
2001-02 Budget Analysis

Review of the Executive Budget

H. Carl McCall
State Comptroller



February 2001

**State of New York
Office of the State Comptroller
Office of Fiscal Research & Policy Analysis
Albany, New York 12236**

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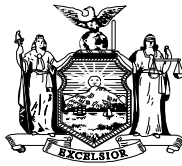
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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

February 7, 2000

To the People of the State of New York:

The Governor's proposed budget continues a six-year trend of failing to address fundamental issues of providing for New York's long-term fiscal health, but the most significant threat to our State's long-term growth is the failure to address the inequities in our education funding system.

This year, the need to reform school aid formula should have been a major cornerstone in the Governor's plans.

In his State of the State address, the Governor made encouraging statements about reforming the school aid distribution formula. However, his budget proposal is based on simplification without real reform and represents a substantial cut in funding scheduled under existing law. Furthermore, the Governor unfortunately decided to appeal a court decision that mandated reform.

During the past seven years of record national economic growth, New York has missed out on a number of opportunities, but none is more disturbing than the failure to fix the inequities in the State's funding of education. Tens of thousands of students lost out on the quality education guaranteed them by the State Constitution because of the inaction in Albany.

Higher education continues to be a poor second cousin in Albany. New York remains near the bottom of all states in terms of financial support for its higher education system. For far too long, the administration has looked at higher education as an expense rather than an investment. While the rest of the nation was bolstering investment in colleges and universities, New York State has sat on its hands. In the new high technology economy, ensuring we have a well-prepared, top-flight workforce should be of utmost importance.

In prior years, a major budget issue has been the need for debt reform to strengthen the State's long term fiscal stability and reduce the cost of paying for debt. This year, we saw positive steps of reducing our reliance on debt to finance transportation projects. The Governor has increased pay-as-you funding for capital projects, which is a long overdue step. However, the defeat of the Transportation Bond Act has left a multi-billion dollar major gap in the Governor's capital plan, and his budget proposal includes little detail of his plans to address that gap.

Given the Governor's failure to address school aid reform, not to mention budget reform and his half-hearted tip of the hat to debt reform, I am concerned that we will continue the State's 15-year late budget streak. I urge the Governor and the Legislature to make an on-time budget a priority. This embarrassment has continued for far too long.

The State budget lays out the direction the State will take in the coming years. Choices made today will impact what the State is able to provide for its citizens not just this year, but long into the future. In many programs, strategic investments must be made if the State is to grow and develop. Fundamental State responsibilities, such as assuring a strong education for all children or addressing rising health care cost need a comprehensive long-term approach. Failure to address those needs can have long-term consequences in the form of lost opportunities. The budget should lay out a clear and responsible plan to address these needs and to move New York into the new millennium. This budget fails that test.

A handwritten signature in black ink, appearing to read "Carl McCall". The signature is stylized and cursive.

H. Carl McCall
State Comptroller

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EXECUTIVE SUMMARY

Overview

The 2001-02 Executive Budget proposes \$83.6 billion in all funds spending, representing a 5.3 percent increase over 2000-01. State funds spending grows by 4.9 percent and General Fund spending increases by 3.6 percent. After reflecting actions designed to deflate General Fund spending, the growth rate increases 4.8 percent. Spending growth is above the projected rate of inflation for 2001 of 2.7 percent.

The Executive projects fiscal year 2000-01 will end with a \$1.4 billion available surplus. The actual surplus is closer to \$1.9 billion. The Executive proposes setting aside \$1.3 billion in the fiscal responsibility reserve for future use and paying \$500 million for additional tax refunds in 2000-01.

Structural Balance

The Executive Budget projects a General Fund gap of \$2.5 billion in 2002-03 and \$2.9 billion in 2003-04. The out-year gap projections do not assume any additional spending efficiencies or apply surplus receipts in order to reduce the size of the gaps.

School Finance

A \$382 million, 2.8 percent school year aid increase is proposed, which is approximately equivalent to projected inflation, but more than \$1 billion below what the present law aid formulas would provide. The proposal includes consolidation of 11 aid formulas into a new “flex aid” category; building aid changes that will require districts to refinance debt and delay State aid payments; a freeze in the planned expansion in the LADDER aids; and freezes and cuts in other programs.

Although it is described as better targeting aid to high-need school districts, the proposal actually provides roughly equivalent percentage increases in aid to all districts without regard to their relative need. For example, the neediest districts receive a 2.84 percent increase on average, while the wealthiest get 2.33 percent. The Executive’s claim of better targeting rests on a single figure: the percentage of the aid increase that goes to high-need districts (205 school districts classified as high-need by the State Education Department). While 68 percent of the Executive’s proposed increase does go to these districts, this figure is not materially different from recent years. For example, it is a very small improvement over the 66 percent share of the aid increase these districts received over the past four years. Receiving a slightly higher share of a much lower increase (as compared to last year) will not help the needy districts. In last year’s budget, for example, the high-need districts received a total increase in aid of \$718 million, more than four times the increase the Executive Budget would give them.

The Executive’s proposal makes no attempt to address the issues raised in the Campaign for Fiscal Equity (CFE) lawsuit, which calls for the State to develop a new finance system that supports the costs of providing a good education for all students. In addition to providing insufficient funding, the proposal is not based on any rational

assessment of the costs related to providing a sound basic education, which is what the Court specifically directed. The Executive has said he will appeal the CFE decision.

Higher Education

No major changes for higher education are proposed, although there are inflationary increases offset by a series of cuts, including significant reductions in opportunity programs and in aid to independent colleges. Over the past five years, New York State ranks 44th among the states in increasing support for higher education.

Bundy aid, which goes to independent colleges and universities based on the number of degrees granted, is cut by more than a fourth. Opportunity programs (including HEOP, EOP, SEEK/CD and STEP/CSTEP) are cut by 25 percent, re-imposing reductions enacted in 1995-96 and restored only recently. SUNY and CUNY receive funding for salary increases, inflation, and allocations for university priorities, offset by reductions in rents and other items, including elimination of last year's legislative adds. Last year's new funding for full time faculty at the community colleges is eliminated, although funding for faculty at the four-year institutions is blended with other allocations. There is no tuition increase for SUNY or CUNY, but it is proposed that campuses be allowed to set their own rates for graduate and professional education. Community colleges receive no additional funding, although a \$175-per-student increase was requested. The State's share of community college budgets in 2000-01 is 31.8 percent: nearly two percent below what it was six years ago, still below the one-third originally provided, and even further below the 40 percent promised in the 1970's.

This year's budget at long last begins to address the shortfall at the SUNY hospitals, which has been growing since SFY 1998-99 when the University ended its fiscal year in deficit. Changes this year will separate the hospital finances from the operating budgets of the SUNY campuses and increase State support for the hospitals, although the \$51 million increase in annual support is probably not sufficient to prevent a continuing shortfalls (which have been closer to \$100 million annually).

Tax Cuts

The Executive Budget proposes a package of tax reductions that costs \$25 million in the first year and \$528 million when fully implemented. Expansion of certain Empire Zones and creation of co-STAR, which reduces county property taxes for seniors and farmers, account for over half the tax cuts.

Health

The Executive proposes Medicaid-related State savings of \$300 million. When federal and local Medicaid shares are included, the proposed budget cuts nursing home rates by approximately \$327 million. These are across-the-board reductions with only one exception. The Executive cites nursing home profits and high costs as justification for these cuts. In addition, he proposes to improve oversight by increasing the number of inspectors. This improvement follows a pattern by this administration of lax enforcement of existing rules and lackluster inspections as documented by OSC and others. While it is true that nursing homes experienced overall profits of approximately \$350 million in

1999, many homes are struggling to stay viable and provide quality care. In fact, more than one-third of the voluntary homes experienced losses. Nursing homes, like other health and non-profit providers, are also having a difficult time attracting and retaining staff. Broad-based Medicaid reductions will only exacerbate these problems and could further erode quality of care.

Child Health Plus (CHIP) eligibility was expanded and benefits enhanced in 1998 and are set to expire on March 31, 2001. The Executive proposes a mere extension of these provisions. The State should move toward the goal of insuring more New Yorkers through a seamless system by simplifying and streamlining the enrollment and renewal process, using the same insurers for all programs when feasible and creating a uniform eligibility standard for children. More than three million New Yorkers lack health insurance. Approximately one million are eligible for existing programs but not enrolled. The reauthorization of the CHIP legislation is a good opportunity to go beyond a simple extension to address these issues.

The Executive proposes creating an independent Pharmacy and Therapeutics Committee to consider measures to promote the appropriate and cost-effective provision of pharmaceuticals. This Committee is charged with making recommendations regarding drug formulary and utilization policies and on options to achieve price discounts on drugs.

Many states have been much more aggressive at finding ways, such as using their purchasing clout, to reduce prices. New York is behind the curve and it is unfortunate that the Executive is only now studying the issue. However, since some of the newer more expensive drugs reduce costs in other areas of health care – costs should not be examined in a vacuum. If formulary changes are considered they should incorporate the positive benefits that certain drugs might yield – such as reduced emergency room visits or the prevention of second heart attacks. The focus of an effective policy should be to reduce the cost of drugs without jeopardizing the quality of care. In addition, it appears this committee will focus on containing costs in the Medicaid program. However, there are millions of uninsured and underinsured residents that could benefit from a comprehensive statewide effort to reduce drug costs generally.

Local Governments

This year's Executive Budget estimates that its actions will save local governments \$443 million, but a closer examination of the figures shows very little positive impact on local governments: only an additional \$1 million total for counties, cities, towns, and villages.

Revenue sharing is virtually unchanged, but certain miscellaneous aids are cut, and New York City is particularly disadvantaged, losing \$114 million annually with the elimination of the Stock Transfer Incentive Fund. A cut of \$34.9 million in CHIPS funding for local highway and bridge operations and maintenance is proposed. The aid program enacted last year to offset new costs for counties under HCRA is continued, but funding remains level while the counties' costs more than double.

A new “Co-STAR” program for counties is proposed, similar to the School Tax Relief (STAR) program. The program would assist income-eligible seniors and farmers, but unlike STAR the taxpayers would have to first pay their county taxes and then wait for a rebate check from the State. Eventually, the proposal would provide \$230 million in property tax relief but the rebates are phased in over five years, and do not begin until 2002-03, when there will be a \$50 million impact. Although it is positive to address county property taxes, an exemption program is only a partial solution, and Co-STAR will not help businesses, renters, or other taxpayers who are ineligible for the proposed rebate. A more comprehensive approach to property taxes should address the many fiscal relationships between the State and county governments.

Debt and Capital

The capital plan submitted with the 2001-02 Executive Budget proposes to increase debt outstanding by \$2.5 billion over five years, from \$38.5 billion in 2001-02, to \$41.0 billion in 2005-06. Debt service will grow to \$4.5 billion by the end of the plan, an increase of approximately \$400 million from 2001-02.

The new plan increases the amount of capital paid for in cash with State dollars compared to the prior capital plan. This is due in part to the use of \$250 million in Debt Reduction Reserve Fund (DRRF) resources to pay cash for transportation projects.

While there have been several positive developments that contribute to this year’s capital plan, including the use of DRRF resources to reduce outstanding debt and increase pay-as-you-go and the continued phase-in and new dedication of resources to the capital program, the Executive Budget has failed to fully address the impact of the Transportation Bond Act’s defeat on the capital program. The Executive Budget patches together a plan to get through the next couple of years. Furthermore, much of this approach includes dubious strategies and leaves just as many questions unanswered. A substantial commitment to funding transportation infrastructure is integral to sustaining and developing our economy in New York State. A more comprehensive way to honor these commitments should be pursued.

The Executive has called for a constitutional amendment to codify the statutory debt caps that were agreed to last year and for a ban on backdoor borrowing. Clearly, constitutional change is necessary to ensure permanence; however, it is unwise to solidify existing, flawed caps that are not meaningful and fail to constrain debt in the foreseeable future.

FINANCIAL OVERVIEW

This section provides a summary description of the Executive Budget, focusing on the financial plan. Highlights of the 2001-02 proposed General Fund Executive Budget follow:

- ✓ Underlying tax collections continue to be strong. Most of the growth is in the personal income and sales taxes.
- ✓ Growth in entitlement programs continues to be manageable, with public assistance caseloads declining. Medicaid spending, however, is projected to grow by 6.9 percent in 2001-02. Proposed school aid spending increases 5.3 percent compared with growth of 8.5 percent in 2000-01 (on a fiscal year basis).
- ✓ \$1.279 billion in surplus funds are set aside in the Fiscal Responsibility Reserve for future use.
- ✓ Medicaid cost containment produces savings of about \$300 million.
- ✓ Approximately \$394 million in special revenue funds are provided through the Health Care Reform Act of 2000 (HCRA 2000) to offset spending that would otherwise be disbursed from the General Fund.
- ✓ \$90 million in unallocated tobacco settlement funds are proposed to offset General Fund Medicaid spending.
- ✓ \$323 million in federal TANF funding for the Earned Income Tax Credit is proposed.
- ✓ \$61 million in federal TANF funding for the Child and Dependent Care Tax Credit is proposed.
- ✓ \$169 million in General Fund relief is proposed by shifting spending for snow and ice removal to the dedicated transportation fund.

The Executive states the 2000-01 surplus will be \$1.359 billion. He proposes depositing \$80 million in the Tax Stabilization Reserve Fund and setting aside \$1.279 billion for deposit into the fiscal responsibility reserve for future use in the event of an economic downturn. However, the actual surplus is larger (approximately \$1.9 billion) because the budget uses \$500 million for increased tax refunds and \$55 million for HCRA relief.

The fiscal health of the State has benefited from the fact that receipts have consistently out-performed expectations and spending has been less than projected.

Strength in the financial markets has driven much of the State's economic success, however, growth cannot continue indefinitely and signs of a slow-down are looming. In the short-term, reserves are higher and year-end surpluses have become common. These are positive steps, but more needs to be done to ensure long-term financial stability. In particular, the State needs to enact meaningful constitutional debt reform.

