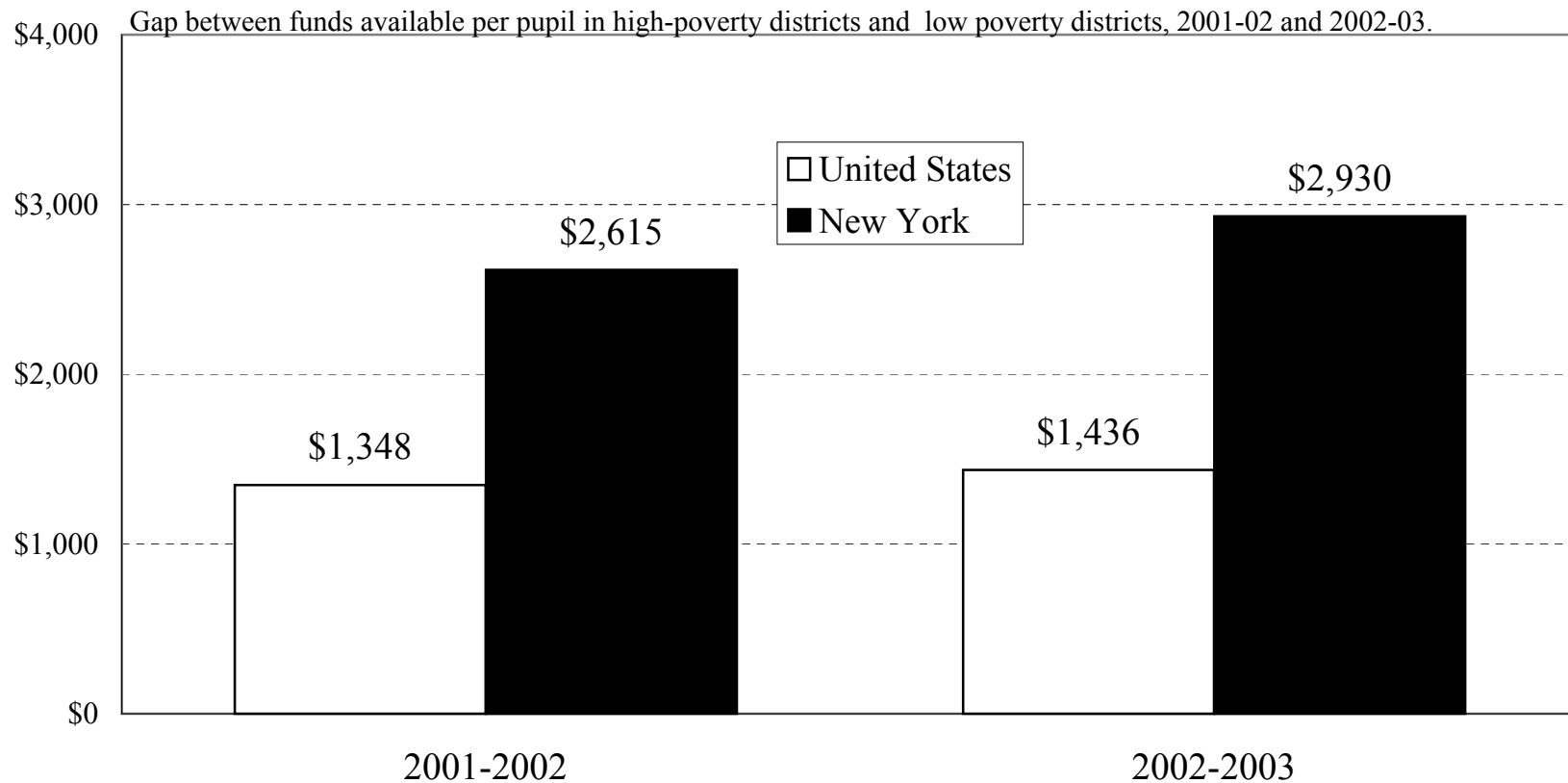
- A second basic flaw of the current program is that similarly situated taxpayers are treated very differently depending on where they live. Two taxpayers with the same incomes and the same property tax bills will get very different amounts of relief through STAR if one of those taxpayers lives in one of the seven counties with median home values of the state median, and the other does not.
- While, on average, residents of some communities may have higher incomes and higher property tax bills than people in some other communities, these averages should not serve as the basis for treating two similarly situated New York taxpayers.
- While a higher percentage of the residents of one community may be in a particular income/property category than the residents of another community, all of the taxpayers with that income/property tax mix should be treated the same.

Governor Pataki's STAR Plus proposal is fundamentally inconsistent with a statewide solution to the Court of Appeals decision in the CFE case.

- The Governor's proposed STAR Plus Rebate program would provide \$400 property tax rebate checks to residents in districts that limit their spending increases to the lesser of 4% or 120% of the increase in the Consumer Price Index.
- Under the proposal advanced by the Governor in the proceeding before the Special Masters, 177 of the 639 districts analyzed needed to increase spending for purposes of providing a Sound Basic Education over and above the levels needed to meet ordinary annual changes in the cost of educational inputs. Modifying this model to make the corrections recommended by the Referees in the CFE case, 477 districts would require additional spending over and above inflationary increases.
- A percentage-based spending cap of this type would institutionalize and exacerbate the inequities inherent in the current system, and this particular cap (the lower of 4% or 120% of the CPI²) is inconsistent with the costs increases school districts currently face, as documented by the New York State Educational Conference Board has documented the fact that school district costs are increasing at a much faster rate than the change in the CPI.
- The legislation proposed by the Governor would exempt from this cap "court ordered spending to provide a sound basic education" even though the Governor and the legislative leaders have all said that they want a legislatively-enacted statewide solution to the CFE case without every needy school district in the state having to go to court.

