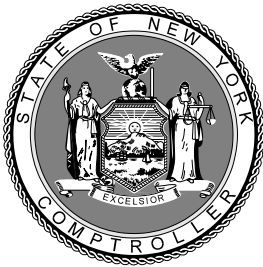

2002-03 Budget Analysis

Review of the Executive Budget

H. Carl McCall
State Comptroller



February 2002

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

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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

February 18, 2002

To the People of the State of New York:

In the wake of the horrific attacks on September 11th, New York is confronting issues and challenges that were unimaginable even one short year ago. As we seek to heal from the tragedy, we must also work to repair the terrible damage to lower Manhattan, and, indeed, the entire State's economy, which had already slipped into recession months prior to the attack.

Confronting these challenges demands more than ever that we prioritize and evaluate our spending and invest in programs that will strengthen our State for the long term. Unfortunately, the Governor's proposed Executive Budget for 2002-03 relies on more than \$2 billion in reserves and \$500 million in one-shots and fund raids. Over-reliance on fiscal gimmicks left New York lagging during the longest period of growth in our nation's history. New York needs to spend more wisely and efficiently with an eye toward the State's future.

This budget shortchanges education, a fundamental investment for New York's future. While the Governor's proposal offers no increase in education funding, school districts' costs will continue to rise, and students' will still need to learn. The budget also lacks any meaningful provision to reform the school aid formula that leaves too many children without an adequate educational opportunity. Instead of providing reform, the Governor continues to fight a State Supreme Court decision mandating an overhaul of the school aid formula.

Higher education fares no better. Over the past ten years, only three states have increased funding to their public universities and community colleges less than New York, and his proposal for withholding TAP funding until after graduation will limit access to higher education as it forces struggling students further into debt.

In addition, the State continues to have nearly 3 million New Yorkers without health insurance and more than half are eligible for State programs but are not enrolled. While the Health Care Reform Act (HCRA 2002) provides important funding for health care worker salaries, the questionable financing arrangements and negative impact on some nursing homes is a cause for concern.

Certainly, this year presents New York with fiscal challenges unlike anything any state has ever faced. But this time will pass, and only by making the right decisions today can we ensure that all of New York emerges from these difficult times stronger and more vibrant than ever.

Sincerely,

A handwritten signature in black ink, appearing to read "H. Carl McCall". The signature is written in a cursive, somewhat stylized font with a large initial "H" and "C".

H. Carl McCall
State Comptroller

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EXECUTIVE SUMMARY

After 10 years of the nation's strongest economic expansion, the nation fell into recession in March 2001. New York's economic slowdown began during the second quarter of 2001. This slowdown was exacerbated with the attacks of September 11. Shortly thereafter, in the November Mid-Year Financial Plan Update, the Division of the Budget estimated current year revenue losses of \$1.63 billion related to both the attacks and the slowing economy, and up to \$8.5 billion for 2002-03, for a two year total of \$10 billion.

The Executive's Budget projects that the State faced a gap of \$1.1 billion in the current fiscal year and \$5.7 billion in 2002-03. According to the Executive, legislation enacted in October providing State fiscal relief (including building aid cuts, enhanced lottery revenue estimates, and debt restructuring) and the use of reserves in the current fiscal year will eliminate the current year gap and lower the 2002-03 gap by almost \$600 million. The Executive Budget projects a General Fund closing balance of \$710 million for the 2002-03 fiscal year.

Overview

The 2002-03 Executive Budget proposes All Governmental Funds spending of \$88.6 billion, a 4.7 percent increase over 2001-02 estimates. State fund spending is projected to increase 1.6 percent to \$58.6 billion. General Fund spending is projected to decline \$1.2 billion or three percent. However, General Fund spending is decreased by over \$2 billion due to the movement of spending to non-General Fund types, questionable restructuring of programs, and savings that are based on assumptions that may not materialize.

Structural Balance

The Executive Budget projects outyear gaps of \$2.8 billion for 2003-04 and \$3.3 billion for 2004-05.

School Finance

The Executive Budget keeps education aid flat and leaves schools without needed resources. This compounds district deficits resulting from last year's very late and under-funded State budget, and undermines efforts to raise student performance in New York.

The Executive Budget reintroduces a proposal from last year, "flex aid", which, if enacted, will leave the State without the comprehensive reform it needs. The budget continues to ignore the need to proactively respond to initial discussions in the Campaign for Fiscal Equity case, which is to develop a new finance system providing strong educational opportunities for all students.

The Executive Budget also proposes extending changes made last year to the reimbursement of school building aid, which will continue to drive up local costs, create

more debt and increase local districts' interest costs. Furthermore, even as the shortage of qualified teachers grows, the Executive Budget proposes cutting teacher funding by 60 percent.

Higher Education

With funding essentially flat-lined for the State's public universities and community colleges, the Executive Budget undermines higher education in New York. The State's spending on higher education already lags the national average. With a ten-year increase in spending of just 19.2 percent (compared to a national increase of 59 percent), New York ranks 47th in the nation. Only Hawaii, Montana, and Alaska have increased spending less. Adjusted for inflation, spending on higher education has declined 11 percent during the period.

Without any increase in State support, SUNY will have to find alternative means to finance nearly \$76 million in salary and inflationary increases, and student fees are likely to be increased. Since 1998-99, fees at SUNY campuses have increased nearly 30 percent.