Size of the Proposed 2001-02 Budget

As presented in the Executive Budget, all funds spending totals \$83.6 billion, an increase of \$4.2 billion, or 5.3 percent; State funds spending increases by 4.9 percent; and General Fund spending increases by 3.6 percent. The Executive's figures reflect a number of accounting actions that serve to reduce reported General Fund spending growth.

Spending by Fund Type 2001-02 Executive Budget (Billions)

Comparison Basis	Proposed 2001-02 Spending	Difference	Change
All Funds	\$83.6	\$4.2	5.3%
State Funds	\$57.4	\$2.7	4.9%
General Fund	\$41.3	\$1.4	3.6%

2001-02 Proposed General Fund Spending

Overall General Fund spending is projected to increase by \$1.4 billion in 2001-02. The largest spending increases are: \$612 million in school aid (on a fiscal year basis); \$390 million in Medicaid; \$211 million in mental health; \$190 million for SUNY and CUNY; \$136 million in general state charges/miscellaneous; and \$105 million for capital projects. There are also some proposed spending reductions.

Spending over the past few years has been affected by several changes, primarily accounting-related, that distort reported growth in spending from year-to-year. In order to provide a more accurate picture of what spending would have been absent these transactions, a number of adjustments need to be made for the years 1999-00 through 2001-02. Some of the adjustments are for actions taken in prior years but are necessary to ensure a stable baseline series to calculate adjusted growth rates. In 2001-02, accounting adjustments total approximately \$1.037 billion. Without the benefit of these actions, spending would grow by almost \$2 billion or 4.8 percent; substantially above the projected inflation rate of 2.7 percent.

The adjustments to 2000-01 and 2001-02 include:

- The HCRA 2000 legislation, which was enacted in December 1999 and extended the existing system of surcharges to support health-related public goods. In addition, it created a new Tobacco Control and Insurance Initiatives pool that is funded through a portion of the State tobacco settlement funds and a nearly doubling of the cigarette tax. This pool supports a number of programs that were previously funded through the General Fund and new programs that would likely have received General Fund support. The total new General Fund relief provided by HCRA 2000 is approximately \$394 million in 2001-02. An adjustment of \$280 million is made in 2000-01. In addition, an annual transfer of \$82 million from HCRA is discontinued beginning in 2001-02.
- A proposed offset of \$90 million to General Fund Medicaid spending in 2001-02 from the unallocated portion of the State tobacco settlement funds. An adjustment of \$77 million is also made in 2000-01, the first year the State took this action.
- \$323 million in 2001-02 attributable to counting a portion of the Earned Income Tax Credit (EITC) as part of the minimum State public assistance spending levels required by the federal government. The EITC is a refundable credit provided to lower-income working families. The addition of these expenditures allows the State to free-up General Fund spending by substituting federal block grant funds. An adjustment of \$49 million is made in 1999-00, the first year the State took this action and \$168 million in 2000-01. A similar adjustment of \$61 million is made for the Child and Dependent Care Credit in 2001-02 and \$5 million in 2000-01.
- \$169 million in Department of Transportation spending for snow and ice removal, which is proposed to be shifted from the General Fund to the dedicated Highway and Bridge Fund in 2001-02. The transfer of this spending would improve coverage ratios of revenues for bonding under the program.

The adjustments that affect 1999-00 include:

- A transfer of \$250 million related to the dissolution and privatization of the Medical Malpractice Insurance Association fund (MMIA) into a special revenue fund to offset General State Charges (GSC) spending. A second planned transfer also of \$250 million scheduled for 2000-01 did not take place since those revenues did not materialize.
- \$100 million from non-recurring excess balances in pools related to the old hospital reimbursement system (NYPHRM), which was used to directly offset Medicaid spending. Normally, these types of fund balances are transferred to the General Fund for budget relief. The balances in these pools were allowed to accumulate.

- \$45 million from current Health Care Reform Act (HCRA) pools, which was used to directly offset Medicaid spending. This is expected to provide a one-time reduction in Medicaid spending.

In addition, the funding for the School Tax Relief (STAR) program was classified during 1998-99 as being disbursed from a dedicated fund; by dedicating a portion of the personal income tax to STAR and reporting the spending out of the special revenue fund, General Fund spending is reduced. This reduces reported General Fund growth for 1998-99 through 2001-02. Unlike most other tax dedications, there is little linkage between this revenue source and the program purpose. In addition, the funding provided under STAR is not dependent on the level of revenues collected. This change highlights the increasing importance of State funds as a more accurate and appropriate measurement of State spending.

**Summary of General Fund Spending Adjustments
1999-00 through 2001-02
(Millions)**

	1999-00	2000-01	2001-02
Reported General Fund Spending	\$37,170	\$39,895	\$41,343
Reported General Fund Spending Growth		7.3%	3.6%
HCRA 2000 General Fund Relief		\$280	\$394
GSC offset from MMIA receipts	\$250		
Medicaid offset from tobacco settlement		\$77	\$90
Medicaid offset from NYPHRM pools	\$100		
Medicaid offset from HCRA 96 pools	\$45		
Earned Income Tax Credit	\$49	\$168	\$323
Child Care Credit		\$5	\$61
DOT snow and ice shift			\$169
Total Adjustments	\$444	\$530	\$1,037
Adjusted General Fund Spending	\$37,614	\$40,425	\$42,380
Adjusted General Fund Spending Growth		7.5%	4.8%

The largest component of proposed General Fund spending is \$12.1 billion in school aid for 2001-02. This amount represents an increase of \$612 million over 2000-01, or 5.3 percent.¹ In 2000-01, growth in school aid spending was 8.5 percent or more than \$905 million.

The next largest category of spending is Medicaid. General Fund spending for this program is expected to grow by \$390 million, or 6.9 percent. However, General Fund growth is lowered due to the use of certain offsets to spending through HCRA special

¹ This increase is on a State fiscal year basis and does not match the school year aid increases discussed elsewhere in this report.

revenues and the proposed use of a portion of the unallocated tobacco settlement, as described above.

**Change in 2001-02 General Fund Spending Compared to 2000-01
With and Without Adjustments**

(Millions)

Spending Category	Proposed 2001-02	Difference from 00-01	Difference from 00-01	Change without Offsets
School Aid	\$12,134	\$612	5.3%	5.3%
SUNY/CUNY	\$2,153	\$190	9.7%	9.7%
All other education	\$2,112	\$2	0.1%	0.1%
Medicaid	\$6,083	\$390	6.9%	7.2%
Public Assistance	\$1,008	(\$244)	-19.5%	-2.3%
Children and Families	\$1,130	\$31	2.8%	2.8%
All other health and soc. serv.	\$1,530	\$121	8.6%	11.32%
Transportation	\$317	(\$194)	-38.0%	-4.9%
Mental Health	\$2,561	\$211	9.0%	10.4%
Public Protection	\$2,521	(\$55)	-2.1%	-2.1%
General State Charges/Misc.	\$3,291	\$136	4.3%	4.3%
Debt Service	\$2,288	\$70	3.2%	3.2%
Other	\$4,216	\$178	4.4%	4.4%
Total	\$41,343	\$1,449	3.6%	4.8%

2001-02 General Fund Receipts

General Fund receipts are estimated to increase by \$2.3 billion, or 5.8 percent, over 2000-01. However, receipts are affected by accounting mechanisms designed to move surplus funds between fiscal years and by the proposed STAR transfer. Absent these transactions that are unrelated to 2001-02 receipt growth, tax revenues grow by 3.5 percent and total receipts grow by 3.0 percent. Although these growth rates may appear low, they actually reflect strong growth in revenues because the increasing costs of phased-in tax cuts mask underlying growth. If tax collections are adjusted to reflect the growing impact of tax cuts, underlying growth approximates 6.4 percent. Much of the growth in taxes is attributable to the personal income tax.

**2001-02 General Fund Receipts
Change from 2000-01
(Millions)**

Revenue Category	2001-02	Difference	Growth	Underlying Growth
Personal Income Tax	\$26,601	\$1,559	6.4%	7.8%
User Taxes and Fees	\$7,442	\$20	0.3%	2.1%
Business Taxes	\$4,171	(\$292)	-6.5%	1.4%
Other Taxes	\$771	(\$10)	-1.3%	30.3%
Total Taxes	\$38,985	\$1,317	3.5%	6.4%
Miscellaneous Receipts	\$1,429	(\$71)	-4.7%	
Transfers from Other Funds	\$2,163	(\$2)	-0.1%	
Receipts pre-accounting actions	\$42,577	\$1,244	3.0%	
Refund Reserve Transactions	\$1,251	(\$865)	-40.9%	
STAR deposit	\$1,371	\$506	-27.0%	
Available General Fund Receipts	\$42,457	\$2,335	5.8%	

2000-01 Surplus

The 2000-01 Enacted Budget did not project a current year surplus. Nor did the Executive identify any additional surplus in the Mid-Year Update to the financial plan. In January, the Executive projected the available surplus at \$1.359 billion. However, the actual surplus is larger (about \$1.9 billion) because the budget uses \$500 million for increased tax refunds and \$55 million for HCRA relief.

**2000-01 Surplus by Source and Proposed Use
(Millions)**

Source	Amount
Higher Receipts	\$2,205
Higher Spending	(\$291)
Total Surplus	\$1,914
Additional deposit to the Tax Stabilization Reserve	\$80
Additional refunds	\$500
HCRA relief	\$55
Fiscal Responsibility Reserve set-aside	\$1,279
Surplus Use	\$1,914

Receipts for 2000-01 are now expected to be \$2.205 billion higher than enacted budget projections. Much of the better-than-expected revenue collections have been driven by the personal income and sales taxes.

Spending is expected to be \$291 million higher than originally projected. Of this amount, \$250 million is related to lower than expected revenues from the dissolution of the Medical Malpractice Insurance Association (MMIA) which had been expected to offset State fringe benefit spending. The remaining increase is due to higher litigation costs, state employee health insurance costs, and Medicaid.

STRUCTURAL BALANCE

Future Budget Gaps

The Executive Budget projects a General Fund gap of \$2.5 billion in 2002-03 and \$2.9 billion in 2003-04.

Executive Budget Projections for Future Year Budget Gaps

(Millions)

Multiyear Gap Projections	2002-03	2003-04
Receipts	\$41,128	\$42,371
Spending	(\$43,806)	(\$45,294)
Use of Community Projects Fund Balance	\$188	\$0
Executive Estimate	(\$2,490)	(\$2,923)

The future gap estimates assume underlying growth in receipts in the neighborhood of 5.7 percent in 2002-03 and 2003-04. This appears consistent with slowed economic growth, since the underlying growth was substantially higher in prior years. Use of the Community Projects Fund reflects a planned pay-out of funds for projects currently in the pipeline but does not reflect a recognition that additional projects will be added by the Legislature in future years.

Spending increases by 6.0 percent in 2002-03 and 3.4 percent in 2003-04. Year-to-year spending declines primarily because there are no new collective bargaining costs assumed after current contracts expire in 2003 thereby understating spending. Grants to local governments represent the largest spending increases. These increases are driven by growth in school aid of 5.4 percent and 5.5 percent in 2002-03 and 2003-04, respectively. Medicaid, the next largest General Fund spending area, is projected to grow by an estimated 9.5 percent in 2002-03 and 7.9 percent in 2003-04. The Medicaid growth rate is slightly less than, but roughly consistent with, the national Medicaid growth rate estimated by the Congressional Budget Office.

The outlook for the next two years has improved when compared to gap estimates for prior years.² Much of this appears to be attributable to a healthy State economy and more accurately reflects growth in receipts and spending. The out-year gap projections do not assume any additional spending efficiencies or apply surplus receipts in order to reduce the size of the gaps.

² OSC estimates of out year gaps made last years, after certain adjustments, were \$3.0 billion in the first out-year and \$4.9 billion for the second out-year. For more detail, see *2000-01 Budget Analysis, Review of the Enacted Budget*, Office of the State Comptroller, pp. 11-12.

Reserves

The Executive Budget includes about \$3.2 billion reserved for future spending needs or in rainy day funds. This amount represents just over 7.5 percent of total General Fund revenues.

Reserves Fiscal Year Ending 2002 (Millions)

Source	Amount	Fund Type
Tax Stabilization Reserve Fund	\$627	General Fund
Contingency Reserve Fund	\$150	General Fund
Community Projects Fund	\$188	General Fund
Universal Pre-Kindergarten Fund	\$14	General Fund
Fiscal Responsibility Reserve	\$1,279	General Fund
Set-aside for future welfare needs	\$835	Federal Funds
Set-aside for future child care needs	\$78	Federal Funds
Total	\$3,171	

While many of the reserves detailed below are earmarked for certain purposes, it is possible to use these monies, with the exception of the federal welfare funds, for other purposes. The only clear reserve for economic hardship is the Tax Stabilization Reserve Fund funded at \$627 million, or only 1.5 percent of General Fund receipts. While the Executive has put forward a proposal to increase deposits to this fund from two to five percent per year, it is still a small amount of funds to have set aside as the only true rainy day reserve. The fiscal responsibility reserve, where most of the surplus funds reside, is not a true rainy day reserve – these monies are not restricted by statute and could be used for any purpose. A larger amount of true reserves need to be clearly set aside in statute to ensure that the State is prepared for an economic downturn.

The reserves have been created for a variety of purposes, including:

- The use of the Tax Stabilization Reserve Fund, which is restricted to unplanned budget deficits.
- The Contingency Reserve Fund, which was created to provide reserves that the State could use for litigation-related costs.
- The Community Projects Fund and the Universal Pre-Kindergarten Fund, which were created to fund future years spending for current legislative programs.
- The Fiscal Responsibility Reserve, which may be used in future years in the event of a significant economic downturn to finance, but its use is not restricted.

- The reserves related to welfare, \$835 million and \$78 million, which are the result of excess federal funding.³ Pursuant to federal law, the State is limited as to what programs these funds could support.⁴ However, the contingency fund for future welfare needs does provide a cushion for increased spending resulting from higher caseloads in the event of an economic downturn. The set-aside for child care provides additional funding over the next two years for increased child care needs related to stricter work participation requirements. Although the State is not actually in receipt of these funds, the federal government accounts reflect unused balances.