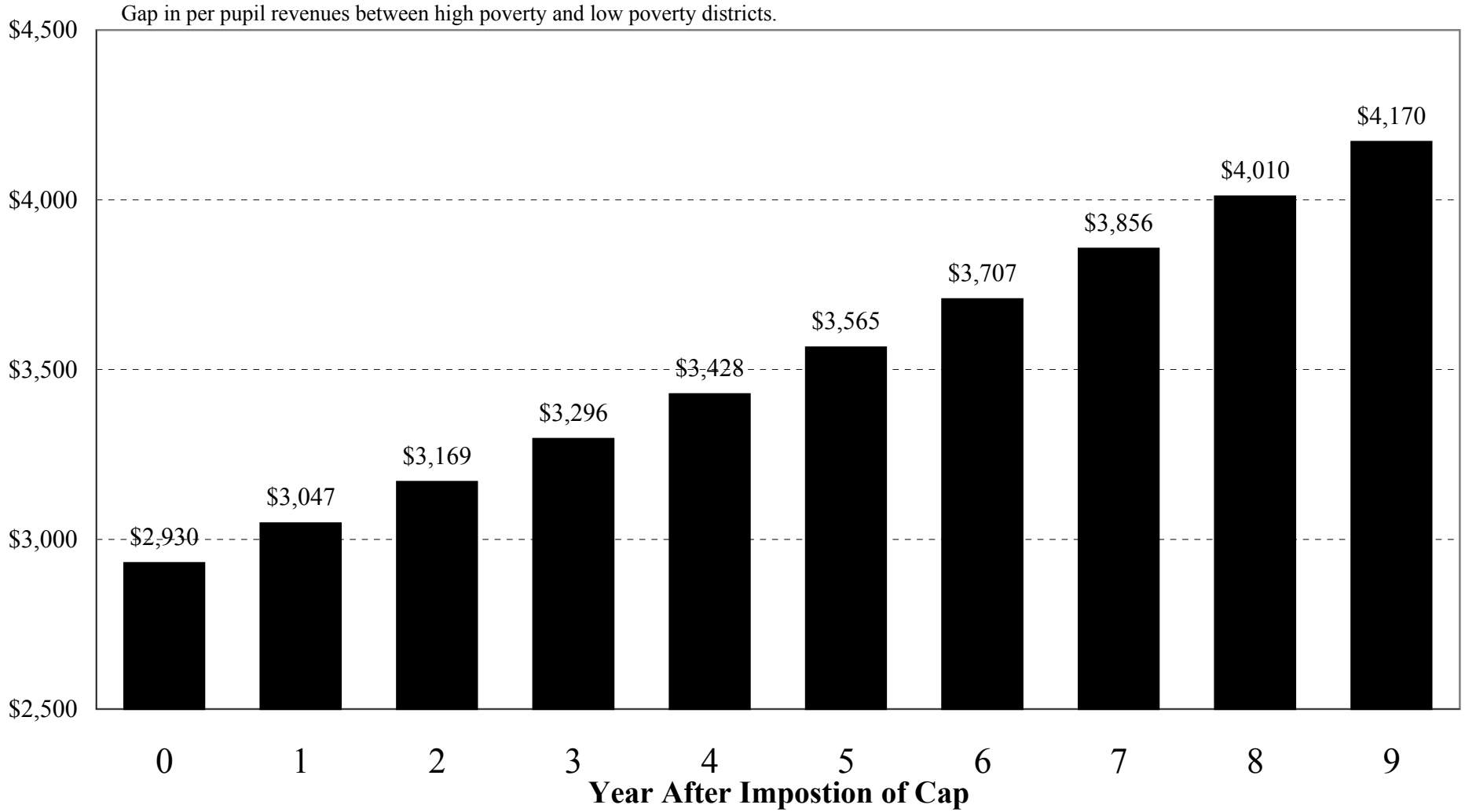
² The proposal sets the percentage increase cap using the average of changes in two national CPI indices despite the fact that the experts engaged by the State in the CFE case recommended the use of the NYC regional CPI rather than the national CPI indices. (The NYC regional CPI tends to increase at a faster rate than the national CPI.)

New York has the largest gap between the resources available in high-poverty and low-poverty school districts of any state in the nation and that gap is growing.



Source: The Education Trust, "The Funding Gap 2004: Many States Still Shortchange Low-income and Minority Students," October 2004 and "The Funding Gap 2005: Low-Income and Minority Students Shortchanged by Most States," Winter 2005. Available at www2.edtrust.org.

If the Governor's STAR Plus Spending Cap were successful in holding all districts to the same percentage increases in spending, this gap would grow wider each year.



What is the Campaign for Fiscal Equity (CFE) court order?

- In May 1993 the Campaign for Fiscal Equity (CFE), a New York based non-profit coalition of parent organizations, community school boards, concerned citizens and advocacy groups sued the State of New York on behalf of New York City schoolchildren, alleging that the state system of funding education had the effect of depriving them of the right to a sound basic education (SBE) under the Education Article of the New York State Constitution.
- In a 1995 appeal of the case's dismissal, the Court of Appeals, the State's highest court, reversed the dismissal, holding that New York's children enjoy the right to a SBE under the State's constitution.
- The case then proceeded to trial from October 1999 until July 2000. The total trial took over 111 days. During that time the Court compiled a transcript of over 23,000 pages and received over 5,000 exhibits into evidence.
- On January 10, 2002 Judge Leland DeGrasse, in a 182-page decision, held that the students' rights had been violated.
- This decision was appealed and on June 26, 2003, the Court of Appeals ruled in favor of CFE, holding that the State must ensure that all school children have the opportunity to receive a meaningful high school education.

What did the June 2003 decision by the NYS Court of Appeals in the CFE case require the Governor and the Legislature to do?

The Court of Appeals ordered the Governor and the Legislature to:

- ascertain the actual cost of providing a sound basic education in to students in New York City
- ensure that every school in New York City has the resources necessary for providing the opportunity for a sound basic education
- ensure a system of accountability to measure whether these reforms actually provide the opportunity for a sound basic education.
- ensure that the higher cost of living in New York City is taken into account.
- ensure that resources are “calibrated with student need.

The Court of Appeals gave the State of New York until July 30, 2004 to comply with its order. Because the state failed to meet this deadline, three court-appointed referees were given until November 30, 2004 to submit a compliance plan to Justice Leland DeGrasse of the State Supreme Court.

What did the court-appointed “referees” conclude?

- The court-appointed referees (or “Special Masters”) concluded that the New York City School District needs an additional \$5.63 billion (in 2004-2005 dollars) per year to provide all NYC school children with the opportunity for a sound basic education and that this additional funding should be phased in over four years starting July 1, 2005. This recommendation was based on their review of: the State’s costing out proposal developed by Standard and Poor’s, the New York Adequacy Study prepared for the plaintiffs by the AIR/MAP research group and a submission by the New York City Board of Education. They concluded that when “flaws” in the Standard and Poor’s study were corrected, all three studies came to approximately the same conclusion.
- Of several methods that had been discussed to adjust for the higher cost of living in New York City, the referees chose a methodology that had been developed by the AIR/MAP team that had completed the New York Adequacy costing out study for CFE and the New York State School Boards Association.
- In order to account for the special needs of low-income, English Language Learners and special education students, pupil counts should be weighted as follows: 1.5 for low-income students; 1.2 for ELL students; and, 2.1 for special education students.
- New York City needs \$9.179 billion in capital resources to improve its facilities. As opposed to the operating resources needed, this capital requirement is a one-time catch-up program. The referees called for this capital funding to be provided over the course of the next five school years.
- Based on a review of New York State’s accountability system, the referees recommended certain enhancements to the existing system but no major overhaul.

The referees did not make recommendations concerning:

- the relative share of the increased funding amounts that the state legislature should or could require New York City to provide. But, the referees did urge the state legislature not to “thwart the implementation of the Court’s order by being arbitrary or unreasonable in its allocation to the City of that funding burden.”
- the simplification or other revision of the statewide formulas currently used to allocate State aid to New York City and other districts. But they did note and strongly support “the consensus among the parties and the *amici* that New York State must re-evaluate and reform its funding formulas, so that spending on education in the State is, at a minimum, tied directly to assuring that the opportunity for a sound basic education is provided to all children.”

While Judge DeGrasse issued an order directing the state to implement the referees’ recommendations, that remedial order is currently on appeal to the Appellate Division of the Supreme Court, and may well go the Court of Appeals. At issue on appeal are the Court’s power to order a specific remedy and whether the amount of the remedy was reasonable.

The Schools for New York’s Future Act, which was developed by a task force convened by CFE, would implement the referees’ recommendations on a statewide basis.