Last year, half of the State's community colleges were forced to increase tuition, a trend that will likely continue without increased funding by the State. Student fees and property taxes are also likely to rise to make up for the shortfall in funding. Last year, local property taxes supporting community colleges increased by \$11 million, or 4.7 percent.

A large reduction in the Tuition Assistance Program (TAP) is proposed that would add to the difficulties facing New York's college students. Under the plan, one-third of a student's TAP award is withheld until graduation, effectively cutting \$155 million from the program. The budget presents this action as a "performance award", attempting to disguise it as an *incentive* for graduation.

Revenue Actions

The Governor's budget proposes to use over \$2.5 billion in non-recurring resources and almost \$640 million in new and questionable revenue sources, including fees and lottery enhancements. Many of these actions have been repeatedly proposed in the past, but never enacted.

Clearly the State needs creative solutions to current budget needs; however, over-reliance on one-shots is shortsighted and jeopardizes the State's future fiscal condition. Efforts to produce savings through more efficient administration could provide significant recurring resources for the State. Numerous audits done by the Office of the State Comptroller consistently identify hundreds of millions in savings each year that could be achieved by better managing the State's current programs.

It is likely the State will have to borrow from the federal Unemployment Trust Fund and raise unemployment insurance taxes levied on employers across the State. The extent of the tax increase could have been somewhat mitigated if the State had better

prepared and addressed impending fund deficits in earlier years. Such a loan from the federal Unemployment Insurance Fund will require interest payments by the State and will likely require a new budget appropriation.

Health and Social Services

Chapter 1 of the Laws of 2002, sometimes referred to as HCRA 2002, is a multi-year plan that improves health care by: addressing the workforce shortage by increasing funding for health care worker salaries by more than \$2 billion, expanding Medicaid coverage for women who are diagnosed with breast or cervical cancer, expanding Medicaid coverage for the disabled, setting up a foundation to improve health care, and by finally making some progress toward simplifying and streamlining the State's health insurance programs.

However, HCRA 2002 relies on some uncertain and non-recurring revenue sources. For example, the President's proposed budget does not include an increase in the federal Medicaid match for states. Although HCRA 2002 has a built-in excess of revenues over spending, this cushion may not be sufficient to ensure funding for all HCRA programs if the FMAP increase is not obtained.

Over the next three years, almost \$1 billion in new HCRA 2002 resources will be used to fund existing programs supported by the State's General Fund and approximately \$1.3 billion in other State budget savings primarily attributable to a new, dedicated revenue stream from a gross receipts tax on nursing homes. While the tax is Medicaid reimbursable, it still has a negative impact on some nursing homes bottom lines. In fact, some nursing homes contend that even after accounting for the increased Medicaid rates for salaries, the net effect is a loss. Surely, removing funding from nursing homes, particularly the homes that have been the most responsive in terms of diversifying their revenue bases, will not improve patient conditions. In fact, it could have the opposite effect and cause some homes to lay-off staff that are desperately needed to maintain high quality care.

The Governor's public assistance budget does little to help people achieve economic success – instead it uses federal TANF monies to replace State General Fund spending to balance the budget. The Governor proposes around \$1.7 billion in State and local budget relief – about double last year's level. New proposals include the questionable use of \$400 million in TANF for existing TAP and pre-K programs.

Local Governments

Most local aid remains unchanged from last year, but 62 towns and villages and three counties are slated to lose \$6.1 million in supplemental municipal aid. Upon close examination of the \$707 million net benefit the budget claims for local governments, it is clear the estimates are overstated. Once those benefits that depend on Congressional approval and those that are inappropriately classified as savings (E911, school aid) are eliminated from the calculation, the true net benefit for local governments drops to \$245 million.

Debt and Capital

The capital plan submitted with the 2002-03 Executive Budget, compared to the prior capital plan, decreases the amount of non-federal capital needs paid for with State cash from 41.5 percent in 2002-03 to 38.6 percent. By 2006-07, State money will finance only 32.6 percent of non-federal capital needs.

The new plan would increase State-supported debt by \$3 billion over five years, from \$39.2 billion in 2002-03, to \$42.3 billion in 2006-07. Annual State-supported debt service will grow from \$3.8 billion in 2002-03 to \$4.8 billion by the end of the plan, an increase of 27 percent.

The capital plan continues to increase debt service costs for future generations, without creating State assets. The Executive's budget calls for the creation of the Empire Opportunity Fund, with \$750 million in additional borrowing aimed at economic development throughout the State (outside of New York City). This is in addition to current programs like \$425 million for the Community Enhancement Facilities Assistance Program (CEFAP) and \$225 million for the Strategic Investment Program (SIP). While these programs are intended to provide economic development initiatives to localities, State assets are not created despite the use of State taxpayer funds. A more comprehensive way of promoting development should be pursued.

The Executive Budget has again called for a constitutional amendment to codify the statutory requirements of the Debt Reform Act of 2000. Clearly, constitutional change is necessary to ensure permanent change. However, the caps that were instituted in the Debt Reform Act were flawed and do not restrict debt issuance for decades to come. As such, any constitutional amendment should dictate meaningful caps that will effectively address current debt management practices.