Additionally, the federal TANF statute is up for renewal in the coming year. States that have not spent their allocations will be in danger of losing these funds. The concept of a block grant is a good one from the standpoint of long-term management. It is fiscally prudent to set aside a portion of funds to prepare for times of economic downturn that would require higher spending levels. States that took this approach should not be punished for being fiscally responsible.

³ Funding set aside for the cost of welfare system redesign is included in the amounts for 2001-02.

⁴ While federal funds can provide State and local budget relief, it is limited by maintenance of effort provisions.

EDUCATION

School Finance

The Executive Budget provides a \$382 million, 2.8 percent school year increase, which is approximately equivalent to inflation and brings total State aid to nearly \$14.1 billion. However, the budget proposes spending \$1.078 billion less than the “present law” aid formulas would have provided.

The Executive’s 2001-02 proposal includes: a consolidation of 11 aid formulas into one “flex aid” category; building aid changes that will require districts to refinance debt and delay State aid payments; and a freeze in the planned expansion in the LADDER aids.⁵ The budget also eliminates several programs, such as teacher resource and training centers and bilingual education, freezes some, and reduces funding for others, including teacher support aid and educational technology funding.

Executive Budget Proposal for 2001-02 (School Districts Grouped by Need)

	Low-Need	Average-Need	High-Need
Average Increase	2.33%	2.46%	2.84%

Source: OSC Analysis based on State Education Department state aid computer runs of 1/16/01.

Although the Executive’s proposal is described as better targeting aid to high-need districts, the formula changes actually provide almost all districts with roughly equivalent percentage increases over 2000-01. As shown in the above table, on average the Executive’s proposal provides the neediest districts with a 2.84 percent increase while providing the State’s wealthiest districts with a 2.33 percent increase. In effect, there is very little variation of need.

The Executive’s claim of better targeting is based on a single figure: the percentage of the aid increase that goes to the 205 school districts classified as high-need by the State Education Department.⁶ It is true that 68 percent of the Executive’s proposed aid increase and 69 percent of the flex aid increase goes to high-need districts, but these

⁵ LADDER is the acronym for Learning, Achieving, and Developing by Directing Educational Resources, an Assembly initiative enacted in 1997, including such programs as pre-kindergarten, full-day kindergarten, class size reduction, educational technology, and minor maintenance. The original agreement calls for annual funding increases in each program.

⁶ The State Education Department uses a “need/resource capacity index” to measure a district’s ability to meet the needs of its students with local resources. The index is the result of a calculation using a poverty measure (free and reduced price lunch) and the combined wealth ratio (the ratio of district wealth per pupil to state average wealth per pupil). The big five city school districts are among the 205 districts considered high-need districts.

figures are not materially different from recent years. For example, last year 66 percent of the aid increase went to high-need districts, and the same percentage increase went to them over the past four years combined.⁷

The high-need districts include the big five city school districts, as well as other suburban, rural and city districts across the State, and together they comprise more than 56 percent of the total student population, and are more than 40 percent below the average wealth level. As such, even under the current flawed formulas, they get a higher-than-average share of aid, receiving about 63 percent of total aid in the current school year, for example. Providing a marginally higher share of an annual increase (i.e., 68 percent rather than the 63 percent of the base) therefore will do very little to help these districts.

The Executive's increase is more than \$1 billion below the amount that the present law aid formulas would provide (an overall increase that is equal to what the Regents recommend). Obviously, the share of the increase these districts receive is far less important to them than the size of the increase they get. For example, last year the high-need districts received an aid increase of \$718 million, more than four times the increase the Executive would give them.⁸ Observing the gaps in performance and the need to help students in districts across the State meet the new standards, the Commissioner of Education said that the Executive's proposal, "in the face of such a challenge, is not sufficient."

It must also be understood that the high-need districts have much more work to accomplish to assist students in meeting the new Regents standards, despite having fewer resources. For example, the high-need districts educate almost 90 percent of the students with limited English proficiency, have much greater concentrations of poverty, and show higher failure rates on standardized exams.

Campaign for Fiscal Equity Case

In the Campaign for Fiscal Equity⁹ (CFE) lawsuit challenging the State's school finance system, the New York State Supreme Court has ordered the State to reform school aid because it does not effectively guarantee children in New York City or elsewhere the opportunity for a "sound basic education." Although the case initially focused on New York City, it applies to all school districts, particularly the hundreds of high-need districts in cities, suburbs and rural areas throughout the State. The Supreme Court's ruling calls upon the State to develop a new finance system that supports the costs of providing a good education for all students, as well as to provide new safeguards to ensure that funds are efficiently and effectively utilized. This is not an unreasonable approach, and it is similar to the reform agendas of most education and citizen groups.

⁷ Note: these percentages are based on categories of aid included on State Education Department computer runs (and therefore exclude some grant categories).

⁸ *2001-2002 Budget Priorities*, State Education Department, prepared for the Legislative Budget Hearing (January 30, 2001), page 10.

⁹ Campaign for Fiscal Equity against The State of New York, Supreme Court, County of New York, State of New York, I.A.S. Part 25, Index No. 111070/93. The Campaign for Fiscal Equity – a group of educators, advocacy groups, parents, and community school boards – initially filed the lawsuit in 1993.

Despite statements by the Executive in his State-of-the-State speech and budget literature about helping high-need districts, it is clear that the budget proposal offers far too few resources to even begin to address the issues raised in the CFE court decision. Moreover, the Executive's reformulation (under flex aid) is not based on any rational assessment of the costs related to providing a sound basic education, which is what the Court specifically directed. The Executive has said the State will appeal the CFE decision.

Flex Aid

The Executive Budget proposal merges 11 school aid categories, mainly unrestricted aids, into one new "flex aid," and increases the overall amount by \$250 million. Flex aid would be comprised of operating, tax equalization, tax effort, limited English proficiency, gifted and talented, extraordinary needs, educationally related support services, private and public excess cost, operating standards and minor maintenance aids. It would total \$9.8 billion, representing about 70 percent of all aid. The flex aid formula starts with 2000-01 aid distribution as a base for each district, and then distributes \$250 million through a simplified formula that incorporates district wealth, regional costs and a measure of poverty. However, the formula includes minimums and is structured in such a way that very little differentiation of needs among districts results.

While consolidating aid categories, increasing unrestricted aids, and accounting for regional cost differences are positive concepts, the proposed changes do not target aid to the State's neediest districts materially better than existing formulas, and in some ways the distribution is worse. The fact that the caps on aid have been eliminated is touted as a major reform, but the new formulation simply does not recognize the need for a large aid increase for any district, and so the caps are no longer needed to limit the State's costs. The majority of districts get between a 2 and 3 percent flex aid increase, and there is little variation among high-, average-, and low-need districts.

Flex aid includes special education funding, which means these aids would no longer be driven by special education placements. Although for years proposals have been considered to convert the special education funding approach to one that does not reward placing pupils in more restrictive environments, the Executive's proposal is considered by many to be too radical a change that would leave districts without support for new, very high-cost pupils.

Building Aid

The Executive Budget proposes a \$170 million year-to-year increase in building aid, bringing the total to more than \$1.3 billion. This amount, however, represents a \$312 million reduction from present law, which is based on reimbursement for existing projects. This reduction is largely caused by the use of an assumed amortization schedule, which reduces aid by \$200 million.

The new schedule would be based on the useful life of buildings – 15 years for reconstruction, 20 years for major reconstruction/additions, and 30 years for new

construction. Districts would have to refinance to align their debt service (for new projects and as well as most existing ones) to match State aid payments, or bear the expense themselves until the aid was received. Building aid would cover refinancing and interest costs. An additional \$112 million would be saved through the delay of debt service payments to districts.

Changes have also been proposed for new building projects, which are not aided until next year. Rather than reimbursing those projects as an entitlement, the Executive would fund new projects on a priority basis, with health and safety projects topping a six-category list. The second and third priorities would be overcrowding, and fixing or replacing buildings in use more than 40 years. Within each classification, districts would be ranked by a “needs resource index,” which measures a district’s ability to raise resources locally relative to students’ needs, and by the building’s age. Building aid for new projects would be capped at \$220 million a year.

Since 1998-99, building aid has increased by more than 41 percent. Although the building aid formula includes wealth, it requires districts to spend money to get money. Without any real prioritization of the funding, it now appears that the large increases in building aid in recent years have not been allocated in proportion to the relative severity of needs. Unfortunately, the Executive’s prioritization comes at the expense of a large cut in current law funding and creates uncertainty for school districts.

The Executive is also reintroducing proposals to: authorize the Dormitory Authority to provide school districts with pooled financing opportunities; and, exempt districts from the Wicks Law, allowing districts to hire a single contractor for construction.

Other School Aid Changes

- **Universal pre-kindergarten**, the largest of the LADDER programs, is funded at \$201.86 million, with an additional \$23.14 million in a reserve fund. Present law would have provided \$529 million in the final phase-in of the pre-kindergarten program, spreading apportionments to nearly all districts (rather than just the neediest districts, which were aided in the initial years). Under the Executive’s proposal to freeze the amount, no more new school districts will be admitted to the program, other than those who kept pre-kindergarten funds in the reserve fund in 2000-01.
- **Class size reduction aid**, the second largest LADDER program, would also remain frozen at the 2000-01 level at \$140 million, which is \$54 million less than present law would provide. Federal class size reduction aid will provide an additional \$141 million.
- A new \$7.5 million **performance incentive** fund is proposed for 2002-03 for schools among the big five city school districts that show academic improvements based on standardized tests.

- **IPP** (Improved Pupil Performance) and **categorical reading programs**, which go to the big five city school districts, would have to be directed at failing schools and used to reward schools that improve.
- New **funding for private schools** is proposed – \$5 million to support after-school and remediation and other types of services at nonpublic schools.
- Funding for public-private partnerships providing **after-school activities** would be increased from \$10 million to \$30 million.
- The Executive Budget proposes reducing **educational technology funding** from \$57 million to \$15 million, and targeting it to the big five cities and other needy districts – calling it instead a “fund for innovation.” According to the Division of the Budget, only \$29 million was claimed in 2000-01 and two-thirds of that went to above-average-wealth school districts.
- **BOCES** (Boards of Cooperative Education Services), **textbook, software and hardware aids** are each frozen at the 2000-01 levels, and **transportation aid** is increased by \$63.5 million. Shared serves aid, which would have provided \$25 million under present law to the big five cities (for instructional support services), is eliminated.

Teachers

With a teacher shortage looming, the Executive Budget proposes doubling to \$50 million funding for a series of new and continuing grant programs – “Teachers of Tomorrow” – originally enacted in 2000-01. These programs are aimed at recruiting and retaining teachers, especially in low performing districts and hard-to-staff subjects and regions. They include:

- Grants for paraprofessional – generally low-paid teaching assistants without certification, but usually lots of in-class experience – to obtain training needed to pass certification exams,
- Exemptions from caps on public salaries for teachers who are retired public employees, like policemen or firefighters; starting salaries for teachers are usually almost double the cap amount,
- Grants for support services for first- and second-year teachers in low-performing schools,
- Pension incentives to encourage teachers near retirement to continue teaching, and
- Programs to train more math and science teachers.

Unfortunately, the Executive Budget also proposes cutting almost \$90 million in existing teacher programs, including:

- A \$52.5 million cut in teacher support aid, which helps big five city school districts supplement low teacher salaries, lowering it from \$67.5 million to \$15 million,
- Elimination of \$30 million in teacher computer training and resource center funding, and
- Elimination of a teacher-mentor intern program (\$5 million), National Standards Board Program grants (\$1 million) and instructional staff development (\$1 million).

Other Proposals

Once again, the Executive proposes that school district spending increases be capped at 4 percent or 120 percent of the CPI, whichever is less. Districts would only be allowed to exceed the cap if they can achieve a “super-majority,” and more than two-thirds of the voters approve the budget. Like last year, this proposal is particularly restrictive in that it applies to all school districts and is virtually identical to the cap now imposed on districts when voters defeat budgets.

The general effect of the proposal is to cap spending in all districts regardless of their current spending levels, educational needs or the will of their voters. The cap is damaging to equity, since low-spending districts with large concentrations of disadvantaged students have a much greater need to increase spending than wealthier areas with relatively fewer educational problems.

Again the Executive is seeking legislation to allow mayors in the big five city school districts authority to oversee schools. Maintenance of effort provisions are also being proposed again this year for the big five.

Another proposal potentially affecting the big five city school districts would allow students attending SURR schools – Schools Under Registration Review, which are failing schools – to transfer to another school within the same district.

The Executive is once again proposing that the State Museum, the State Library and the State Archives be removed from the State Education Department, and together form a separate agency overseen by a board appointed by the Executive. The Executive Budget does not include the Regents request for \$183 million to update the libraries, library systems, and the State Museum.

Higher Education

No major changes for higher education are proposed, although there are inflationary increases offset by a series of cuts, including significant reductions in opportunity programs and in aid to independent colleges.

Bundy Aid

The biggest programmatic cut is to Bundy aid, which goes to independent colleges and universities based on the number of degrees granted. This aid program is currently funded at \$47.25 million, less than half of the “statutory level” (arrived at through a dollars-per-degree calculation set in statute), and has not been fully funded since 1990-91. The Executive cuts the program by \$12.6 million, or more than a fourth, by removing last year’s legislative add (\$3 million) and also eliminates funding for any students from outside the State. Although it is based on the number of students served, Bundy aid goes directly to institutions to help keep the independent sector healthy. New York State benefits significantly from the large number of independent colleges within its borders, particularly *because* they bring in out-of-state students who generate economic activity and often settle in the State upon graduation. The Executive is apparently considering rescinding this cut in the 30-day amendment period.

Opportunity Programs

The Higher Education Opportunity Program (HEOP) that applies to independent colleges is also cut by \$5.6 million. This re-imposes the 25 percent cut enacted in 1995-96 and restored only recently. The STEP/CSTEP science and technology opportunity programs were also cut by \$2.5 million, or 25 percent, as are opportunity programs at the State and City Universities. Since originally cutting opportunity programs in 1995-96, the Executive has repeatedly fought legislative restorations. Even though these programs are now funded at roughly the level they were in 1994-95, and will presumably be restored in the enacted budget, it must be recognized that constant dollar funding over seven years represents a tremendous loss to inflation.