- This proposal would apply, on a statewide basis, the principles used by the referees to estimate the funds needed by the New York City school system.
- It also proposes a “fair share” method of allocating funding responsibility between the state and local school districts.
- Overall, the Schools for New York's Future Act, sets forth a simplified education funding system that would provide:
 - ▶ An additional \$8.6 billion per year for operating expenses, when fully implemented, with \$4.6 billion of that amount going to New York City and \$4 billion going to other school districts; and a one time \$10 billion investment in improving capital facilities
 - ▶ A clear, fair formula for determining each districts state/local share
 - ▶ An enhanced accountability system
 - ▶ A provision that no district would receive less aid in the future than in the current year.
 - ▶ A requirement that districts (like New York City) with less than 60% of their students passing the 4th grade English language arts (ELA) exam, the 4th grade math exam and the five Regents exams fully fund their local share.

Improving educational opportunities is essential to the future of the state's economy and to New Yorkers' quality of life, but doing so will require billions of dollars in new spending. How can the state meet this challenge without jeopardizing other important state priorities?

Some state leaders have said that the resources for funding a statewide solution to the CFE case can come from "natural growth" in state revenues as the state's economy grows. While there is such natural growth, it basically covers the increasing cost of current services, including the current level of educational services. So how can New York meet this challenge without putting other important state priorities in jeopardy?

- As a start, the governor can stop recommending additional tax cuts.
- Second, he can, as he has proposed, dedicate all the revenue from his gambling initiatives to education.
- Third, he can work to close more of the state's corporate tax loopholes.
- And, finally to the extent that additional resources are necessary, the state can move in the direction of a tax system based on the 1972 rates, brackets, and personal exemptions - adjusted for changes in the cost of living. By moving in this direction, the Governor and the Legislature can raise the necessary revenue while reducing taxes for most New Yorkers and making New York's tax system much fairer.

Additional Budget Balancing Options

Many of the cuts and freezes proposed in the Executive Budget would have negative effects on the state's economy and its quality of life. In order to balance the 2006-07 budget in a more economically sensible manner, the following approaches should be considered.

- **Public Procurement Reform.** New York State should reduce wasteful contracting out to high priced consultants. Use the state's purchasing power to get better prices on prescription drugs.
- **Federal Assistance.** New York's government, labor and business leaders should work with their counterparts in other states and at the national level to secure the implementation of policies that other steps necessary to protect state finances and provide appropriate federal assistance.
- **Corporate Tax Reform.** New York State should even the economic playing field by eliminating corporate tax avoidance schemes and instituting appropriate corporate tax reforms so that all corporations pay a fair share of taxes and that government subsidies are only provided for jobs actually created.
- **Sales Tax Reform.** New York State should continue its to implement the Streamlined Sales Tax Project so that New York retailers do not face unfair competition from remote sellers. It should also more aggressively enforce current laws on the collection of sales and use tax by remote sellers, and consider the extension of the sales tax base to include additional services.
- **Environmental Tax and Fee Reform.** New York State should expand the bottle bill to a broader range of beverages, raise the deposit to 10 cents, and reclaim a portion of unclaimed deposit revenues for public purposes. It should also ensure that the tradable emission permits under the regional carbon cap agreement are auctioned rather than given away in order to ensure that the windfall revenues to be generated are available to mitigate the proposals negative effects and to serve other economically and socially important purposes.

Public Procurement Reform

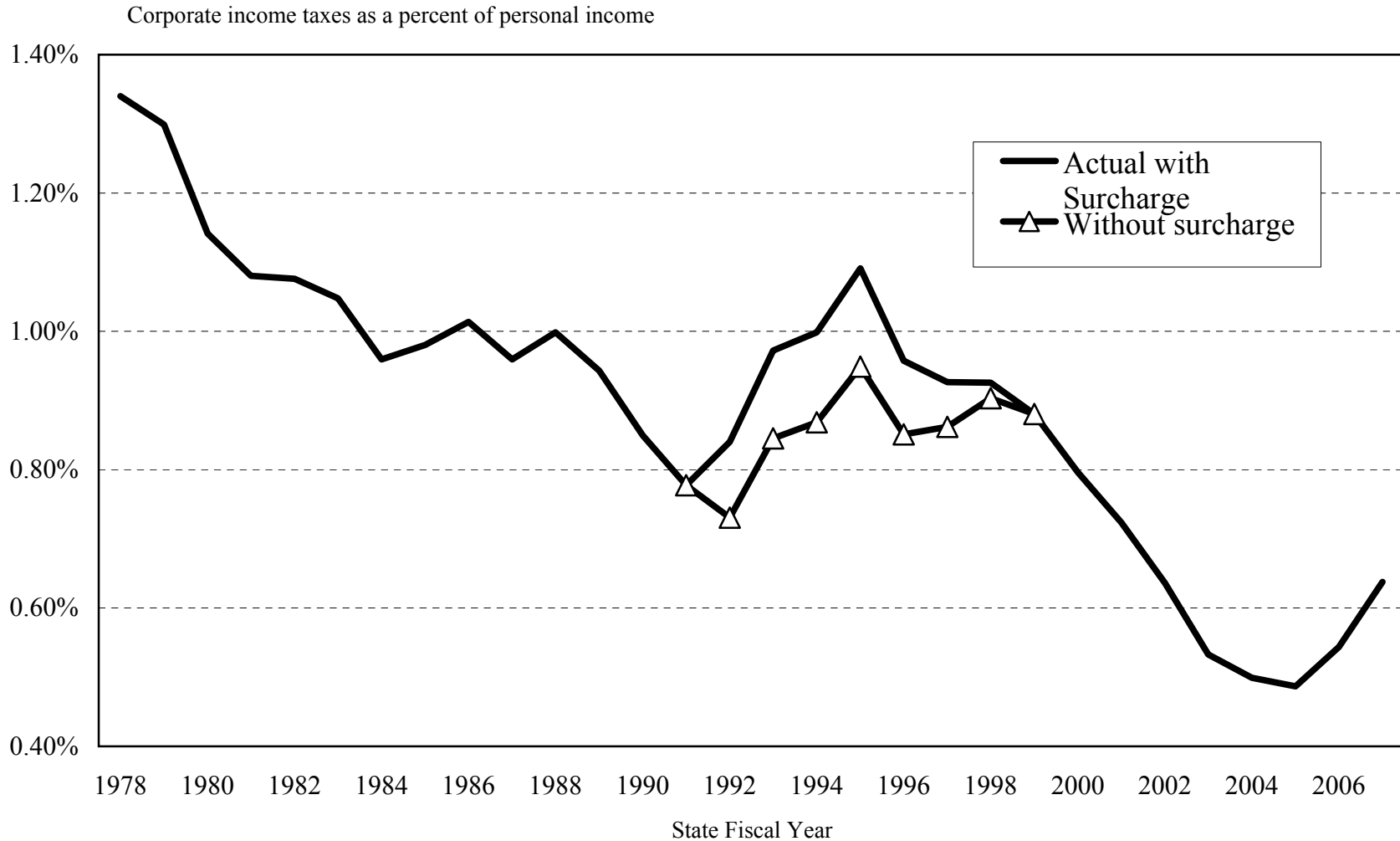
- **The New York government should reduce wasteful “contracting out.”** Up to \$500 million a year is wasted by NYS each year by contracting out work that could be done by State employees at a significantly lower cost.³ There are numerous State contracts under which NYS pays contractors up to four times the salary of a State employee (including a 35% fringe benefit factor) to do the same work done by State employees. A more rational approach to contracting out would protect state taxpayers by requiring a cost/benefit analysis before a contract for personal services is executed to determine whether those services could be performed at a lower cost by State employees. Maine and Massachusetts have already adopted legislation restricting wasteful contracting out. The current system could also be improved through disclosure with each agency’s proposed budget of information regarding proposed state operations personal service contracts.
- **New York State should spend less on prescription drugs by combining state and local purchasing power to get lower prices.** The savings of aggressive action on this front are substantial. For example, the Health Reform Program at Boston University School of Public Health has estimated (using data for 2000) that New York could reduce its Medicaid expenditures by over \$400 million per year if it were able to purchase brand name prescription drugs at federal supply schedule prices. These researchers have also concluded New Yorkers would have saved \$3 billion in 2001 if international pharmaceutical makers accepted the same prices for brand name prescription drugs in the United States that they charge in Canada. The State's share of these savings would easily exceed \$1 billion.