FINANCIAL OVERVIEW

This section provides a summary description of the Executive Budget, focusing on the financial plan. Highlights of the 2002-03 proposed General Fund Executive Budget follow:

- T The State is expected to end the 2001-02 fiscal year with a closing General Fund balance of \$2.1 billion. This includes \$1.1 billion in unrestricted reserves and \$710 million in the Tax Stabilization Reserve (rainy day) Fund.
- T The Division of the Budget projects a \$5.1 billion General Fund gap for 2002-03 without additional budgetary and/or administrative action, as proposed in the Executive Budget.
- T The financial plan reports a 14 percent decline in personal income tax from 2001-02; however, when receipts are adjusted for refund reserve, STAR transactions, and incremental tax cuts underlying growth is approximately 1.6 percent.
- T Overall General Fund receipts are projected to decline \$3.8 billion. However, after adjustments are made for incremental tax cuts and personal income tax transactions, underlying growth is approximately two percent. This includes \$463 million in additional nursing home assessments as provided in the health care legislation passed in January.
- T General Fund disbursements are projected to decline \$1.2 billion partially due to the utilization of \$885 million in federal TANF reserves for health care, welfare, and higher education.
- T General Fund spending for Medicaid is projected to increase 0.4 percent due to \$512 million in offsetting actions including increased Intergovernmental Transfers and Upper Payment limits (\$74 million) and the imposition of a six percent nursing home tax (\$289 million) and other HCRA financing.
- T General Fund school aid spending is projected to remain flat at \$12.1 billion. An increase in school year needs, partly to pay for last year's aid, is offset by increased lottery revenue estimates of \$347 million and TANF funding.
- T General Fund spending for welfare programs is expected to decline 44 percent primarily as a result of additional use of TANF funds. Projected welfare caseloads are expected to increase by 13,000 from 687,500.
- T Overall General Fund health care spending is projected to decrease 30 percent or \$204 million largely because of dedicated HCRA funding of \$323 million. Health programs that are affected by such funds include Elderly Pharmaceutical

Insurance Coverage (EPIC) at \$194 million, Roswell Park Cancer Institute (\$60 million), and other programs for AIDS, Indian Health, and Immunization and Water Supply Protection (\$69 million).

T The Tuition Assistance Program (TAP) faces a General Fund spending cut of 72 percent or \$497 million, due to utilization of TANF funds (\$345 million) and program restructuring (\$182 million).

The Executive Budget estimates that the State faces a loss of approximately \$6.8 billion over two fiscal years as a result of the declining economy and the attacks of September 11, 2001. Efforts to close a \$1.1 billion fiscal year 2001-02 gap include the use of \$646 million in reserves and \$435 million in already enacted legislative and administrative actions (including building aid cuts, lottery re-estimates, and debt service savings). However, these actions help to create a closing General Fund balance of \$2.1 billion for fiscal year 2001-02, which includes \$1.1 billion in unrestricted reserves and \$710 million in the Tax Stabilization Reserve Fund.

While the attacks on the World Trade Center have certainly had an impact on New York's economy, the State has also suffered from a recession for most of the current fiscal year. The National Bureau of Economic Research estimates that the current recession began in March 2001 and the Division of the Budget expects it last through the first quarter of 2002. As a result, the Division of the Budget projects revenues to rebound during the second half of fiscal year 2002-03, especially in the fourth quarter.

Size of the Proposed 2002-03 Budget

The Executive Budget proposes All Governmental Funds spending of \$88.6 billion, a 4.7 percent or \$4 billion increase over estimated 2001-02 levels; State Funds spending increases 1.6 percent or \$929 million; General Fund spending decreases 3.0 percent or \$1.2 billion, because of a number of actions taken to reduce spending and shift spending to non-General Fund accounts.

Spending by Fund Type
2002-03 Executive Budget
 (Billions)

Comparison Basis	Proposed 2002-03 Spending	Difference	Change
All Funds	\$88.6	\$4.0	4.7%
State Funds	\$58.6	\$0.9	1.6%
General Fund	\$40.2	(\$1.2)	(3.0%)

Source: Division of the Budget

2002-03 Proposed General Fund Spending

Proposed General Fund spending declines by \$1.2 billion in 2002-03. The largest General Fund spending decreases come in public assistance (\$429 million), health and other social services (\$176 million), other education including tuition assistance programs (\$649 million), and debt service (\$267 million). Higher education, public assistance, and health spending decrease as a result of General Fund actions that shift spending to All Governmental Funds, as further described below. Debt service is expected to decrease because of proposed debt structure changes and lower annual debt service payments due to the past use of Debt Reduction Reserve Fund proceeds to retire debt early. General State Charges are projected to increase \$227 million because of higher insurance costs and lower than expected rates of return in the State's pension fund resulting in the need for additional contributions.