SUNY, CUNY and Community Colleges

Overall, SUNY receives a \$41.8 million net increase and CUNY \$9.1 million. At both systems increased funding for salary increases, inflation, and allocations for university priorities is offset by reductions in rents and other items, including elimination of last year’s legislative adds providing funding for opportunity programs (EOP, SEEK/CD), child care, community college contract courses, and the SUNY Academic Achievement Scholarship program. The legislative adds for full-time faculty at the community colleges are also eliminated, but last year’s funding for full-time faculty at the senior colleges is blended with the allocations for system priorities.

There is no tuition increase for SUNY or CUNY, although it is proposed that campuses be allowed to set their own rates for graduate level and professional education programs.

Community colleges receive no additional funding, although a \$175-per-student increase was requested by the SUNY and CUNY boards. The budget notes that per-student aid has increased from \$1,800 in 1994-95 to \$2,250 today, but these figures do not include the impact of the elimination of aid for disadvantaged students, as well as for business and technical programs. Overall, State aid for community colleges has gone up by only 12 percent from 1994-95 to 2000-01, while inflation has been 16 percent and operating costs have gone up 18 percent. The difference has been made up by local revenues (largely property taxes) that have gone up by 28 percent, and by tuition and fees. Average tuition and fees have increased by 23 percent over the period, and tuition and fees at New York State community colleges are now nearly twice the national average.¹⁰

The community college aid increases, moreover, have not been at a level sufficient to restore the State's share of funding to about one-third, as was originally provided; the State's share is even further below the 40 percent share promised in the 1970's when the community colleges were asked to serve as full opportunity institutions, opening admissions to all students with a high school diploma or passing an equivalency exam. In fact, the State's estimated share of expenditures for 2000-01 is 31.8 percent – about two percent below what it was six years ago.

Student Aid

The budget continues the enhancements for the Tuition Assistance Program (TAP) enacted last year. The changes, which are phased-in over four years, include increases in the maximum grant from \$4,125 to \$5,000, in the income ceiling for eligibility, in the minimum grant levels, and in the maximum award for SUNY and CUNY students. However, because of reduced program expenditures attributed to a natural decline in program participation and “bracket creep” in the award schedules due to rising income, this year's TAP funding will remain at last year's level of \$636 million. This decline in participation continues a trend seen last year.

In another change enacted last year, a State personal income tax deduction or credit for college tuition will be provided. The deduction will begin in calendar year 2001, effecting tax returns due in April of 2002, and so will have only a negligible cost in the 2001-02 year. This program will eventually represent a tax expenditure of \$200 million annually. When fully effective, a deduction for tuition up to \$10,000 annually will be available for New Yorkers, regardless of where the tuition is paid (in- or out-of-state).

High Technology Partnerships

The budget also includes prominent descriptions of “Centers of Excellence,” a new program to provide funding for public-private high-tech partnerships at selected universities. The goal for the centers is to link universities and private industry to tap into the high-technology/biotechnology market. There have been announcements that the first

¹⁰ United States Department of Education, National Center for Education Statistics (NCES); average tuition and fees at community colleges in New York State are \$2554 in comparison to a national average of \$1,336; only four states are higher: Vermont, New Hampshire, Maine and South Dakota.

three centers will be Bioinformatics at Buffalo, Photonics and Optoelectronics at Rochester, and Nanoelectronics at Albany; other centers are planned on Long Island and in New York City.

Although no statutory program or detailed appropriations are contained in the budget, the program is to provide \$283 million in State funds over the next five years. The intention is that this funding can be leveraged to obtain additional federal, university, and private funds to bring the program total to \$1 billion. The State funding will provide \$37 million in operating funds annually for five years, and \$100 million in capital funds over five years. However, no capital disbursements will occur until SFY 2002-03 (\$10 million), with the majority being disbursed in 2003 through 2005.

The Executive's program is generally similar to the Senate's Gen*NY*sis proposal, but is placed in the Empire State Economic Development Corporation, rather than the New York State Office of Science, Technology and Academic Research (NYSTAR). The Senate's Staff Analysis of the SFY 2001-02 Executive Budget criticizes it strongly because "No explanation is presented as to why a duplicative higher education technology program is created in an agency with a poor track record in this field."¹¹

SUNY Hospitals

This year's Executive Budget at long last proposes to begin to address the shortfall at the SUNY hospitals, which has been growing since SFY 1998-99 when the University ended its fiscal year in deficit. Changes this year will separate the hospital finances from the operating budgets of the SUNY campuses and increase State support for the hospitals, although the \$51 million increase in annual support is probably not sufficient to prevent a continuing shortfall (which have been closer to \$100 million annually).

The financial difficulties at the three hospitals operated by SUNY stem from a variety of changes in the health care industry that put financial pressure on these institutions, including the rapid growth of managed care and changes in the State and federal health care financing systems. However, reduced State funding for the SUNY hospitals during the 1990's also played a substantial role.

In the 1980's the University hospitals received an appropriated subsidy from the State. It was assumed that the hospitals would not make money because of their teaching mission and the higher costs it entailed, as well as because they were public hospitals serving large proportions of indigent patients. The direct subsidy was dramatically reduced in the early 1990's and beginning in 1992-93 the approach was reversed and the hospitals were required to contribute an increasing amount of revenues to support campus academic programs, thus reducing the State's contribution. Eventually, the revenue required from the hospitals rose to \$116 million. Although officials at the Division of the Budget now say that this requirement was actually meant to recapture the fringe benefit and debt service payments made on behalf of the hospitals elsewhere in the budget, the

¹¹ *Staff Analysis of the 2001-02 Executive Budget*, Senate Finance Committee, January 2001, page 17.

fringe benefits had always been funded by the State outside of SUNY's budget, even when the hospitals received an additional, explicit subsidy.

As conditions changed the hospitals could not keep up with these contributions. The Executive deferred action on the problem year after year, as the State University's negative year-end balance grew from \$77 million to \$209 million, which is the shortfall projected at the end of the University's current fiscal year.

A consultant's study last year (from PriceWaterhouseCoopers) confirmed that there was no readily available solution to the hospital shortfall and that the budget for the State University system was predicated on revenue targets that could not be attained. Because circuitous budgeting methods had been used, the hospital shortfall threatened campus budgets, and there was even discussion of a tuition increase as a possible method to address the shortfall.

The budget this year proposes the following steps to help address the situation:

- Financial separation of the hospitals from the SUNY campuses' operating budget, through a change in the appropriation structure. This is a positive approach that the Comptroller has recommended.
- Under the new approach the hospitals will no longer have to provide \$116 million to support the campus operating budgets. However, they will be responsible for paying for their fringe benefits and debt service payments directly, which are expected to be \$157 million in 2001-02.
- Through internal transfers, the hospitals' effective payment to the State will be reduced from \$116 million (which they were asked to contribute to the campuses in previous years) to \$65 million (which will be their contribution to the new fringe benefits and debt service payments budget after various transfers). This is a decrease of \$51 million in the hospitals' annual target, which the Executive refers to as an increase in the subsidy (which had been calculated as the difference between \$116 million and the cost of the fringe benefits and debt service).
- The budget envisions that the \$209 million accumulated deficit will be paid back over a multiyear period (possibly as long as seven years), with the State paying off \$85 million (\$15 million of which will be paid this year), and the hospitals paying \$124 million (none of which will be paid this year).

- Statutory changes are also offered to provide the hospitals with greater operating flexibility (primarily raising contract approval thresholds and providing greater autonomy in various contracting procedures). It is doubtful, however, that these changes will produce the dramatic changes in the hospital revenue outlook that will be needed to meet the Executive's revenue targets.

The financial separation of the hospitals' budgets from the campuses and the recognition that the hospitals have additional costs that the State must help meet are both positive. The increased funding is a positive step as well, but the increase is only at about half the level of the annual operating deficits that have occurred. In addition, the hospitals' responsibility for paying off \$124 million of the accumulated deficit will place an additional strain on their budgets.

It is at this point doubtful that the Executive's changes will be enough to fully address the hospitals' problems, and it is entirely possible that operating deficits will continue to occur. For example, the Senate's analysis of the Executive Budget speculates that the hospitals may not be able to reach their target (even though it has been reduced to \$65 million from \$116 million), and concludes that the accumulated deficit at the end of 2001-02 may still be nearly \$200 million.¹²

If the hospitals cannot meet the targets, they may have to continue borrowing funds from the SUNY system, or a deficiency appropriation may be required in the following budget cycle (the Executive has already proposed a deficiency appropriation for this year). Although the Executive Budget has begun to address the SUNY hospitals crisis, it is clear that there is still a long way to go before a comprehensive solution is achieved.

¹² *Staff Analysis of the 2001-02 Executive Budget*, Senate Finance Committee, January 2001, page 171.

HEALTH AND SOCIAL SERVICES

Medicaid

The Executive Budget includes new proposals that provide savings of \$300 million in 2001-02. Of this amount, approximately \$162 million is achieved by maximizing other sources of revenue to lower State costs. These actions reduce Medicaid spending or provide General Fund revenues without impacting provider Medicaid payments. The remaining \$138 million represents reductions in State Medicaid spending. The bulk of these reductions, approximately \$131 million, decrease the Medicaid rates paid to nursing homes. When the impact of the federal and local Medicaid shares are incorporated, nursing homes would face an estimated total reduction of \$327 million. In addition, prior year cost containment actions, extended in December 1999 until March 31, 2003, save the State more than \$800 million and local governments approximately \$300 million.

Pursuant to the Health Care Reform Act of 2000 (HCRA), the proposed budget includes \$90 million in tobacco settlement receipts to offset State General Fund Medicaid spending. HCRA is slated to provide \$335 million in 2000 and \$419 million for programs that would have otherwise been supported by the General Fund. However, due to potential shortfalls in HCRA supported programs, the Executive Budget reduces the transfers from HCRA by \$55 million in calendar year 2000 and \$107 million in calendar year 2001. These reductions include eliminating an annual \$82 million transfer to the General Fund from HCRA pools, reducing amounts for the payment Medicare Part B policies for eligible Medicaid recipients, and decreasing the subsidy for Roswell Park Cancer Institute. In addition, the Executive Budget links the HCRA relief to passage of the nursing home cost-containment proposals.

Assuming enactment of the Executive's proposals, Department of Health General Fund Medicaid costs are estimated to decrease 1.6 percent in 2000-01 and increase 6.9 percent in 2001-02. These growth rates are affected by a number of actions including new cost containment, changes in the value of already enacted cost containment, spending offsets, and changes in the spending offsets.

**Department of Health General Fund
Medicaid Spending: Executive Budget**
(Millions)

	Amount	Growth
1999-00 Actual	\$5,783	4.0%
2000-01 Estimated ¹³	\$5,693	-1.6%
2001-02 Proposed	\$6,083	6.9%

The Executive projects growth in State Medicaid spending, absent changes in cost containment and offsets that reduce spending, of slightly less than seven percent in 2001-02. This growth rate better represents program trends, or underlying growth. Current law provides for automatic inflationary adjustments to hospital and nursing home Medicaid rates. Program growth is higher due to overall inflationary pressures in the system, particularly in home care and prescription drug costs. In addition, an estimated 105,000 Medicaid-eligible children will be transitioned from CHIP to Medicaid.

At the national level, the Congressional Budget Office projects federal Medicaid spending will grow 7.8 percent in federal fiscal year 2001 and 8.1 percent in 2002.¹⁴ While the national estimated growth rates provide some insight into the overall trends, caution must be used when extrapolating to the State since the State's share of total Medicaid costs differs from the federal share depending on the type of medical service.

The Executive Budget includes the following recommendations:

- **Nursing home actions.** Eliminating inflationary increases in Medicaid payment rates to nursing homes (\$54 million). Removing supplemental Medicaid payments to nursing home facilities with more than 300 beds (\$28.6 million) and eliminating the return on equity incentive in the payment rates to proprietary nursing homes (\$12 million). Reducing nursing home Medicaid payments by eliminating the Medicaid-only case mix adjustment (\$50.2 million). All of these provisions would be in effect until June 30, 2003.
- **Other long-term care.** Remove the limit on savings from certified home health care agency administrative cost cap (\$2 million).
- **Recipient actions.** Require Medicaid managed care recipients to make a co-payment on prescription drugs (\$10 million).

¹³ Medicaid 2000-01 spending projections are increased by approximately \$98 million from the enacted budget estimate. Nearly half of the increase is attributable to higher than expected home care expenditures.

¹⁴ *The Economic and Budget Outlook: An Update*, Congressional Budget Office, July 2000.

- **Revenue actions.** Offset General Fund Medicaid costs through the use of tobacco settlement funds (\$90 million). Increase revenue maximization actions (\$85 million). Continue the Health and Hospitals Corporation intergovernmental transfer (\$45 million) that was expected to only be available last year. Obtain federal participation for Medicaid costs for services provided to inmates of State-operated prisons (\$14.7 million). Remove the statutory limit on the maximum that could be collected from nursing home provider assessments (\$18.6 million).
- **Medicaid expansions.** The Executive Budget would also expand Medicaid eligibility to disabled individuals with incomes of up to 250 percent of the federal poverty level and \$10,000 in resources.¹⁵ The Executive's proposal is expected to increase Medicaid costs by \$2.7 million in 2001-02 and \$5.5 million in 2002-03. The budget includes a proposal to expand Medicaid eligibility to women with incomes below 250 percent of poverty (around \$35,000 for a family of three) who are diagnosed with breast and/or cervical cancer through the National Center for Disease Control's screening program. This expansion is estimated to cost \$500,000 in 2001-02 and \$1.1 million in 2002-03.

Long-Term Care

Studies, audits and reports released by the Office of the State Comptroller since 1994 indicate that the State has failed to make the care and safety of seniors a priority.¹⁶ Despite projections that the number of New Yorkers over age 65 will grow significantly in the years ahead, the State does not have a coordinated plan to address their needs. State agencies responsible for providing services directly have not taken meaningful steps to ensure that those who need and qualify for services receive them. At the same time, agencies with oversight responsibility for providers of services to the elderly have not done enough to guarantee that those agencies are caring for or promoting the independence of our seniors adequately. At the same time, inadequate oversight by State agencies raises questions about the potential misuse of limited public funds – funds that clearly are needed to meet growing senior service demands. As a result, the safety and long-term well-being of New York's existing and growing aging population is at risk.