³ Fiscal Policy Institute, “Privatization without Competition Equals Huge Losses: How the New York State Government Wastes Hundreds of Millions of Dollars without Increasing Service Quality,” June 2005.

Corporate Tax Reform

- **New York State should eliminate loopholes that do not create jobs.**
- **New York State should reform New York's Corporate Alternate Minimum Tax (AMT).** Several significant loopholes were added to New York's Corporate AMT in 1994. These changes could be repealed. Alternatively, New York's current AMT could be replaced with a variation of the Alternative Minimum Assessment (AMA) adopted by New Jersey in 2002. While the New Jersey AMA applies to all businesses with gross profits of \$1 million or more, New York could apply such an assessment only to businesses with gross profits of over \$5 million in order to ensure that this revision would not hurt small businesses.
- **New York State should crack down on schemes that create "Nowhere Income."** Many large corporations pay no taxes on profits derived from sales made in states in which they do not have a physical presence. 25 states, including Texas, Utah, Oregon and California, have enacted "throwback rules" to ensure that profits earned in a state in which a corporation may not be subjected to an income tax are taxed instead by its home state.
- **New York State should Adopt "Combined Reporting."** 16 states including California, Colorado, Illinois, and New Hampshire require multi-state and multi-national corporations to file a combined return for their entire "corporate family" rather than being able to use inter-subsidary transactions to move income to countries or states where that income is not taxable. Under combined reporting, a corporate family files a single tax return covering the income of all of its subsidiaries, with that income apportioned among the states based on the locations of all its property, payroll and sales.

Corporate income tax revenues have fallen substantially relative to the size of the economy.



Note: Includes the state's main income tax on general corporations (the Corporate Franchise Tax, Article 9-A & 13), as well as the Corporation and Utilities Tax (Article 9), the Insurance Tax (Article 33) and the Bank Tax (Article 32).