The Executive utilizes the following accounting measures and offsets in order to reduce General Fund spending or increase General Fund resources:

- T \$885 million from TANF funding including \$345 million for higher education, \$60 million for education, and \$479 million for welfare;
- T \$785 in HCRA offsets, including \$365 million in Medicaid relief, \$68 million in other Health Department General Fund offsets, \$60 million for Roswell Park, \$200 million from EPIC, and \$72 million in bad debt and charity care pool redistributions.
- T \$73 million in new additional HCRA offsets to General Fund Medicaid;
- T \$2.5 billion in non-recurring resources, including the use of all General Fund reserves except the Tax Stabilization Reserve Fund and various fund sweeps including the Environmental Protection Fund and the State of New York Mortgage Agency; and
- T \$225 million in estimated debt service savings because of variable rate debt and interest rate swaps and the use of revenue bonds.¹

2002-03 General Fund Receipts

General Fund receipts in fiscal year 2002-03 are estimated to decrease \$3.58 billion, or 8.4 percent, from 2001-02. However, receipts are affected by accounting mechanisms that move surplus funds between fiscal years and STAR transactions. Absent these transactions that are unrelated to 2002-03 receipt declines, tax revenues grow by slightly over 0.75 percent and total receipts grow by slightly under 0.75 percent. Revenue losses related to tax cuts mask the growth in receipts attributable to the economy. If tax collections are adjusted for the cost of incremental tax cuts and the

¹ Note that the market has yet to react at all to revenue bonds and projected savings of \$25 million is unknown at best and the use of variable rate bonds and interest rate swaps has yet to be approved and any savings is very dependent on market conditions.

impact of non-recurring actions, estimated underlying growth associated with the economy is actually closer to 2 percent.

**2002-03 General Fund Receipts
Change from 2001-02
(Millions)**

Revenue Category	2001-02	2002-03	Difference	Growth	Estimated Underlying Growth
Personal Income Tax	\$25,632	\$25,987	\$355	1.4%	1.6%
User Taxes and Fees	\$7,082	\$7,069	(\$13)	-0.2%	0.4%
Business Taxes	\$3,829	\$3,775	(\$54)	-1.4%	6.3%
Other Taxes	\$781	\$783	\$2	0.3%	5.1%
Total Taxes	\$37,324	\$37,614	\$290	0.8%	1.9%
Miscellaneous Receipts	\$1,609	\$1,606	(\$3)	-0.2%	
Transfers from Other Funds	\$2,157	\$2,329	\$172	8.0%	
Receipts pre-accounting actions	\$41,090	\$41,549	\$459	1.1%	
Refund Reserve Transactions	\$2,905	(\$65)	(\$2,970)	-102.2%	
STAR deposit	(\$1,310)	(\$2,630)	(\$1,320)	-100.8%	
Debt Reduction Reserve	(\$250)	\$0	\$250	100.0%	
Available General Fund Receipts	\$42,435	\$38,854	(\$3,581)	-8.6%	

Source: OSC

2001-02 General Fund Closing Balance

In September, the Executive estimated a year-end closing balance of \$2.7 billion with an available surplus of \$1.8 billion. However, that update did not take into consideration the events of September 11 and the related financial ramifications. In October, the Division of Budget released another updated financial plan that projected a year-end balance of \$1.2 billion, \$1.6 billion lower than the September update.

It is difficult to isolate the financial implications of the attacks on the World Trade Center from the slowing economy generally; however, together they have had a substantial negative impact on New York's financial condition. In January, the Executive reduced the estimate of the revenue loss resulting from the September 11th attack and the economy from \$1.6 billion to \$1.1 billion for the current fiscal year. The 2002-03 closing fund balance is now projected at \$2.1 billion, a 71 percent increase from October. Of this balance, the Executive is labeling none as "available surplus" as everything but the Tax Stabilization Reserve Fund is slated for projected needs in the 2002-03 fiscal year.

Personal income tax revenues are expected to be lower than October estimates by \$119 million (after adjustments). However, overall revenues are expected to be \$344 million higher due primarily to better than expected business taxes and miscellaneous receipts.

Spending is projected to be \$518 million lower than October estimates. This new estimate is comprised of \$578 million in lower spending, offset by \$60 million additional spending for homeland security and World Trade Center expenses.² Lower spending estimates are primarily made up of: lower school aid costs due to revised school aid data and lottery re-estimates (\$310 million); and, agency savings because of management initiatives including lower debt service costs due to use of the Debt Reduction Reserve Fund (\$268 million).

2001-02 Closing Fund Balance
(Millions)

Source	Amount
Tax Stabilization Reserve Fund	\$710
Contingency Reserve Fund	\$81
Community Projects Fund	\$142
Universal Pre-Kindergarten Fund	\$11
Unrestricted reserves ³	\$1,133
Total	\$2,077

Source: Division of the Budget

² The State has incurred some expenses that are related to the attacks on September 11, 2001 that may not be reimbursable by the federal government, although the State is applying for such funds. These funds include costs to increase tourism in New York City.

³ This amount is not actually a reserve. Instead the additional funds are made available in 2002-03 by transferring them through the Personal Income Tax Refund Reserve account.

STRUCTURAL BALANCE

Future Budget Gaps

The Executive is projecting General Fund budget gaps for 2003-04 of \$2.8 billion and \$3.3 billion for 2004-05.

Executive Projections for Future General Fund Budget Gaps (Millions)

Multiyear Gap Projections	2003-04	2004-05
Receipts	\$39,747	\$41,820
Expenditures	(\$42,561)	(\$45,081)
Executive Gap Estimate	(\$2,814)	(\$3,261)

Source: Division of the Budget

These future budget gaps assume growth in revenues of approximately three percent for 2003-04 and five percent for 2004-05. The Division of the Budget is predicting that the recession that began nationally in March 2001 will end in the second quarter of 2002 and average historical growth will resume throughout 2004. While these projections are lower than previous years, they reflect incremental tax cuts scheduled to be implemented in each year.