This finding has been supported by numerous reports and correspondence from other oversight agencies. For example, the federal Department of Health and Human Services had serious concerns regarding the State's nursing home oversight performance. In addition, there have been some highly visible examples of inadequate care reported in the media. After years of warning, the Executive has finally begun to take action. The

¹⁵ This expansion was first proposed by the Assembly, where legislation was passed that increased income eligibility for the disabled to 400 percent of the federal poverty level. However, action was not taken by the Senate or the Executive.

¹⁶ See: *Study of New York State's Population, Audit of State Office for the Aging – Monitoring of Selected Programs, Audit of Department of Health and Office of Children and Family Services – New York's Oversight of Adult Care Facilities, Audit of Department of Health – Monitoring Nursing Home Compliance with Medicaid Participation Requirements and Controlling Provider Payments, Audit of Department of Health and Department of Social Services – Long Term Home Health Care Program, Audit of Department of Health – Monitoring Home Care for Medicaid Recipients.*

Executive Budget proposes a package of proposals aimed at increasing oversight of nursing homes and the quality of care given to New York's seniors.

However, nearly all the Medicaid provider cuts proposed in the Executive Budget impact the nursing home industry. Although it is clear the industry may have a few bad apples, it would be unwise to punish an entire industry for those few, and reduce funding for homes that are struggling to stay financially viable, and provide a high quality of patient care. As a justification for the proposed reductions, the Executive points to nursing home profits over the past several years. In 1999, cost reports indicate overall profits of \$354 million. However, these profits are not evenly distributed among nursing homes generally. In fact, more than two-thirds of the voluntary, not-for-profit homes lost money in 1999. The nursing home cost containment proposals reduce funding for all nursing homes, with the exception of the proposed elimination of the return-on-equity. Many of these homes may not be able to sustain these cuts. In addition, the proposed reductions come at a time when nursing homes are finding it increasingly difficult to attract and retain workers. These across-the-board reductions could further exacerbate the situation and cause patient care to suffer.

Child Health Insurance Plus (CHIP)

CHIP was created in 1991 to help make health insurance for children more affordable. Many children are ineligible for Medicaid because their families' earnings are over the eligibility threshold, yet these same families earn too little to afford health insurance. CHIP pays for, or subsidizes, health insurance for these children.

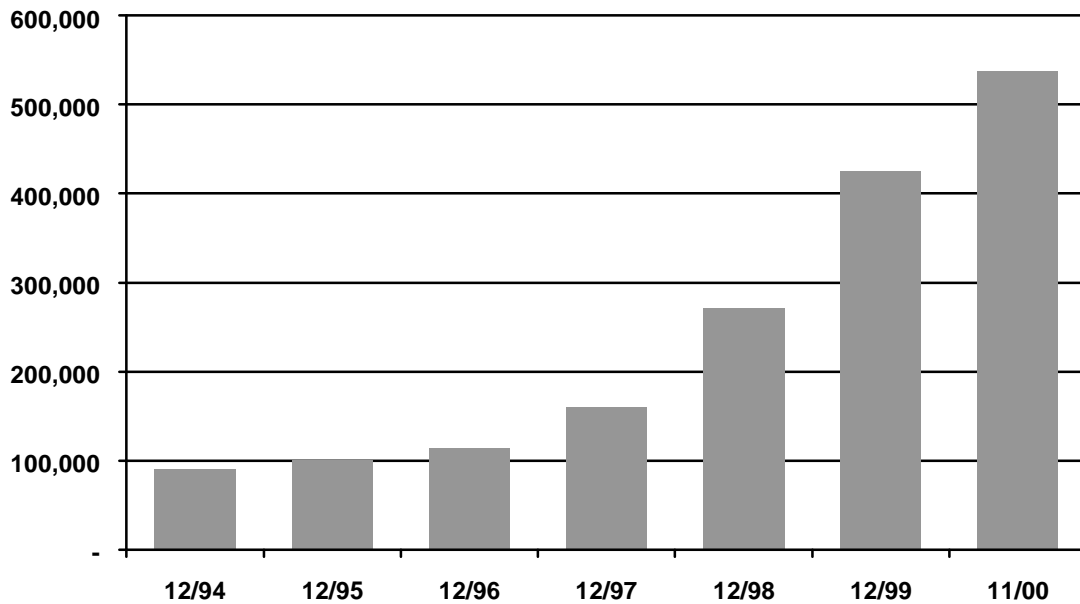
The federal Balanced Budget Act of 1997 included a new block grant program for states to provide expanded health insurance coverage for children. New York receives approximately \$256 million annually in federal funds. This funding, combined with existing State funding enabled the State, after some debate, to dramatically expand and improve the current program.¹⁷ Legislation passed in 1998 expanded the number of children eligible for the program, expanded the covered services to include vision, dental and certain mental health visits, and reduced the premium payments made by families.

These expansions are set to expire on March 31, 2001. The Executive proposes a straight extension of these provisions until June 30, 2003. The State should move toward the goal of insuring more New Yorkers through a seamless system by simplifying and streamlining the enrollment and renewal process, using the same insurers for all programs when feasible and creating a uniform eligibility standard for children. More than 3 million New Yorkers lack health insurance. Approximately 1 million are eligible for existing programs but not enrolled. The reauthorization of the CHIP legislation is a good opportunity to address these issues.

¹⁷ Initially, the Executive proposed only a modest reduction in the required family CHIP premium contribution and an expansion in the services covered by CHIP (vision, dental and mental health). However, according to a report by the Office of the State Comptroller entitled *Child Health Insurance: Current Issues and Policy Options* (June 3, 1998) the Executive's plan left an estimated \$650 million in available federal funding unspent over the next six years.

CHIP enrollment has increased dramatically – from 153,000 in November 1997 to 537,000 in November 2000. The 2001-02 Executive Budget estimates total enrollment of approximately 500,000 children at year-end. This is after the transition of a projected 105,000 children from CHIP to Medicaid.¹⁸

CHIP Enrollment



The Executive recommends total CHIP funding of \$736 million. New York has spent more than the State’s annual federal allocation due to the availability of prior year federal funding. This funding (rollover funds) has been attributable to the delay in obtaining State plan approval and the smaller size of the program several years ago.

In addition, Congress required that federal funds not spent after three years be pooled and redistributed to all states that had spent all of their first year (FY1998) money. An estimated \$2 billion in federal 1998 SCHIP funding was unspent and set to be reallocated in October. Last April, Comptroller McCall joined with then Senator-candidate Hillary Rodham Clinton to provide the first warning of a potential loss of federal funding for the Child Health Plus program. At that point there were efforts underway to amend the law and allow states that had not fully expended their funds two more years to spend the 1998 federal allocation. This would have meant the loss of more

¹⁸ A recent audit found an estimated 41 percent of CHIP enrollees appeared eligible for Medicaid. *Department of Health – Management of Child Health Plus Program*, Office of the State Comptroller, Report 97-S-10, April 1998.

than \$400 million in federal funding for New York this year. Congress recently approved legislation, supported by Comptroller McCall, which retains much of the federal funding that was at risk. A total of \$735 million in additional federal funds is anticipated over the next two years.

The State portion of CHIP funding through June 30, 2003 comes from the Health Care Initiatives Pool contained in Health Care Reform Act of 2000 (HCRA 2000). The Executive Budget proposes that \$69 million in excess funds under the expired HCRA be allocated to CHIP and any amounts above \$69 million be dedicated to HCRA programs that are not guaranteed funding.

Child Health Insurance Program Summary
(Millions)

Program	Estimated 2000-01	Proposed 2001-02	Difference	Growth
Federal Funds	\$449	\$478	\$29	6.5%
State Funds	\$269	\$258	-\$11	-4.1%
Total Spending	\$718	\$736	\$18	2.5%

Prescription Drugs

Drug costs have been rising rapidly in recent years. The growth in spending on prescription drugs has far outpaced general health care inflation. Over the past three years, drug costs have experienced double-digit growth of approximately 16 percent annually. The dramatic increases in drug costs have been commonly cited as one of the primary factors contributing to increased costs of Medicaid and private sector health insurance costs.

Drug costs have been a particular problem for the elderly since Medicare, a primary source of health insurance coverage for those over age 65, does not generally cover prescriptions that are administered outside of a hospital setting. According to a recent AARP study, seniors represent 12 percent of the population but pay approximately one-third of total drug costs. For the elderly, prescription drugs have contributed to unacceptably high out-of-pocket expenses for their medical care.

The State created the Elderly Pharmaceutical Insurance Coverage (EPIC) program in 1986 to provide assistance to non-Medicaid eligible seniors for prescription coverage. Enrollees must pay a portion of the costs of the program. Given the difficulties many seniors have had in purchasing needed prescriptions, the Legislature expanded the program in last year's enacted budget. These changes included:

- An increase in the income eligibility limit from \$18,500 to \$35,000 for single individuals.

- An increase in the income eligibility limit from \$24,400 to \$50,000 for married couples.
- A reduction in annual fees and co-payments by approximately 20 percent.

The expanded program became effective on January 1, 2001 and applications were available on October 1, 2000. The fully implemented cost of expansion is estimated at \$180 million in 2002-03. Program enrollment has increased significantly from approximately 114,000 in January 2000 to 161,000 in January 2001. When the expansion is fully implemented in 2002-03, enrollment is projected to jump to 215,600.

Total funding for EPIC is projected to increase to \$360 million in 2000-01. The significant increase in projected spending is primarily attributable to the program expansion, increased enrollment, and increasing drug costs and utilization.

Elderly Pharmaceutical Insurance Coverage (EPIC)
(Millions)

Program	Estimated 2000-01	Proposed 2001-02	Change	Growth
General Fund Support	\$49.9	\$95.4	\$45.5	91.2%
State Funds Support	\$54.4	\$95.0	\$40.6	74.6%
HCRA State Funds	\$148.0	\$170.0	\$22.0	14.9%
Total Spending	\$252.2	\$360.4	\$108.2	42.9%

The Executive proposes a series of changes to the EPIC program that are estimated to reduce the cost of the program by \$36 million in 2001-02. The Executive Budget includes provisions that would bring the pharmacy-reimbursement methodology and manufacturer’s rebates in line with the other DOH drug dispensing programs, such as Medicaid. Private insurers that cover EPIC enrollees will be required to match enrollee files to ensure that EPIC is the payor of last resort.

Lastly, the Executive proposes creating an independent Pharmacy and Therapeutics Committee to consider measures to promote the appropriate and cost-effective provision of pharmaceuticals. This Committee is charged with making recommendations to the Commissioner of Health regarding drug formulary and utilization policies and on options to achieve price discounts on drugs.

Many states have been much more aggressive at finding ways, such as using their purchasing clout, to reduce prices. New York is behind the curve and it is unfortunate that the issue is only now receiving attention by the Executive. However, since some of the newer more expensive drugs reduce costs in other areas of health care, costs should not be examined in a vacuum. If formulary changes are considered they should incorporate the positive benefits that certain drugs might yield – such as reduced emergency room visits or the prevention of second heart attacks. The focus of an

effective policy should be to reduce the cost of drugs without jeopardizing the quality of care. In addition, it appears the Executive's committee will focus on containing costs in the Medicaid program. However, there are millions of uninsured and underinsured residents that could benefit from a comprehensive statewide effort to reduce drug costs generally.

Public Assistance

In 1997, New York made major programmatic and financial changes to its public assistance program in response to the federal Personal Responsibility and Work Opportunity Reconciliation Act. Family Assistance, which consists of time-limited cash assistance, replaced Aid to Families with Dependent Children. A new safety net program for adults that, in many instances, provides non-cash benefits replaced Home Relief. Both programs have a number of federal and State-imposed work requirements. If the federal work requirements, which gradually increase, are not met, the State could face substantial fiscal penalties.

Federal funding is provided to New York through an annual block grant of \$2.4 billion. The amount of this grant is based on 1995 public assistance caseloads. Since that time, caseloads have declined significantly and New York now receives a greater share of total program costs from the federal government. The additional amount of federal funding compared to the old program is often called the "TANF surplus." These monies are spent on many support services (such as child care, job training, and transportation) designed to assist families in attaining self-sufficiency. In 1997-98, the first year the State TANF was in place, the base surplus level associated with that fiscal year was \$624 million. In 2001-02, the Executive estimates that it will be \$1.5 billion.

In order for the State to draw down the full amount of the federal block grant, spending must adhere to the required maintenance of effort (MOE) level of \$1.7 billion. The MOE is split equally between the State and local governments. Both the State and local governments are not expected to reach the required MOE in 2000-01 and must therefore increase State and local spending to comply with the federal requirement.

TANF Surplus

The 2000-01 Executive Budget calls for using \$876 million of the TANF surplus to fund support programs that might have otherwise been paid for by the general funds of the State and local governments. This represents an increase of \$173 million from the prior year. The largest components include a Social Services Block Grant (Title XX) transfer and the Earned Income Tax Credit (EITC). Title XX is a block grant that New York can use to fund various social services programs, including adoption, day care, housing, and transportation. The benefit of the Title XX transfer is shared equally between the State and local governments.

The EITC provides a personal income tax credit for income-eligible families. In 1999-00, the State began to claim a portion of the Earned Income Tax Credit against the MOE. Spending for this credit totaled \$168 million in 2000-01 and will grow to an estimated \$323 million in 2001-02. In 2000, the EITC was increased from 20 percent of

the federal credit to 22.5 percent. In 2001, it will be further increased to 25 percent of the federal credit. By the time the expansion of the EITC is fully implemented, it should be fully funded with resources made available from federal funding.