blank page

Economic Backdrop

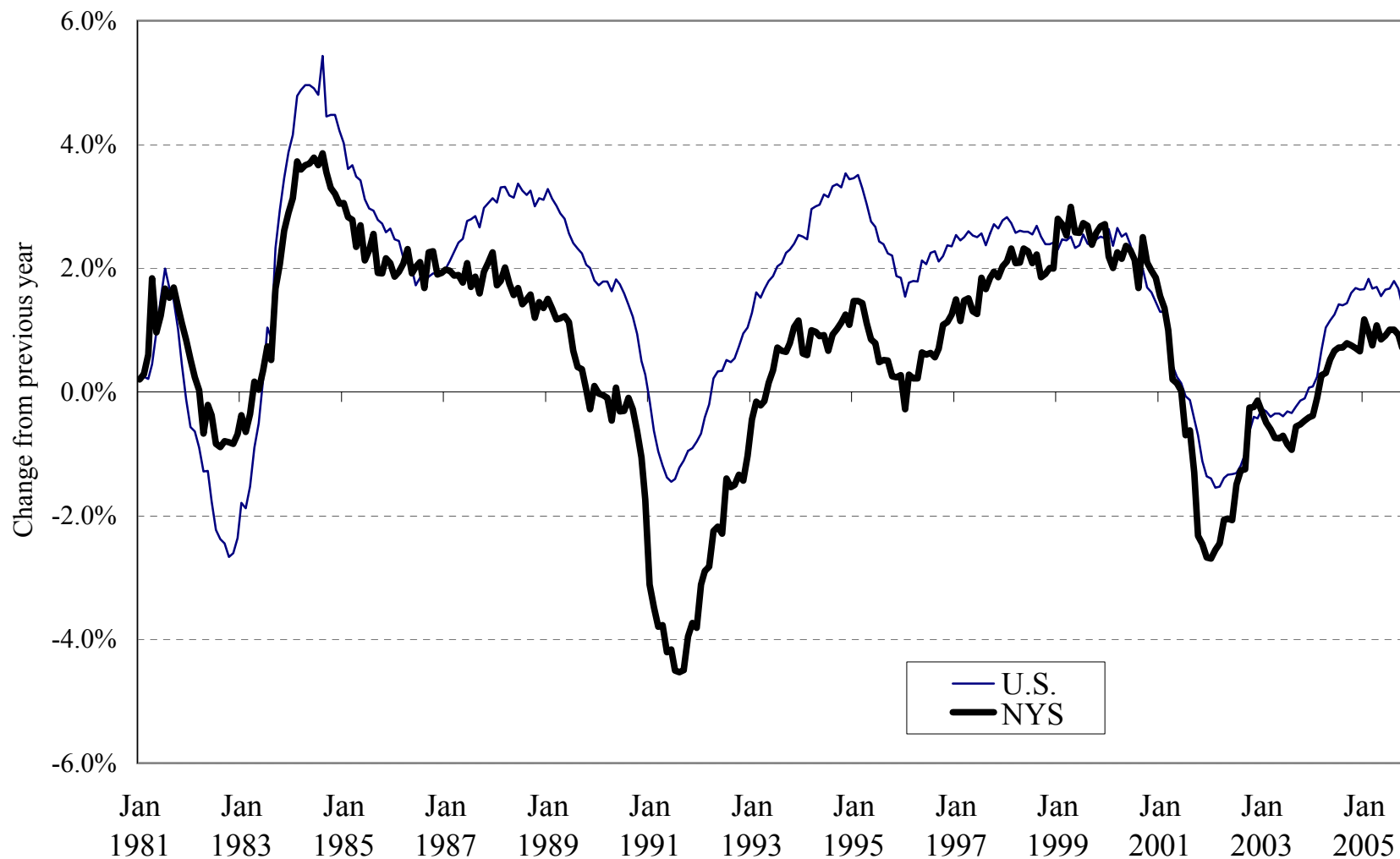
and

Economic Outlook

The State of Working New York: Treading Water in a Tenuous Recovery

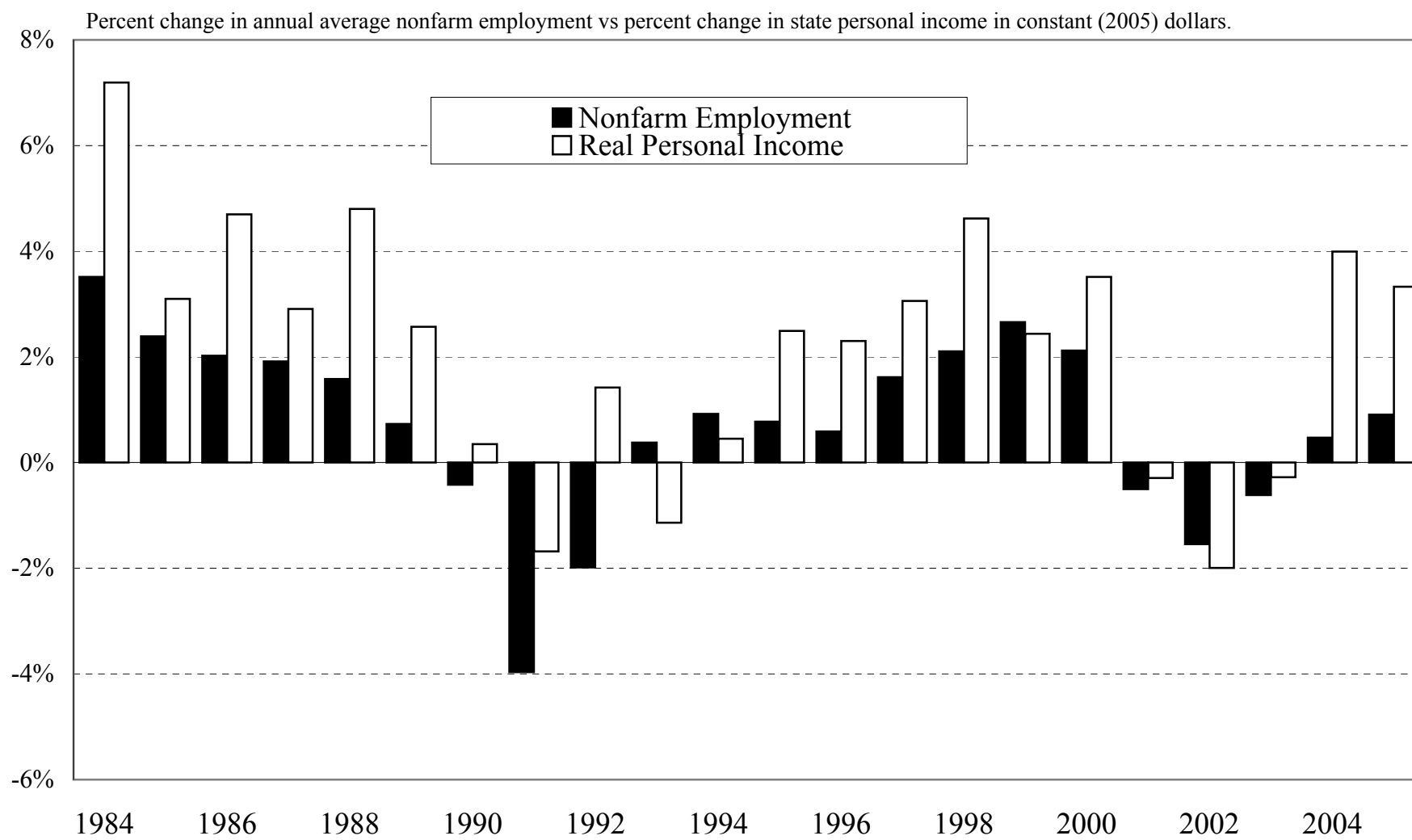
- “Treading Water in a tenuous Recovery” is the descriptive subtitle of the latest edition of FPI's biennial report on the State of Working New York.
- National recovery that started in mid-2003 is the weakest recovery in terms of job growth since 1949.
- The recovery is tenuous because it has been largely fueled by borrowing on the part of households (through mortgage debt) and all levels of government. Total national debt has increased 50% faster than the growth in GDP.
- Workers and their families are treading water in this recovery largely because the growth in wages (14%) has dramatically trailed the growth in profits (65%). (measured from 1st Q 2001 to 1stQ 2005) Real hourly wages have fallen; housing, energy and health care costs are rising; and income polarization has intensified.

2001-03 downturn not as steep as early 1990s, but NYS lags even historically weak national job growth.



Source: BLS, NYS DOL. Not seasonally adjusted. Analysis by FPI.

While New York's income growth often exceeds job growth, this was particularly the case in 2004 and 2005



New York State AGI, the base for the NYS income tax, has grown rapidly in 2004 and 2005 with the resumption in growth in capital gains and Wall Street wages.

	New York State Adjusted Gross Income (NYSAGI) (\$ millions)	Net Capital Gains (\$ millions)	Total Wall Street Wages (\$ millions)	Change from prior year			Capital Gains and Wall Street Wages as share of	
				AGI (\$ millions)	Capital Gains (\$ millions)	Wall Street Wages (\$ millions)	AGI	AGI change from prior year
1991	276,058	8,735	12,321	-7,369	-392	12,321	7.3%	
1992	294,861	9,457	17,850	18,803	722	5,529	9.3%	33.2%
1993	297,112	13,365	18,572	2,251	3,908	722	10.7%	205.7%
1994	301,362	12,032	17,274	4,250	-1,333	-1,298	9.7%	-61.9%
1995	321,124	14,086	20,187	19,762	2,054	2,913	10.7%	25.1%
1996	347,981	22,441	24,534	26,857	8,355	4,347	13.5%	47.3%
1997	383,179	31,563	28,790	35,198	9,122	4,256	15.8%	38.0%
1998	417,996	38,929	33,602	34,817	7,366	4,812	17.4%	35.0%
1999	448,531	48,330	35,116	30,535	9,401	1,514	18.6%	35.7%
2000	508,934	62,302	48,777	60,403	13,972	13,661	21.8%	45.7%
2001	481,001	29,450	49,810	-27,933	-32,852	1,033	16.5%	113.9%
2002	459,919	20,398	40,278	-21,082	-9,052	-9,532	13.2%	88.2%
2003	473,778	28,455	38,008	13,859	8,057	-2,270	14.0%	41.8%
2004	525,751	49,427	46,161	51,973	20,972	8,153	18.2%	56.0%
2005	571,592	69,855	56,316	45,841	20,428	10,155	22.1%	66.7%
2006	599,872	67,473	65,046	28,280	-2,382	8,730	22.1%	22.4%
2007	631,563	72,011	72,851	31,691	4,538	7,805	22.9%	38.9%
Change, 1995-2000	187,810	48,216	28,590					
Change, 2000-2002	-49,015	-41,904	-8,499					
Change, 2002-2005	111,673	49,457	16,038					
Change, 2005-2007	59,971	2,156	16,535					
%change from prior year								
2003	3.0%	39.5%	-5.6%					
2004	11.0%	73.7%	21.5%					
2005	8.7%	41.3%	22.0%					
2006	4.9%	-3.4%	15.5%					
2007	5.3%	6.7%	12.0%					

Sources: NYSAGI and Capital Gains, New York State Division of the Budget; 2004-2007 are DoB projections.
Wall Street Wages from NYS DoL: 1991-1999 on SIC basis; 2000-2007 on NAICS basis.
2005-2007 Wall Street wages are FPI projections.