Expenditures are projected to increase 6 percent in 2003-04 and 2004-05. Most of the growth is attributable to grants to local governments for school aid (1.7 percent and 5.5 percent respectively), Medicaid (7.5 percent each year and consistent with Congressional Budget Office projections), and mental hygiene (7.8 percent and 5.8 percent respectively). State operations spending is expected to increase two percent in 2003-04 and five percent in 2004-05. While this does not consider additional salary increases after 2003-04 (when contracts expire), it does consider normal step growth in wages and inflationary increases in non-personal services. Furthermore, the growth in State operations incorporates an additional institutional payroll cycle in 2003-04 and costs associated with snow and ice removal.

Outyear gaps are merely projections for an extended period of time. Past results have clearly demonstrated a difficulty in predicting economic behavior effectively. In the past, gaps as high as \$5 billion have been successfully reduced through more accurate receipts and spending re-estimates based on updated information and budget actions. As this year's circumstances have provided data that are particularly difficult to use in projection models, additional updated information will certainly provide more accurate projections.

Reserves

The Executive's budget proposes using all General Fund reserves with the exception of the Tax Stabilization Reserve Fund for the 2002-03 fiscal year. This provides \$1.4 billion in one-time General Fund resources.

Reserves Fiscal Years Ending 2002 and 2003 (Millions)

Source	FYE 2002	FYE 2003	Difference
Tax Stabilization Reserve Fund	\$710	\$710	\$0
Contingency Reserve Fund	\$81	\$0	(\$81)
Community Projects Fund	\$142	\$0	(\$142)
Universal Pre-K Fund	\$11	\$0	(\$11)
Unrestricted	\$1,133	\$0	(\$1,133)
Total General Fund Reserves	\$2,077	\$710	(\$1,367)

Source: Division of the Budget

While most of the reserves listed above are restricted to certain purposes, the statutorily defined use is broad enough that they can be used within the Executive's budget proposal. The only General Fund reserve that is restricted solely to unanticipated budget deficits is the Tax Stabilization Reserve Fund, commonly referred to as the rainy day fund. After a \$70 million deposit in 2001-02, the fund will hold \$710 million, or 1.8 percent of General Fund receipts.⁴ In 1999, the national average for rainy day funds was 4.5 percent of revenues, well above that of New York State.

According to the Executive proposal, the State will utilize all other General Fund reserves in the upcoming fiscal year in the following way:

- T The \$81 million balance of the Contingency Reserve will be used to offset costs related to the proposed Yonkers desegregation settlement in which the State has agreed to pay the City \$290 million over five years (yet to be approved by the courts).
- T The \$142 million balance of the Community Projects Fund will be used for ongoing legislative and gubernatorial initiatives.
- T The \$11 million balance in the Universal Pre-K fund will be used for local expenses relating to the Pre-K program.

⁴ While the State Finance Law restricts the amount in, and the amount deposited to, this particular reserve (two percent and 0.2 percent of General Fund spending respectively), the amount in the reserve is not up to capacity and very low compared to other state's with similar revenue structures. The Executive is expected to submit legislation to increase the limits for both balance and deposit to five percent and .05 percent respectively.

T Finally, the only unrestricted reserve of \$1.1 billion is proposed to offset revenue losses related to the World Trade Center attacks and the slowing economy.

Federal Reserves

The State also has reserves of federal funds. The Temporary Assistance for Needy Families (TANF) Block Grant provides New York State with over \$2.4 billion in federal funds for welfare needs. Since the funding stream is based on caseload figures from 1995 and the State's caseload population has decreased since then, the State realizes a surplus, some of which is generally unallocated and reserved for future needs. The State has approximately \$885 million in TANF funding available from prior years. The Executive's proposal utilizes all these funds for welfare, higher education, and education needs, most of which had previously been supported by the General Fund (See section on Social Services).

REVENUE ACTIONS

Tax Cuts/Revenue Reducing Actions

The Executive proposes the following new tax cuts:

- T ***Low Income Housing Tax Credit Program*** – The Executive proposes increasing the yearly allowance to the program by \$2 million to further spur economic growth. The financial plan assumes a \$2 million revenue reduction in fiscal year 2002-03 and subsequent years.

- T ***Brownfields Package*** – The Executive proposes a tax incentive package to encourage cleanup and development of brownfields throughout the State. Incentives include tax credits for costs associated with the initial purchase and remediation of particular sights and additional credits for developmental costs. Fully implemented, this program is expected to reduce State revenues by approximately \$70 million beginning in 2003-04 with no financial impact for 2002-03.

- T ***The School Tax Relief Program (STAR)*** – The Executive proposes the establishment of a cost of living adjustment (COLA) for the income threshold for senior citizens eligible for enhanced STAR benefits. The COLA is expected to cost \$20 million in 2002-03.

Approximately \$300 million in incremental tax reductions/credits are scheduled to take place in the upcoming fiscal year, including those related to the marriage penalty, college tuition, child care, Empire Zones, energy sales, multiple business taxes and banks.