**Proposed Allocation of Available
Federal TANF Surplus Monies**
(Millions)

Program	2001-02
Child Welfare (Title XX, local JD/PINS, NYC foster care tuition)	\$462
Tax Credit for Low-Income Working Families	\$384
EITC	\$323
Child and dependent care credit	\$61
Child Care	\$304
Reserves	\$152
Employment/Transitional Initiatives	\$100
Services/Education/Health	\$73
Systems	\$20
Child Support Disregard	\$8
Total	\$1,503

Source: Division of Budget

The Executive Budget sets aside \$152 million for future public assistance needs. Combined with \$20 million for systems, the total set-aside increases to \$834.6 million. In addition, a \$200 million reserve was created in the 1999-00 budget to fund child care needs. In 2000-01, \$51 million was drawn from the fund. The Executive Budget proposes using \$71 million from the reserve. It is expected that the remaining \$78 million will be used in 2002-03. Other uses of the TANF surplus include:

\$304 million to the child care block grant, the same level as the current fiscal year;

\$100 million to fund employment and transitional-related programs and services (e.g., NY Works block grant, transportation, drug screening and treatment services, job-specific training and a transitional block grant). The amount allocated for these purposes declines significantly when compared to last fiscal year; however, according to the Executive there is approximately \$800 million currently obligated for these purposes from prior years but not yet spent;

\$73 million to fund various educational and health-related services (e.g., food pantries, pregnancy prevention, and a local social services district welfare reform implementation block grant); and

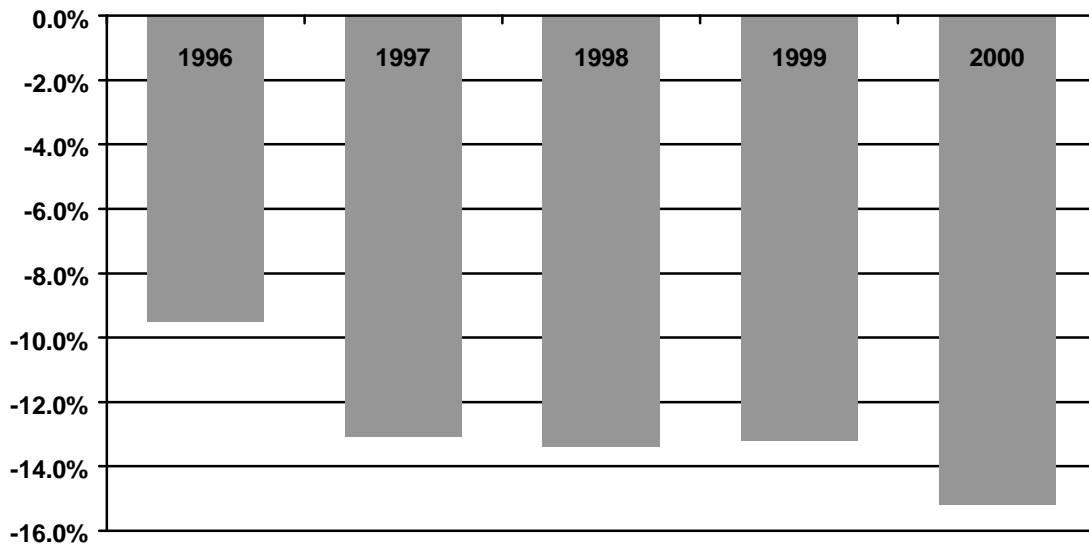
As mentioned earlier, federal funding is provided to New York through an annual block grant. This is up for renewal next year. The restrictions and the amount of the block grant expire on September 30, 2002.

Caseloads

For the first eleven months of 2000, the monthly average number of public assistance recipients declined 14.5 percent following declines of 13.4 percent and 13.2 percent respectively for 1998 and 1999. For the first eleven months of 2000, the number of family assistance recipients declined 14.6 percent and safety net recipients declined 13.6 percent.

Beginning in 1997, the federal government began imposing a 60-month (or five-year) lifetime limit on benefits for public assistance recipients. Once the limit is reached, family assistance benefits cease. Benefits provided after that point must come from State and local resources (i.e., federal funds cannot be used to pay for benefits). The Executive estimates that approximately 45,000 recipients, who have met the 60-month limit, will transition from family assistance to safety net programs.¹⁹ Overall, the Executive projects the number of family assistance recipients will decline 4.8 percent and the number of safety net recipients will decline 3.8 percent in 2001-02.

Public Assistance Recipients
Year-Over-Year Percentage Change*



* Calculated using monthly averages for the year

¹⁹ In the short-term, the additional State and local expenditures would be effectively offset by a reduction in State and local funding for TANF using the available surplus funds, as long as they maintain a level of spending on social services programs set by the State.

Due to the projected decline in caseloads, General Fund spending for safety net programs is expected to decrease 0.8 percent to \$258 million. Although family assistance caseloads continue to decline, the State must meet the required MOE and therefore the reduction in spending is not proportional to the projected decline in recipients. The State share of Supplemental Security Income (SSI) is estimated to remain the same.

Assistance Programs: General Fund
(Millions)

Program	2001-02	2000-01	Change	Growth
Family Assistance	\$357	\$352	(\$5)	(1.4%)
Safety Net	\$258	\$260	\$2	0.8%
State Share of SSI	\$627	\$627	0	0.0%
Total	\$1,242	\$1,239	(\$3)	-0.2%

Source: Division of Budget

Child Care

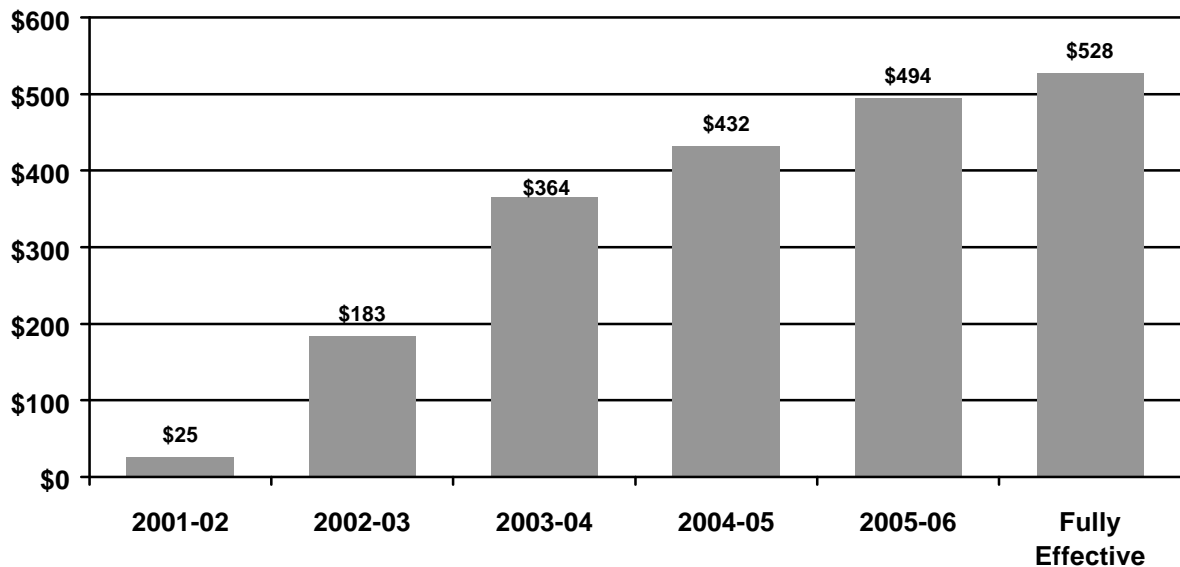
The proposed 2001-02 budget increases total funding for the Child Care Block Grant by \$36 million to \$840 million. The block grant was created in 1997-98 and combines the public assistance, transitional, at-risk, and State low-income day care into one seamless funding system. The funding breaks down as follows: \$301 million from federal funds, \$96 million from State funds, \$68 million from local funds, and \$375 million from federal TANF surplus monies. The year-to-year increase in the block grant is due in part to the use of federal TANF surplus funds, including the use of \$71 million from the TANF child care reserve.

REVENUE ACTIONS

Tax Cuts

The Executive Budget proposes a package of tax reductions that costs \$25 million in the first year and \$528 million when fully implemented. Expansion of certain Empire Zones and creation of Co-STAR, which reduces county property taxes for seniors and farmers, account for over half the tax cuts. The package also includes several proposals specifically geared toward farmers.

**Incremental Cost of Tax Cuts
Proposed in 2001-02 Budget
(Millions)**



The cost of the Executive's tax package is fairly minimal in its first year, 2001-02, and grows substantially when fully implemented. During the next few fiscal years, the cost of the proposed cuts – when combined with prior year tax cuts – increases significantly.

Tax Reductions Included in the 2001-02 Proposed Budget
(Millions)

Description	01-02	02-03	03-04	04-05	05-06	Fully Effective
Co-STAR	\$0.0	\$50.0	\$101.0	\$146.0	\$190.0	\$230.0
Expansion of Empire Zones	\$0.0	\$82.5	\$93.7	\$100.3	\$107.7	\$116.0
Elimination of AMT/Single Sales Factor Computation	\$23.3	\$23.3	\$60.8	\$74.2	\$83.8	\$83.8
Brownfields Package	\$0.0	\$12.0	\$67.7	\$70.6	\$71.5	\$58.7
Property Donor Credit	\$0.0	\$3.0	\$12.0	\$12.0	\$12.0	\$12.0
Historic Homes Credit	\$0.0	\$3.0	\$10.0	\$10.0	\$10.0	\$10.0
Farmland Restoration Credit	\$0.0	\$2.0	\$8.0	\$8.0	\$8.0	\$8.0
Rented Farmland – School Tax Credit	\$0.0	\$1.0	\$5.0	\$5.0	\$5.0	\$5.0
Corporate Farms – STAR	\$0.0	\$3.0	\$3.0	\$3.0	\$3.0	\$3.0
Biotechnology Refundable Credit	\$0.0	\$1.0	\$1.0	\$1.0	\$1.0	\$1.0
Low- and Moderate-Income Housing Credit	\$2.0	\$2.0	\$2.0	\$2.0	\$2.0	\$0.0
TOTAL	\$25.3	\$182.8	\$364.2	\$432.1	\$494.0	\$527.5

Description of the Executive's 2001-02 Proposed Tax Cut Package

- **Co-STAR.** Modeled after the STAR program, Co-STAR reduces county property taxes for approximately 700,000 seniors and farmers across the State. New York City residents, who are disproportionately renters, get a reduction in their personal income taxes. Income-eligible seniors and farmers would be able to exempt part of the taxable value of their homes for purposes of calculating their county property taxes. This program reduces taxes next year by an estimated \$50 million and \$230 million when fully effective.
- **Expansion of Empire Zones.** Increases the size of 22 upstate Empire Zones, which are virtually tax-free for businesses that operate within the zone, from two to four square miles. Businesses that locate in these zones are eligible for real property tax and tax reduction credits, as well as sales and use tax exemptions. The credits take effect January 1, 2001 and the exemptions March 1, 2001. When fully implemented, this reduces taxes by an estimated \$116 million annually.
- **Elimination of AMT/Single Sales Factor Computation.** Phases out over five years the alternative minimum tax (AMT) on businesses. Because of the AMT, businesses that would otherwise be able to reduce their tax liability to zero through the use of tax credits and tax shelters, pay tax of 2.5 percent of their entire net income. As the AMT is eliminated, corporations could potentially see their tax

liability reduced – through greater use of tax credits and tax shelters – to a fixed dollar minimum based on their gross payroll amount.²⁰

The Single Sales Factor changes the method for computing corporate income for firms with a multi-state presence. Currently, corporate income is apportioned based on the New York average share of worldwide sales, property, and payroll with sales double-weighted.²¹ Under this proposal, corporations would transition to a formula based only on the New York sales factor. The proposal will likely result in some corporations paying lower taxes due to a lower allocation percentage (winners) and other corporations paying higher taxes because the allocation percentage increases (losers). As the table below demonstrates Company D would pay higher taxes than under the proposed change. Company D is distinguished from the other companies in that New York accounts for a relative high share of its sales relative to its share of property and payroll. The elimination of AMT and single sales factor computation together cost an estimated \$84 million when fully effective.

Allocation Percentages Under the Current and Proposed System

Description	Co. B	Co. C	Co. D
NY/Worldwide Sales	50%	40%	50%
NY/Worldwide Sales (double-weighted)	100%	80%	100%
NY/Worldwide Property (single-weighted)	60%	40%	30%
NY/Worldwide Payroll (single-weighted)	60%	40%	30%
Current – based on average of property, payroll and double weighted sales	55%	40%	40%
Proposed – based only on sales	50%	40%	50%
Winner/Loser	Winner	N/A	Loser

- Brownfields Package.** Provides property tax credits for brownfields, which are industrial or commercial facilities with possible environmental contamination. Brownfields that are located upstate and larger than 10 acres are eligible. Additional benefits are included for brownfields that are more than 100 acres. This package provides tax incentives for the cleanup of brownfields to promote redevelopment and beneficial use. This includes tax credits for the cost of both site preparation and buildings. This package reduces taxes by an estimated \$59 million when fully effective.

²⁰ \$100 for firms with gross payroll of \$250,000 or less, \$225 for firms with gross payroll between \$250,001 and \$500,000, \$325 for firms with gross payroll between \$500,001 and \$1 million, and \$425 for firms more than \$1 million and less than \$6.25 million, and \$1,500 for firms with over \$6.25 million in payroll.

²¹ To calculate the average under the current system: $[\text{double-weighted sales} + \text{property} + \text{payroll}]/4$.

- **Property Donor Credit.** Provides a personal income tax credit to taxpayers who donate property and conservation easements to a qualified nonprofit land trust, State or local government, or federal agency. This credit takes effect beginning in the 2002 tax year. When fully implemented, it reduces taxes by an estimated \$12 million annually.
- **Historic Homes Credit.** Provides a personal income tax credit for a portion of qualified rehabilitation expenditures made by a taxpayer for the rehabilitation or purchase of an historic home. This credit takes effect beginning in the 2002 tax year and reduces taxes by an estimated \$10 million when fully effective.
- **Farmland Restoration Credit.** Provides a one-time State personal income tax credit, up to \$10,000, for 25 percent of the capital costs for specified land improvements designed to restore farmland, build fences, and repair silos. This credit takes effect beginning in the 2002 tax year and reduces taxes by an estimated \$8 million when fully effective.
- **Rented Farmland – School Tax Credit.** Expands the school property tax credit under the personal income tax to cover land rented for farming. This credit takes effect beginning in the 2002 tax year. When fully implemented, it reduces taxes by an estimated \$5 million.
- **Corporate Farms – STAR.** Expands STAR eligibility to farmers who own their farms as a corporation or partnership. It takes effect beginning in the 2002-03 school year and reduces property taxes by an estimated \$3 million annually.
- **Biotechnology Refundable Credit.** Allows biotechnology companies that do not qualify as “new businesses” to claim a refund of their investment and tax credit. It is limited to companies with fewer than 100 employees in New York State. This credit takes effect January 1, 2002 and reduces taxes by an estimated \$1 million annually.
- **Low- and Moderate-Income Housing Credit.** Enhances the already established State tax credit for the construction of low- and moderate-income housing modeled after the Federal Low-Income Housing Tax Credit. This credit reduces taxes by an estimated \$2 million annually.