New York State's Economic Outlook for 2006

- Though job growth slowed in the last half of 2005, job and income growth projected to continue at moderate pace in 2006.
- Real estate market has started to cool but job growth has picked up in financial and professional services (these 2 sectors accounted for 1/3 of 2005 NYS net job growth).
- Tourism continues to boost NYC job growth in the arts, hotels and restaurants.
- Construction job growth is weak, and manufacturing job decline has moderated but continues.
- Temp agencies and security guards are experiencing moderate job gains.
- Most of the information sector, particularly publishing and telecommunications, have been flat and are not expected to pick up.
- Revenue growth likely to moderate because of real estate market and slower growth in capital gains.

NYS job growth in the recovery period since mid-2003 is at less than half the national pace

Employment	(in thousands, seasonally adjusted)	U.S.	New York State	New York City
March 2001	(U.S. peak month)	132,511	8,672	3,741
November 2001	(end of national recession)	130,879	8,472	3,603
May 2003	(U.S. employment trough)	129,827	8,399	3,529
December 2005*	(latest month)	134,468	8,534	3,585
March 2001 - November 2001 (Recession)				
Change		-1,632	-200	-138
% change		-1.2%	-2.3%	-3.7%
November 2001 - May 2003 (Post-recession Downturn)				
Change		-1,052	-73	-74
% change		-0.8%	-0.9%	-2.1%
May 2003 - December 2005 (31 months of recovery)				
Change		4,641	135	56
% change		3.6%	1.6%	1.6%
March 2001 - December 2005 (from national pre-recession peak to latest)				
Change		1,957	-138	-156
% change		1.5%	-1.6%	-4.2%

Source: Bureau of Labor Statistics (BLS), New York State Dept. of Labor. NYS and NYC seasonal adjustment by FPI.

*December 2005 data are subject to revision

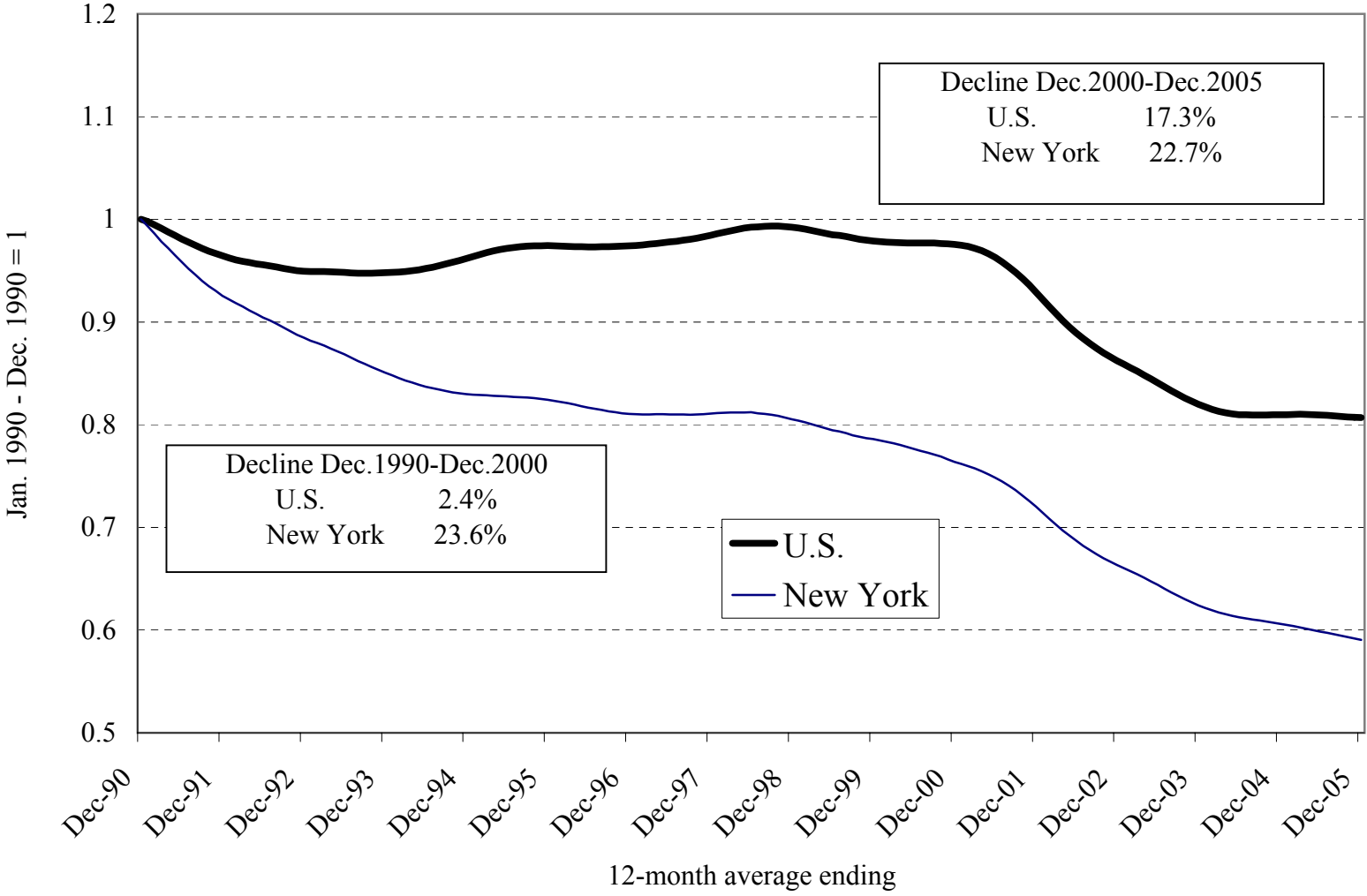
Within New York, job growth during the recovery has been best in Eastern NY, weakest in Northern and Western NY