Unemployment Insurance

At this point it is becoming clear that the State will have to borrow from the federal Unemployment Trust Fund and raise unemployment insurance taxes for employers across the State in order to continue providing unemployment insurance to recipients. While it is unknown how much the State will have to raise to keep up with the increasing demand for unemployment insurance, it is known that the State inadequately prepared for such a consequence. Since borrowing from the Unemployment Insurance Trust Fund will require interest payments that will probably be a General Fund charge, cost the State needs to be considered and the financial plan adjusted accordingly.

Revenue Proposals

The Executive proposes approximately \$640 million in revenue enhancing initiatives. Most of the increase comes from lottery provisions based on the controversial Quick Draw game. The Governor again proposes to permanently extend the game, which is scheduled to expire March 31, 2002. A number of administrative enhancements

(additional legislation is not required) to the game are planned for next year, which are forecast to raise an additional \$100 million in lottery revenues. The Executive proposes an increase of \$68 million in additional fees, many of which have been proposed in the past, but rejected by the Legislature.

Description	2002-03
Revenue Enhancements	
Permanent extension of Quick Draw (Revenue Preservation)	\$182.70
Elimination of Quick Draw restrictions	\$43.00
Instant Cash Games	\$17.50
Quick Draw – Next Vision *	\$31.70
Quick Draw – EZ Pass *	\$4.70
Millennium Millions *	\$31.60
Weekly Millions *	\$34.30
Alcoholic Beverage Control	\$8.00
Abandoned Property Receipts	\$15.00
Personal Income Tax Technological Enhancement	\$130.00
Personal Income Tax – EFT Threshold (non-recurring)	\$25.00
Sales and Use – EFT Threshold (non-recurring)	\$32.50
Prepaid Cigarette Sales Tax Index (non-recurring)	\$5.80
Alcoholic Beverage Control Enforcement (Revenue Preservation)	\$3.00
Logo Sign Program	\$0.50
Gas Leasing Fees *	\$5.40
Total Revenue Enhancement	\$570.70
Fee Increases	
Food Processing License	\$1.40
Weightmaster	\$0.02
Pet Food Registration	\$0.49
Council on the Arts Surcharge	\$22.50
Pesticides	\$2.40
Bulk Petroleum Storage	\$1.00
Hazardous Waste Generators	\$18.40
Hunting and Fishing Licenses	\$5.90
Boat Registration	\$1.30
Boat Registration Surcharge	\$0.60
Snowmobile Trail and Maintenance	\$1.30
Various Department of State Regulatory Fees	\$2.60
Lake George Park Commission	\$0.30
Transportation Penalty Schedule	\$3.00
Overweight Trucks	\$1.50
Weights and Measures Administration *	\$0.03
Consumer Protection Board *	\$1.40
Hospital Mortgage Servicing *	\$4.00
Total – Fee Increases – State level	\$68.14
Total – Enhancements and Fees	\$638.84
Local Fee Authority	
Statewide Wireless Network Cellular Surcharge	\$28.10

* Denotes administratively imposed

Source: Division of Budget

Non-Recurring Resources (One-Shots)

The Executive claims a total of \$562 million in non-recurring revenue actions in the 2002-03 proposed budget. This includes funding from such sources as HCRA, the Environmental Protection Fund, State of New York Mortgage Agency and the New York State Housing Finance Agency. It does not include such items as the use of unrestricted reserves, one-time manipulation of tax revenues, and General Fund supplements from federal TANF funds. Further analysis indicates the use of nearly \$2.5 billion in non-recurring revenues, 6.2 percent of proposed General Funds spending.

Non-Recurring Resources 2002-03

(Millions)

Description	Amount
State of New York Mortgage Agency	\$150.00
New York State Housing Finance Agency	\$50.00
Port Authority of New York/New Jersey (last WTC Payment)	\$16.00
Environmental Protection Fund	\$100.00
Various Health/Medicaid Special Revenue Funds	\$114.00
Personal Income Tax – EFT Threshold	\$25.00
Sales and Use – EFT Threshold	\$32.50
Prepaid Cigarette Sales Tax Index	\$5.80
TANF Reserve	\$885.00
Unrestricted reserves	\$1,133.00
Total – Non-recurring Revenue	\$2,511.30

Source: OSC

Clearly the State needs creative solutions to current budget needs; however, over-reliance on one-shots is shortsighted and jeopardizes the State's future fiscal condition. Efforts to produce savings through more efficient administration could provide significant recurring resources for the State. Numerous audits done by the Office of the State Comptroller consistently identify hundreds of millions in savings each year that could be achieved by better managing the State's current programs.

EDUCATION

School Finance

The Executive Budget essentially holds school aid constant at about \$14.2 billion, providing a \$6 million, four one-hundredths of one percent school year increase.⁵

School aid is flat, and the proposed merger of existing aids does not approach the level of school finance reform needed in New York State. Furthermore, even as the shortage of qualified teachers grows for many regions of the State, the Executive has proposed reducing teacher funding by more than \$75 million. Aid for smaller class sizes has been cut, and other LADDER aids are frozen.⁶ A proposed change in building aid will discourage schools from spending cash for capital projects (aid will be paid as if the schools are borrowing for the maximum term). A proposal to bond out school aid payments owed for prior years may help address a large gap in current year funding for New York City, but is not a long-term solution.