Total Value of Tax Cuts Enacted Since 1994-95
Proposed Law, All Funds
(Millions)

Description	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Personal Income Tax	\$5,390	\$5,746	\$6,184	\$6,768	\$7,331	\$7,531
User Taxes and Fees	\$1,120	\$1,255	\$1,358	\$1,461	\$1,546	\$1,608
Business Taxes	\$2,107	\$2,461	\$2,805	\$3,164	\$3,255	\$3,236
STAR & NYC PIT	\$1,877	\$2,571	\$2,769	\$2,938	\$2,993	\$3,047
Other Taxes	\$1,083	\$1,330	\$1,376	\$1,426	\$1,498	\$1,573
Total	\$11,577	\$13,363	\$14,492	\$15,757	\$16,623	\$16,995

Source: Division of the Budget

Incremental Value of Tax Cuts Enacted Since 1995-96
Proposed Law, All Funds
(Millions)

Description	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Personal Income Tax	\$160	\$356	\$438	\$584	\$562	\$201
User Taxes and Fees	\$553	\$135	\$103	\$103	\$85	\$62
Business Taxes	\$505	\$354	\$344	\$359	\$92	(\$20)
STAR & NYC PIT	\$682	\$694	\$198	\$169	\$55	\$54
Other Taxes	\$393	\$247	\$46	\$50	\$72	\$75
Total	\$2,293	\$1,786	\$1,129	\$1,265	\$866	\$372

Source: Division of the Budget

Summary of Revenue Actions
(Millions)

Description	2001-02
Revenue Increases	\$158.9
Authorize multi-state lottery (Powerball)	\$125.0
Surcharge on Hazardous waste generators	\$18.1
Eight-year commercial license renewals*	\$9.6
Gas leasing fees	\$5.3
New regional license plates	\$0.5
Videoconferencing equipment lease*	\$0.2
Change tax on moist snuff tobacco from price to weight-based	\$0.2
Revenue Preservation	\$25.0
Mandatory surcharges on vehicle and traffic violations	\$25.0
Fee Increases	\$18.5
Hunting and fishing licenses	\$5.3
Uniform Commercial Code fee changes	\$3.1
Licensing fees for certain occupations regulated by the Department of State	\$2.6
Pesticide fees	\$2.4
Bulk petroleum storage fees	\$1.3
Snowmobile registration fees	\$1.0
Fees for camping and off-season vehicle use*	\$1.0
Camping fees*	\$0.8
Boat registration fees	\$0.7
Boat and docking fees on Lake George	\$0.3
Fee Reduction	
Professional licensing renewal fees regulated by the Department of Education	(\$5.0)
Total	\$197.4

* Denotes administratively imposed measures.

Source: Division of the Budget

The Executive recommends a number of actions that increase, preserve, or reduce both general and special revenue funds. For 2001-02, actions that increase revenues total \$159 million, provisions that preserve revenues total \$25 million, and changes to fees that raise revenues total \$19 million. The Executive also proposes reducing the professional licensing renewal fee, which reduces revenues by \$5 million. The major revenue enhancement includes authorization for a multi-state lottery game, a surcharge on hazardous waste generators, and a change in commercial license renewals from four years to eight years. In the area of revenue preservation, a surcharge on vehicle traffic infractions and certain traffic violations in cities with over 100,000 people is made

permanent. Fee increases are imposed on a number of existing licensing fees, including: hunting and fishing licenses and certain occupational licenses.

Non-Recurring Actions (One-Shots)

The Executive Budget includes \$146 million in one-time actions, consisting of three pieces. Approximately \$97 million is attributable to retroactive federal fund claims for child welfare (\$57 million), special education (\$25 million), and prison health costs (\$15 million). Additional funds are generated from the Dormitory Authority of the State of New York (\$28 million). Remaining actions in the amount of \$21 million are largely comprised of fund sweeps and transfers to the General Fund, including \$19 million in nursing home assessments.

Once again, the Executive proposes a multi-state lottery rejected by the Legislature last year. The measure is promoted as a means of raising funds for education. This proposal does not, in reality, contribute additional funding for education since the lottery is simply part of the pool of resources that is divided among various competing needs in the State budget process. Even though the revenue estimates of \$125 million in 2001-02 have been adjusted for losses that occur when new games draw revenues from existing ones, it is unclear to what extent projected revenues would materialize.

Local Governments

This section of the report discusses municipal and county governments; school districts are covered in the education section. This year's Executive Budget estimates that its actions will save local governments \$443 million, but a closer examination of the figures shows very little positive impact on local governments: only an additional \$1 million total for counties, cities, towns, and villages.

Revenue sharing is virtually unchanged, but certain miscellaneous aids are cut. New York City is particularly disadvantaged, losing \$114 million this year and thereafter with the proposed elimination of the Stock Transfer Incentive Fund. The new unrestricted aid program for counties that was enacted last year to offset increased costs under HCRA is continued. However, while the HCRA costs more than double this year, no increase is provided. This year the Executive is again calling for reform of the Wicks law and an increase in the E-911 surcharge.

Unrestricted Aids

General Purpose Local Government Assistance, also referred to as revenue sharing, remains virtually unchanged at \$562 million. The Executive again proposes to amend the State Finance Law to permanently end the original revenue sharing formula. The formula, were it allowed to operate, would generate approximately \$2 billion in State tax revenue sharing for local governments. The formula is annually overridden in budget legislation with aid amounts frozen or altered across-the-board. Revenue sharing amounts peaked in 1988-89 at \$1.02 billion before dropping to the current level.

The Stock Transfer Incentive Fund, which has provided New York City with \$114 million in unrestricted aid, is eliminated. The City had received this aid since 1977 to offset losses from the elimination of the Stock Transfer Tax, and it has become an integral part of the City's budget.

Other unrestricted aids, such as emergency and supplemental aids, remain at the same level as last year. Miscellaneous Financial Assistance, however, has been cut by \$5.6 million. Of that amount, \$4.5 million for parking garages in Troy and Schenectady is being reconsidered by the Executive and may be reinstated. The remaining \$1.1 million, which primarily impacts counties, has been eliminated.

State appropriations increase to \$17 million to continue funding the \$22 million aid program (county fiscal year basis) designed to offset the costs of last year's HCRA legislation (\$5 million was given towards those costs in SFY 2000-01). The Executive Budget does not provide an increase in this aid, although HCRA's cost to counties (for the new Family Health Plus Program) is now doubling, and tripling in 2003. The county share is estimated to be \$22.6 million in the 2001 calendar year, \$48.2 million in 2002, and \$68.2 million in 2003.

Co-STAR

The Executive proposes a new “Co-STAR” program, similar to the School Tax Relief (STAR) program. Eventually, the program would provide \$230 million in county property tax cuts over five years to income-eligible seniors and farmers, but the rebates do not begin until 2002-03, with the program’s initial \$50 million in that year’s State budget. Unlike STAR, taxpayers will receive a rebate check from the State after county taxes are paid. This method will not lower property taxes up front, as STAR does, and taxpayers will have to wait for rebates.

Although it is positive to address county property taxes, an exemption program is only a partial solution, and it should be kept in mind that Co-STAR will not help businesses, renters, or other taxpayers who are ineligible for the proposed rebate. Unrestricted aid, such as revenue sharing, could help minimize property taxes and provide fiscal relief to county governments. A comprehensive approach to property taxes should address the many fiscal relationships between the State and county governments.

CHIPS Highway Funding

The Consolidated Highway Improvement Program (CHIPS) provides aid for highways and bridges distributed to counties, cities, towns, and villages based on a complex allocation formula including road miles, motor vehicle registrations, and population.

CHIPS aid provides approximately \$277 million annually and has two components: operations and maintenance funding, and capital aid (\$59 million and \$218 million respectively). The operations and maintenance funding is paid out of the State’s general fund revenues whereas the capital program is funded through bonds backed by dedicated highway fund revenues. As it did last year, the Executive Budget recommends a cut of \$34.9 million in CHIPS operations and maintenance funding, eliminating all of this aid to New York City and county governments statewide (although capital aid remains constant).

Estimating the Budget’s Impact

Each year the Executive Budget provides an overall estimate of the budget’s impact on local governments. These calculations, sometimes referred to as “puts and takes,” attempt to measure all of the budget’s impacts, including aid program changes, reimbursement changes, taxes, local mandates, and other requirements.

The impact of the State budget on localities goes far beyond the direct forms of aid, such as revenue sharing or the Consolidated Highway Improvement Program (CHIPS). Many other State programs and reimbursement practices affect local governments, either by increasing the amount they must spend or by decreasing State reimbursements for mandated programs. Additionally, many State statutes are altered in budget legislation that affect local tax collections and impose or revise mandates on local governments. Federal programs and other events also have an impact, as do State government actions relating to the administration of federal programs.

An accurate accounting of all the variables is difficult, especially as there are often different perceptions as to what constitutes an added cost or a source of fiscal relief. Also, the State's April through March fiscal year does not match the fiscal years used by local governments. As such, a comparison on a State fiscal year basis does not match the impact on local governments in their fiscal years.

This year's Executive Budget estimates that its actions will save local governments \$442.6 million in State fiscal year 2001-02, through cost reductions, aid increases, and mandate relief. Nearly 74 percent of this figure is based on increased funding for schools. The balance includes various increases and decreases in welfare, public protection, environment, taxes, health, and Medicaid as well as the Stock Transfer Incentive Fund cut. The table below presents this estimate, with adjustments to focus the impact specifically on local governments, to account for cuts not included by the Executive and to remove items inappropriately described as mandate relief:

Impact of the Executive Budget on Local Governments
(Millions)

	Counties	NYC	Others*	Total
Executive Budget's Estimated Impact	\$93.3	\$160.5	\$188.8	\$442.6
School Aid	-	(\$141.9)	(\$183.6)	(\$325.5)
CHIPS	(\$21.4)	(\$13.5)	-	(\$34.9)
FIT Chargeback	(\$6.2)	-	-	(\$6.2)
Emergency 911 Surcharge	(\$45.0)	(\$30.0)	-	(\$75.0)
Adjusted Impact	\$20.7	(\$24.9)	\$5.2	\$1.0

Source: NYS Division of the Budget estimates and backup tables.

* Includes cities outside of NYC, towns, villages and schools.

As shown, school aid is the greatest portion of the Executive Budget's estimated local government impact. Without including this aid (totaling \$326 million), the Executive's figure drops to \$117 million. The total is further reduced by the cut in CHIPS and the elimination of the FIT Chargeback,²² which the Executive Budget does not include in its estimate (instead classifying them as non-recurring legislative adds). The Executive does include, however, an increase in funds due to the proposed Emergency 911 surcharge. The surcharge is counted in the Executive Budget as a \$75 million benefit to local governments, and is described as mandate relief rather than a tax increase. This inappropriately inflates the impact because counties must spend any additional revenues raised for 911 services, and so will not receive any fiscal relief. Once it is removed from consideration, New York City is left with a cut of \$24.9 million, counties with only a \$20.7 million increase, and other cities, towns and villages with a \$5.2 million benefit.

²² The FIT Chargeback aids counties outside New York City for the local share charged to them for their students who attend Fashion Institute of Technology (FIT).

In summary, after appropriate adjustments, the Executive Budget's impact on local governments overall is only narrowly positive (+ \$1 million). The budget documents also claim that the previous six budgets have had a positive impact on local governments approaching \$6 billion. However, that figure is primarily composed of school aid increases and involves other problems discussed above. Additionally, it excludes or understates negative impacts that are not fully effective in the first year they are enacted.

DEBT AND CAPITAL

The capital plan submitted with the 2001-02 Executive Budget increases the amount of capital paid for in cash with State dollars compared to the prior capital plan. This is due in part to the use of \$250 million in Debt Reduction Reserve Fund (DRRF) resources to pay cash for transportation projects.

The new plan proposes to increase debt outstanding by \$2.5 billion over five years, from \$38.5 billion in 2001-02, to \$41.0 billion in 2005-06. Debt service will grow to \$4.5 billion by the end of the plan, an increase of approximately \$400 million from 2001-02.

While there have been several positive developments that contribute to this year's capital plan, including the use of DRRF resources to reduce outstanding debt and increase pay-as-you-go and the continued phase-in and new dedication of resources to the capital program, the Executive Budget has failed to fully address the impact of the Transportation Bond Act's defeat on the capital program. The Executive Budget patches together a plan to get through the next couple of years. Furthermore, much of this approach includes dubious strategies and leaves just as many questions unanswered. For example, higher State capital spending was achieved by cutting local programs, certain gaps in project funding were not addressed at all, and some plan assumptions do not appear to be based on tangible or sustainable funding commitments.

A substantial commitment to funding transportation infrastructure is integral to sustaining and developing our economy in New York State. A more comprehensive way to honor these commitments should be pursued.

Debt Outstanding and Debt Service

The five-year capital plan included in the Executive Budget projects an increase in the amount of State-supported debt outstanding. The new plan proposes to increase debt outstanding by \$2.5 billion over a five-year period, from \$38.5 billion in 2001-02 to \$41.0 billion in 2005-06. The capital plan released following enactment of the 2000-01 budget assumed greater growth in debt – an increase of \$5.0 billion from \$38.0 billion in 2000-01 to \$43.0 billion in 2004-05.