Employment*	Dec-00	Dec-03	Dec-05	Change 12/00 to 12/03		Change 12/03 to 12/05	
				number	%	number	%
UNITED STATES	133,308,000	131,026,000	135,188,000	-2,282,000	-1.7%	4,162,000	3.2%
NEW YORK STATE	8,831,400	8,548,200	8,667,500	-283,200	-3.2%	119,300	1.4%
NEW YORK CITY	3,821,400	3,593,900	3,647,200	-227,500	-6.0%	53,300	1.5%
EASTERN NEW YORK	2,691,900	2,696,300	2,764,100	4,400	0.2%	67,800	2.5%
Nassau-Suffolk, NY Metropolitan Division	1,253,800	1,251,300	1,274,000	-2,500	-0.2%	22,700	1.8%
Putnam-Rockland-Westchester	567,900	567,400	589,000	-500	-0.1%	21,600	3.8%
Albany-Schenectady-Troy, NY MSA	448,600	447,000	456,400	-1,600	-0.4%	9,400	2.1%
Glens Falls, NY Metropolitan Statistical Area	50,000	51,200	53,300	1,200	2.4%	2,100	4.1%
Kingston, NY Metropolitan Statistical Area	65,600	65,000	67,000	-600	-0.9%	2,000	3.1%
Poughkeepsie-Newburgh-Middletown, NY MSA	245,200	253,500	259,200	8,300	3.4%	5,700	2.2%
Columbia County	21,800	21,500	22,000	-300	-1.4%	500	2.3%
Greene County	14,400	14,000	14,700	-400	-2.8%	700	5.0%
Sullivan County	24,600	25,400	28,500	800	3.3%	3,100	12.2%
WESTERN AND NORTHERN NEW YORK	2,316,600	2,257,700	2,261,300	-58,900	-2.5%	3,600	0.2%
WNNY Metropolitan areas	1,854,800	1,800,300	1,797,600	-54,500	-2.9%	-2,700	-0.1%
Binghamton, NY MSA	121,300	113,800	113,300	-7,500	-6.2%	-500	-0.4%
Buffalo-Niagara Falls, NY MSA	564,800	555,700	555,200	-9,100	-1.6%	-500	-0.1%
Chautauqua County	59,700	56,700	57,000	-3,000	-5.0%	300	0.5%
Elmira, NY MSA	44,500	40,700	40,200	-3,800	-8.5%	-500	-1.2%
Ithaca, NY MSA	59,900	62,500	63,800	2,600	4.3%	1,300	2.1%
Rochester, NY MSA	536,700	517,200	505,300	-19,500	-3.6%	-11,900	-2.3%
Syracuse, NY MSA	330,300	321,100	327,800	-9,200	-2.8%	6,700	2.1%
Utica-Rome, NY MSA	137,600	132,600	135,000	-5,000	-3.6%	2,400	1.8%
WNNY Non-metropolitan areas	461,800	457,400	463,700	-4,400	-1.0%	6,300	1.4%

Source: Bureau of Labor Statistics, New York State Department of Labor

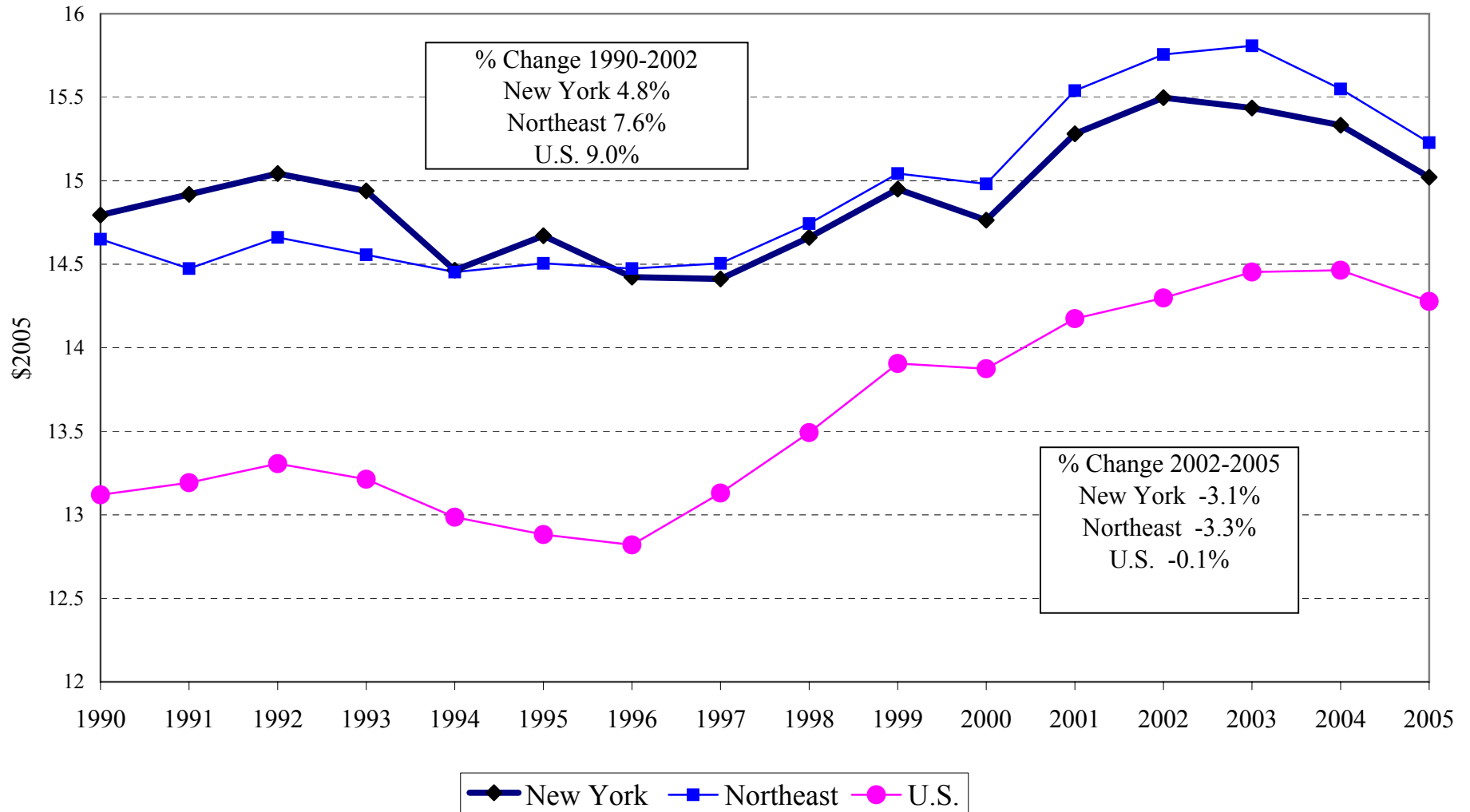
*not seasonally adjusted

Manufacturing jobs, still critical to the upstate economy, have declined faster in NYS than in the US over the past 15 years.



Source: BLS, NYS DOL. December 2005 numbers subject to revision.

Inflation-adjusted median hourly wages in NYS had gone up in 2001 and 2002, but have fallen each of the last three years.



Source: Economic Policy Institute analysis of Current Population Survey data 1990-2004; FPI analysis 2005

Although there has been some job recovery in finance and professional and technical services, the average wage of sectors gaining job share in NYS is still 23% less than the average wage of sectors losing job share.