This budget will leave schools without needed resources, and the string of deficits that appeared in districts across the State after last year's very late and under-funded budget will be compounded. The Governor is appealing the Campaign for Fiscal Equity (CFE) case. This continuing pattern of inaction will not only undercut the statewide effort to raise educational performance, it may well lead to a Court-ordered solution which this Administration has protested it does not want.

Flex Aid

The Executive again proposes merging major operating aids into a “flex aid” proposal, but would freeze aid at \$10.4 billion, the fiscal year 2001-02 amounts for the 13 aid programs included in flex aid. Like the Executive’s proposal from last year, flex aid would include: 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. This year, however, the Executive proposal includes BOCES aid and special services aid for the large city districts.

⁵ Traditionally, the Executive’s budget is compared to “present law” amounts, which represent school aid funding that would be provided if existing formulas were allowed to run in the coming year. Because the Legislature enacted a school aid package without formulas for the bulk of aid in 2001-02 (providing most funding in the form of a grant), the State Education Department estimates for 2002-03 school aid exclude many aid programs and provisions that sunset annually. However, if all of the one-year programs were left at 2001-02 levels, the 2002-03 school year increase would be more than \$1 billion.

⁶ 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.

BOCES aid and special services aid — both expense-based aids — would be frozen at current levels regardless of any increased or decreased expenses incurred by districts in the preceding two years. Also, as is the case in the current year, special education funding would not be driven by special education placements or support new, high-cost pupils.

While consolidating aid categories is a positive concept, the flex aid formula does not target aid to districts most in need. While the Executive proposes that future flex aid increases take into account students' wealth and educational needs, this prospective proposal is meaningless in the coming school year, especially since the passage of flex aid as proposed is unlikely.

Building Aid

Although estimates are not available for individual school districts, the Executive estimates that under his proposal the overall level of building aid will not increase.

The Comptroller has been critical of the assumed amortization schedule imposed on districts as a result of the 2001-02 State Budget. Even for projects already bonded, districts will have to refinance their debt, spreading it out over the longest possible term and raising local interest costs.⁷ Now the Executive proposes extending assumed amortization requirements to “hard dollar projects” — smaller projects for which districts generally pay cash and are fully reimbursed the following year. As of fiscal year 2001-02, districts receive State building aid for bonded projects on an assumed amortization schedule, which is based on a project's useful life and stretches payments from 15 to 30 years. Education organizations oppose this change because it will drive up local district costs.

For voter-approved projects after July 1, 2002, building aid will be based on the current year building aid ratio rather than the selected aid ratio. The Executive is also reintroducing proposals to: authorize the Dormitory Authority to provide school districts with construction management services and exempt districts from the Wicks Law, allowing districts to hire a single (rather than multiple) contractor for construction.

Prior Year Aid Claims

The Executive Budget claims to provide a \$214 million accelerated payment of prior year claims. These are funds already owed to the school districts from revised aid claims in previous years, but the State generally only pays a small proportion of these claims each year (\$57 million against an estimated \$537 million in claims).

The so-called acceleration in payments is actually only an authorization for the large city school districts to borrow against future school aid payments (they can borrow

⁷ The Comptroller issued a report — “School Construction and Building Aid: An On-Again, Off-Again Priority” — in January 2002, criticizing building aid policies enacted in 2001-02, and detailing the negative impacts the State's approach to funding school building projects has had on local districts.

up to the amount of prior year adjustments already owed). The Municipal Bond Bank Agency (MBBA) will issue bonds, but cities must pay off the bonds, with interest.

This fiscal maneuver is being portrayed as a way to help the Big 5 city school systems, which would otherwise receive no new aid or experience actual cuts. However, this proposal will cause big city governments to dig themselves into a hole with an enormous one-shot. The big city school systems, like others around the State, are already reeling from the effects of last year's budget, and each is struggling to close a budget gap in the current year.

Other School Aid Changes

- T **Universal pre-kindergarten** is frozen at \$205 million. Under the initial plan agreed by the Governor in 1997, the pre-kindergarten program would have been universal by this point, providing more than \$500 million and spreading apportionments to nearly all districts (rather than just the neediest districts, which were aided in the initial years). Again, no new districts will be admitted to the program.

- T **Class size reduction aid** is reduced from the 2001-02 level of \$140 million to \$128.12 million, eliminating \$11.85 in start-up rants. (federal class size reduction aid, which was \$141 million in the current year, will be merged in 2003 with teacher funding.)

- T **Transportation aid** increases by \$93 million to cover rising local costs.

Teachers

With a teacher shortage growing in many regions of the State, especially the poorest districts, the Executive freezes funding for Teachers of Tomorrow at \$25 million, and reduces other teacher funding programs by more than \$75 million. These programs are aimed at recruiting, retaining and training teachers, especially in low performing districts and hard-to-staff subjects and regions. The Executive proposes:

- T A \$52.5 million cut in teacher support aid, which helps Big 5 city school districts supplement low teacher salaries, lowering it from \$67.5 million to \$15 million.

- T \$10 million for teacher computer training and resource center funding, representing a \$20 million cut.

- T Reducing the teacher-mentor intern program from \$5 million to \$1.7 million.