Projected State Supported Debt Outstanding
2001-02 Executive Budget Compared to August 2000 Capital Plan
 (Billions)

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
2001-02 Capital Plan	\$37.1	\$38.5	\$39.4	\$40.1	\$40.6	\$41.0
August 2000 Plan	\$38.0	\$39.4	\$40.7	\$42.0	43.0	NA

Projected growth in debt service declines slightly when compared to the prior capital plan. The new capital plan projects that debt service expenses will grow from \$4.1 billion in 2001-02 to \$4.5 billion by 2005-06. These projected debt service figures compare to the latest actual figure of \$3.7 billion for 1999-00, an increase of 22 percent over seven years.

Projected State Supported Debt Service
2000-01 Executive Budget Compared to August 2000 Capital Plan
 (Billions)

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
2001-02 Capital Plan	\$4.2	\$4.1	\$4.3	\$4.3	\$4.4	\$4.5
August 2000 Plan	\$4.0	\$4.2	\$4.4	\$4.3	\$4.5	NA

Capital Spending

Total capital spending over the life of the new capital plan declines by about \$724 million over the life of the prior plan. Year-to-year spending under the new plan increases by \$627 million in 2001-02, declines by \$152 million in 2003-04 and again increases by \$232 million in 2003-04, before declining in the last two years of the plan by \$335 million in 2004-05 and \$39 million in 2005-06.

Projected Capital Spending
2000-01 Executive Budget Compared to August 2000 Capital Plan
 (Millions)

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
2001-02 Capital Plan ²³	\$4,338	\$4,965	\$4,813	\$5,045	\$4,710	\$4,671
August 2000 Plan	\$4,542	\$5,048	\$5,167	\$5,157	\$5,014	NA

²³ The actual figure for 1999-00 is \$4,224 million.

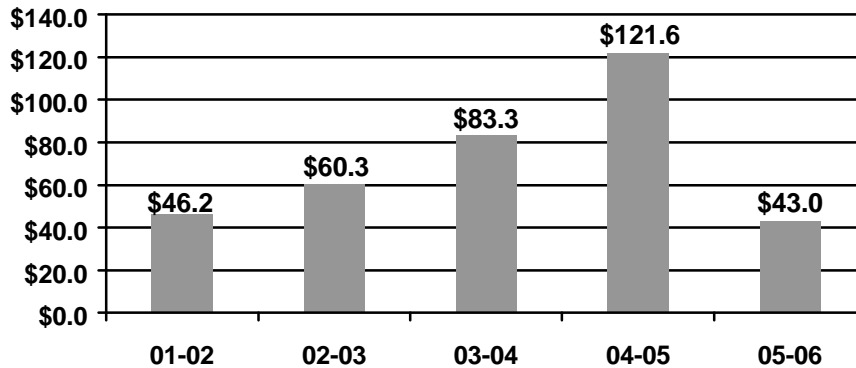
Financing Sources

State pay-as-you-go spending, that portion of the capital plan paid for in cash with State dollars, is funded at a new higher level. Under the new five-year plan, pay-as-you-go increases by \$1.2 billion as compared with the prior plan. This is a positive step toward paying for a greater portion of capital with current resources.

The largest year-over-year increase of \$514 million occurs in 2001-02. This is primarily due to the planned use of \$250 million in pay-as-you-go resources from the Debt Reduction Reserve Fund (DRRF) for transportation projects. The \$250 million will be used in 2001-02 to support a State highway and bridge construction letting level of \$1.75 billion. The infusion of DRRF resources is expected to reduce bonding in that year and free-up capacity in the dedicated highway and bridge trust fund to support the \$1.75 billion construction letting level in 2002-03.

Federal funds spending is also projected to grow under the new capital plan, with no apparent basis for that projection. Federal spending under the new plan would increase by a total of \$791 million, over the life of the prior plan. Over the first two years of the plan, the projected increase in federal funds totals approximately \$107 million. In 2003-04 and 2004-05, this projected increase virtually doubles to \$205 million.

**Capital Plan - Federal Funds
Dollar Change
(Millions)**



Part of the reason for this increase lies with underlying assumptions particularly with regard to federal transportation aid. The current authorizing statute called Transportation Equity Act for the 21st Century or TEA-21 expires in 2003. The new capital plan assumes an increased level of commitment under a future (yet to be determined) federal authorizing statute that would maintain construction letting levels of \$1.75 billion for the last two years of the Department of Transportation (DOT) Capital Plan (which covers the years 2001-01 through 2004-05).

While it would be a positive development if these increased federal funds for New York materialized, planning for capital financing purposes should be based upon credible assumptions such as currently authorized statutory funding levels or upon realistic historical growth. Without reasonable assumptions, the capital planning process loses its integrity. A gap in funding for projects should not be masked with a plug of federal aid.

The use of authority bonds increases over the life of the new plan, adding \$158 million more in borrowing over the life of the prior plan. Under the new plan, authority bonding increases by approximately \$67 million in 2001-02, \$41 million in 2002-03 and \$164 million in 2003-04 before declining by \$225 million in 2004-05.

General obligation bonds fall substantially over the life of the new plan, declining by approximately \$2.9 billion over the life of the prior plan. General obligation bonds totaled just under \$4.1 billion in the prior plan and fell to a level of \$1.2 billion under the new plan, a considerable reduction in the use of voter approved debt. This is primarily due to the defeat of the Transportation Infrastructure Bond Act in November 2000. The Bond Act was proposed to fund \$3.8 billion in transportation projects including \$1.8 billion for State highways and bridges, \$1.6 billion for the Metropolitan Transportation Authority (MTA) capital plan, and \$400 million for rail, aviation, non-MTA transit, canals and ports.

Rather than making a comprehensive effort to address the impact of the failure of the Bond Act on the Transportation Capital Plan, the Executive Budget has patched together a plan to get through the next couple of years. This approach incorporates some positive elements such as the dedication of \$250 million in Debt Reduction Reserve Fund (DRRF) proceeds to fund projects on a pay-as-you-go basis and the continued phase-in (enacted in 2000-01) of the increase in transportation-related taxes to the dedicated highway and mass transit trust funds.

However, much of the approach includes questionable strategies and leaves just as many questions unanswered. For example, the higher proposed State construction letting level was augmented with \$200 million of funds cut from the Multi-modal program, which funds local transportation projects, primarily roads. Some gaps in project funding were not addressed at all, such as the MTA Capital Program and enhanced rail and aviation program levels under the Bond Act. In addition, certain plan assumptions do not appear to be based on tangible or sustainable funding commitments such as projections for federal aid (see above), a stated commitment by the Commissioner of DOT to essentially stretch-out the DOT program until all projects were funded, without regard to sources of funding beyond the five years of the program, and no revised project list. Funding for canals is planned to be reduced to \$50 million and to be funded half by federal funds and half by the Thruway Canal Corporation, who requested a toll increase just last year.

A substantial commitment to funding transportation infrastructure is integral to sustaining and developing our economy in the State. New York ranks 24th in state and

local spending for highways.²⁴ If the projects put forward, not only as part of the \$3.8 billion Bond Act, but as part of the overall transportation capital program, were as essential as voters were led to believe, a more comprehensive way to honor these commitments should be pursued.

Capital Program

Specific areas of capital program spending are highlighted below. Transportation as always is the largest area of capital spending, accounting for approximately 60 percent of total spending, while environment, education and public protection also have significant capital programs.

- Use of \$250 million from the Debt Reduction Reserve Fund (DRRF) fund to support the Department of Transportation capital plan and \$1.75 billion construction letting level.
- New appropriations of \$150 million for environmental projects under the Environmental Protection Fund (EPF), funded through dedicated revenues; new appropriations of \$170 million from the Clean Water/Clean Air Bond Act; and \$105 million in disbursements from the new Remedial Program Transfer Fund to finance the cleanup of hazardous sites.
- Capital appropriations and reappropriations of \$1.8 billion for the Department of Corrections to include the completion of the new maximum-security prison in Seneca County.
- New appropriations and reappropriations of \$4.9 billion for the Capital Investment Plan for the State and City Universities of New York.
- New appropriations and reappropriations of \$1 billion for construction and preservation of the State's low- and moderate-income housing stock.
- New appropriations and reappropriations of \$2 billion for mental hygiene capital projects.
- Continued support for renovation of the Alfred E. Smith State Office Building including a new appropriation of \$21 million for construction of parking.
- Redirection of \$60 million in Community Enhancement Facilities Assistance Program (CEFAP) bonding and \$40 million in cash resources to fund Centers for Excellence as well as research facilities, business incubators, and other high tech initiatives.
- Continued funding to expand capacity and replace the Harlem Valley Youth Facility.

²⁴ *State Fact Finder 2000*, Congressional Quarterly.

Capital Spending by Function: 2001-02 Capital Plan
(Millions)

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Transportation	\$2,608.4	\$2,917.4	\$2,917.3	\$2,995.4	\$2,901.9	\$2,880.7
Environment						
Clean Water/Clean Air, EPF, Remedial Transfer Program	\$290.9	\$393.2	\$394.2	\$399.2	\$369.2	\$369.2
Federal/Other	\$408.4	429.0	413.3	362.6	342.5	341.2
Education	\$352.2	426.0	327.4	446.5	447.4	487.2
Public Protection	\$259.7	203.5	194.1	201.2	201.2	201.2
Mental Hygiene	\$149.4	184.0	201.7	205.7	182.4	173.0
Housing/Eco. Dev.	\$188.8	284.3	196.1	249.5	114.2	99.2
Other	\$80.6	127.7	169.3	184.5	151.4	119.0
Total	\$4,338.4	4,965.1	4,813.4	5,044.6	4,710.2	4,670.7

Other Proposals

The Debt Reduction Reserve Fund (DRRF) was created as part of the 1998-99 budget with a \$50 million deposit (used in 1999-00), and received additional deposits of \$250 million in 1999-00 and \$500 million in 2000-01. The Executive Budget makes no new deposit into the fund for 2001-02. The proposed capital plan assumes use of \$500 million in DRRF resources to defease high-cost State debt (\$421 million) and increase pay-as-you-go (\$79 million). The \$79 million used to pay cash for bond-financed capital projects includes \$50 million for the Buffalo Inner Harbor project and \$22 million for Community Enhancement Facilities Assistance Projects (CEFAP). The balance of \$250 million in DRRF will be used to pay cash for transportation projects in 2001-02. The Executive estimates interest cost savings at \$450 million.

The Executive Budget proposes a new revenue-bond financing program. Under the proposal, 25 percent of revenues from the personal income tax would be pledged to support debt service on the new State-supported bonds, subject to an appropriation. The proposal is intended to improve the creditworthiness of State-supported debt and lower interest costs. The Executive estimates savings at \$20 million in 2001-02. The new revenue bonds would be issued instead of State-supported appropriation-backed bonds, for State purposes, by certain currently authorized public authorities and public benefit corporations.

The structure of the proposal raises questions as to whether it will achieve the stated goals of improving creditworthiness and producing \$20 million in financial plan savings for 2001-02. Results will depend largely on the reaction of the bond market and rating agencies to the new structure. There is the question of whether these bonds will be

regarded like other appropriation-backed credits since an appropriation is required, or like revenue bonds since there is a dedicated revenue source. There may be no increased credit rating at all since some rating agencies such as Standard and Poor's, for example, currently rate straight appropriation credits the same as those with a dedicated source like Local Government Assistance Corporation (LGAC) bonds, upon which the new revenue-bond structure is modeled. The more relevant factor may be how the bonds trade in the market, as investors will distinguish between similarly rated bonds based on demand for diversity in debt portfolios and other factors. An additional factor may be the decision to keep the dedicated revenues within the General Fund, for accounting purposes, unlike LGAC, and how the market will treat this feature.

The Executive is expected to submit a constitutional debt reform bill that would place the statutory Debt Reform Act of 2000 in the State Constitution. The legislation would make permanent: the cap on new debt issued and outstanding at 4 percent of personal income; the cap on debt service for new debt issued at 5 percent of all funds receipts; and provisions that debt only be used for capital purposes and that State-supported debt not have a maturity longer than 30 years. In addition, the Executive's constitutional debt reform amendment would ban back-door borrowing, authorize a limited amount of revenue-debt, ensure that one-half of all new debt is approved by the voters, and authorize multiple general obligation bond act proposals.

Comptroller Debt Reform Proposal

The Comptroller will again introduce legislation this year for a constitutional debt reform bill. The proposal would address the deficiencies of the debt reform statute enacted in 2000 with a permanent solution that would provide meaningful reform and ensure that future debt is affordable.²⁵ The Comptroller's bill would provide for the following:

- Ban back-door borrowing. The State would be prohibited from using backdoor borrowing through public authorities to finance State projects.
- Create a new form of revenue debt to replace back-door borrowing. The new revenue debt would be backed by a dedicated revenue source. This debt would be paid whether or not there is an appropriation, and would therefore result in lower interest rates and reduced borrowing costs.
- Impose stricter caps to limit debt than are currently in statute.
- Cap debt. All future general obligation bonds and the new revenue debt would be capped at 3.5 percent of State personal income. The cap is cumulative and applies to all debt issued and outstanding after the legislation is enacted. The current statutory cap is 4.0 percent of State personal income and is phased-in over a 10-year period.

²⁵ For more detail, please see: *2000-01 Budget Analysis Review of the Enacted Budget*, Office of the State Comptroller, pp. 55-59.

- Cap debt service. No new debt could be issued if the State's *total* debt service exceeded 5.0 percent of governmental funds receipts. The current statutory cap is on *new* debt service only and phases up to 5.0 percent of all funds receipts over 13 years.
- Limit debt to capital projects. Debt could not be issued to finance operating expenses.
- Create a Debt Management Board. This Board would set policy related to debt management issues (such as refundings, debt structure, and credit enhancement) and set policy guidelines on the use of debt for the capital budget. It would include the Governor, Comptroller, Budget Director, Assembly Speaker and Temporary President of the Senate.
- Require public hearings. The Governor would be required to hold public hearings on the capital plan.
- Allow multiple bond acts. Eliminate the existing prohibition against multiple bond resolutions being placed on the ballot in a single year to encourage more frequent use of general obligation debt and enhance public participation.

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