(New York State employment in thousands) SUPERSECTOR*	Employment		2004 Average	Change	Job Change	Share Change
	July-03	December-05	Annual Wage		Gain/Loss	Change (pps.**)
Health Care and Social Assistance	1,160.3	1,202.5	\$37,374	42.1	gained jobs	0.27%
Educational Services	333.1	357.0	\$38,413	23.9	gained jobs	0.21%
Administrative and Support Services	391.0	412.1	\$33,404	21.2	gained jobs	0.17%
Professional, Scientific, and Technical Services	508.1	528.6	\$73,580	20.5	gained jobs	0.14%
Food Services and Drinking Places	445.9	465.2	\$16,289	19.3	gained jobs	0.14%
Retail Trade	855.9	877.0	\$26,517	21.2	gained jobs	0.08%
Arts, Entertainment, and Recreation	127.1	134.9	\$38,824	7.8	gained jobs	0.07%
Finance and Insurance	518.0	530.2	\$143,420	12.3	gained jobs	0.04%
Real Estate and Rental and Leasing	179.8	184.8	\$45,809	5.0	gained jobs	0.02%
Accommodation	77.5	80.2	\$31,206	2.7	gained jobs	0.02%
Other Services	349.6	356.8	\$28,022	7.1	gained jobs	0.01%
Waste Management and Remediation Services	19.0	19.9	\$44,041	0.9	gained jobs	0.01%
Subtotal, industries gaining job share	4,965.2	5,149.1	\$41,928	184.0		1.2%
Manufacturing	608.0	572.9	\$50,247	-35.1	lost jobs	-0.53%
Government	1,486.9	1,482.3	\$45,754	-4.5	lost jobs	-0.35%
Wholesale Trade	354.7	350.0	\$60,436	-4.7	lost jobs	-0.12%
Information	272.7	269.6	\$73,648	-3.1	lost jobs	-0.09%
Management of Companies and Enterprises	121.8	119.7	\$115,678	-2.1	lost jobs	-0.05%
Construction	320.4	322.6	\$49,317	2.2	gained jobs	-0.04%
Transportation and Warehousing	220.9	222.3	\$38,351	1.4	gained jobs	-0.03%
Utilities	41.0	39.9	\$82,496	-1.1	lost jobs	-0.02%
Subtotal, industries losing job share	3,426.3	3,379.4	\$54,602	-47.0		-1.2%
Total	8,391.5	8,528.5	\$49,921	137.0		

*Analysis excludes natural resources and mining and not elsewhere classified.

** Percentage point change.

Job Quality Ratio	-0.25
--------------------------	--------------

Note: The average wage for the two groups is computed by weighting the industry average wage by each industry's share of the change in the job share for its group. For a description of the Job Quality Ratio, see State of Working New York, 2005, fig.3.3, p 38.

Source: New York State Department of Labor Insured Employment series, analyzed by Fiscal Policy Institute.

Relative to New York's total job growth, job growth in industries with a lot of minimum-wage jobs has fared well since the January 2005 minimum wage increase.

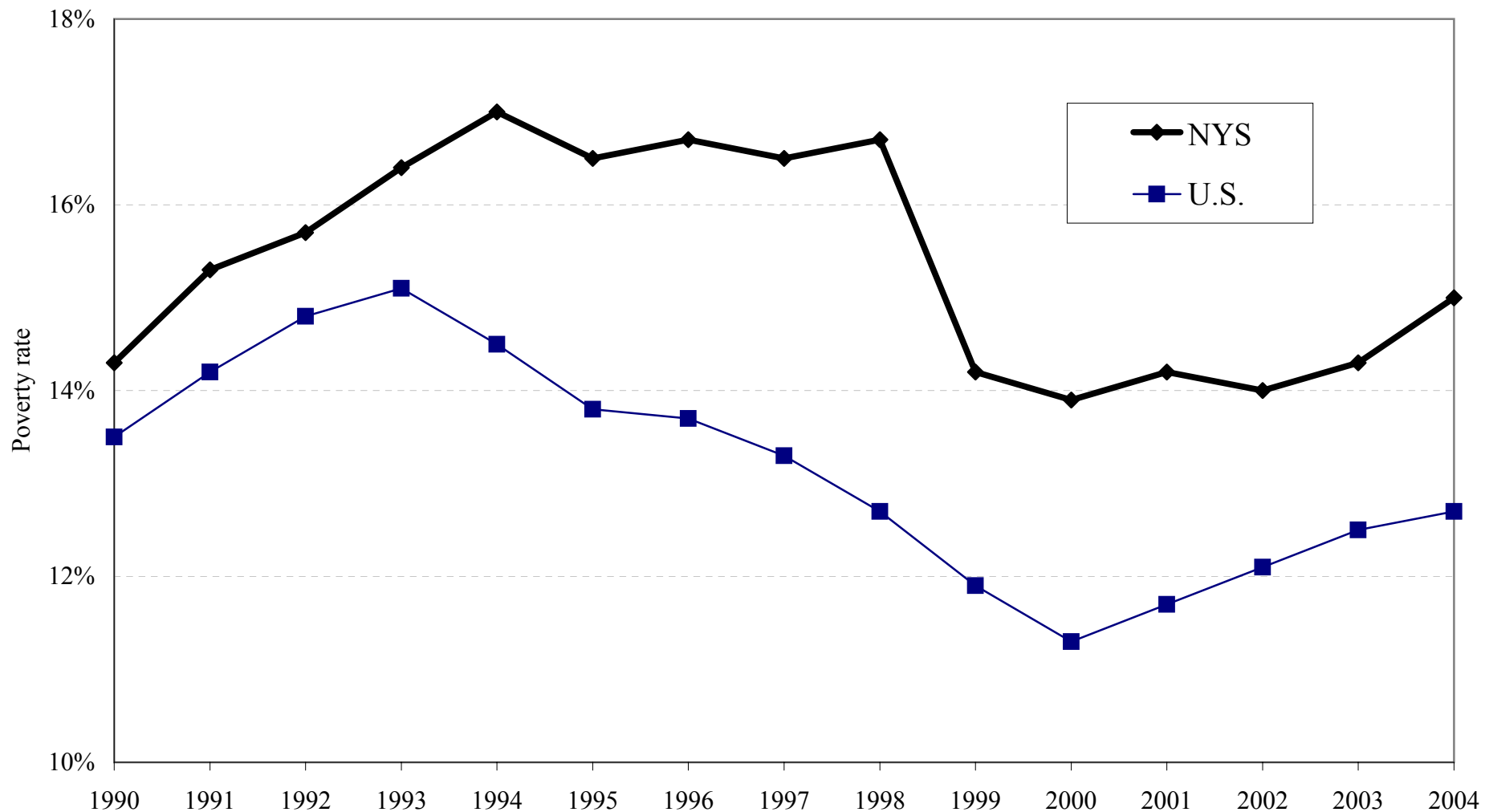
	Employment (000s)			Ratio of change in low-wage to overall change
	December 2004	December 2005	Change	
New York State				
All non-farm	8,604.6	8,667.5	0.7%	
Retail trade	924.0	929.8	0.6%	
Food service	456.9	467.7	2.4%	
Low-wage	1,380.9	1,397.5	1.2%	1.64
Four neighboring states (NJ, PA, MA, CT)				
All non-farm	14,691.1	14,817.5	0.9%	
Retail trade	1,775.2	1,788.1	0.7%	
Food service	862.0	881.6	2.3%	
Low-wage	2,637.2	2,669.7	1.2%	1.43
United States				
All non-farm	133,187.0	135,188.0	1.5%	
Retail trade	15,646.1	15,729.4	0.5%	
Food service	8,885.4	9,095.8	2.4%	
Low-wage	24,531.5	24,825.2	1.2%	0.80

Note: Retail trade and food services are the largest employers of minimum-wage workers.

December 2005 figures are preliminary

Source: Bureau of Labor Statistics

After dropping at the end of the late 1990s expansion, New York State's poverty rate increased in 2003 and 2004.



Source: US Census Bureau.