Other Proposals

- T The Executive proposes requiring SED to reduce redundant or unnecessary reporting requirements, an effort the Comptroller has long advocated.

T The Executive is reintroducing proposals rejected in previous years, giving mayors in the Big 5 city school districts authority to oversee schools, and proposing that the State Museum, the State Library and State Archives be removed from the State Education Department, and instead be overseen by a board mostly appointed by the Executive.

Campaign for Fiscal Equity Case

In the Campaign for Fiscal Equity⁸ (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 is similar to reform agendas of most education and citizen groups.

Despite statements by the Executive about helping high-need districts, it is clear that the Executive's budget proposal once again 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 appealed the CFE decision.

School Tax Property Relief Program (STAR)

School tax relief benefits will be similar to last year. The Executive recommends a total 2002-03 STAR program of \$2.7 billion.

The Executive proposes a cost of living adjustment (based on the Consumer Price Index) to the \$60,000 income ceiling for senior citizen enhanced STAR benefits, and that income eligibility be verified every three years (rather than annually).

⁸ Campaign for Fiscal Equity v. State of New York, 187 Misc. 2d 1 (Sup. Ct. NY Co. 2001), The Campaign for Fiscal Equity – a group of educators, advocacy groups, parents, and community school boards – initially filed the lawsuit in 1993.

HIGHER EDUCATION

At a time when New York faces an uncertain economic future, a strong and accessible higher education system is critical to economic growth and the highly trained workforce that sustains it. Unfortunately, the 2002-03 Executive Budget proposal continues to undermine higher education.

Funding for public universities is essentially flat-lined for 2002-03: SUNY will receive \$1.2 billion in General Fund support, and \$618 million is earmarked for CUNY senior colleges. The Governor's failure to adequately support these institutions further compounds the damage created by last year's budget, including the 25 percent reduction in opportunity programs.

Community colleges are also slated to receive no increase in funding. Base operating aid will remain \$2,250 per FTE. Last year, half of the State's community colleges were forced to increase tuition. It is likely this trend will be repeated. This is unfortunate since the latest College Board figures indicate that the cost of community colleges in New York State is already more than 50 percent higher than the national average.

Without additional state funding, SUNY will be forced to self-finance nearly \$76 million in salary and inflationary increases. Student fees will likely be used to make up shortfalls at four-year colleges, and tuition, fees, and property taxes will likely go up at community colleges. Fees at SUNY colleges have already gone up nearly 30 percent since 1998-99. Last year, local property taxes supporting community colleges increased by \$11 million, or 4.7 percent.

The Governor's TAP cut clearly adds to the difficulties facing New York's college students. Under the plan, 1/3 of a student's TAP award is withheld until graduation, effectively cutting \$155 million from the program. The budget presents this action as a "performance award", attempting to disguise it as an *incentive* for graduation.

Students need TAP to attend school, not afterward. This action essentially undoes the restoration of TAP enacted in the 2000-01 budget. The plan will force struggling students further into debt as they take out more loans to make up the difference. In fact, one of the components of the TAP plan is a \$10 million TAP loan program—specifically directed to students that have exhausted their federal loan eligibility yet still need additional loans to cover the 1/3 cut. The State's promise to reimburse students for interest on these loans hardly mitigates the damage. Rather, it highlights the additional costs.

Additionally, the proposal put forth by the Governor will do little to alleviate campuses over-reliance on part-time, adjunct faculty, and will likely exacerbate it. There has been a marked decline over the past decade in the percentage share of full-time

faculty vs. part-time faculty at SUNY campuses. In 1991-92, full-time faculty made up 72.4 percent and part-time faculty 27.6 percent. By 2000-01, full-time faculty made up only 62.9 percent and part-time faculty 37.1 percent.

There is no change in funding for SUNY's three teaching hospitals at Stony Brook, Brooklyn, and Syracuse. Some statutory changes aim to increase procurement and employment flexibility of the SUNY hospitals. The budget states that hospitals are also scheduled to benefit from the Health Care Worker Retention and Recruitment act recently passed, but it is doubtful that these actions alone will solve the financial problems of the State's hospitals.

The budget also claims to recognize the need to facilitate increased collaboration between industry and universities, and has proposed a \$250 million High Technology Initiative. The plan would authorize the Urban Development Corporation to issue \$250 million in bonds to fund a variety of capital projects (research facilities, business parks, incubators, etc.). However, only \$62.5 million will be made available in 2002-03 for actual projects.

NYSTAR will receive \$54.4 million in support. The majority (\$22.5 million) will go towards restoration of the agency's Research Development Programs. An additional \$4.2 million is also appropriated to NYSTAR's High Technology Matching Grant Program. Most other programs will continue at 2001-02 funding levels. A net reduction of \$600,000 in the State Operations Fund is also proposed. This reflects the elimination of 10 full-time-equivalent positions through expected vacancies.

New York State's spending on higher education already lags far behind the national average. With a ten year increase in spending of just 19.2 percent (compared to a national spending increase of 59 percent), New York ranks 47th in the nation. Only Hawaii, Montana, and Alaska have fared worse. Once inflation for the period is taken into account, higher education has suffered a net decline of 11 percent in State support.

Medicaid

The Executive Budget includes few new proposals since major health care legislation was enacted just a week prior to its release. Chapter 1 of the laws of 2002, sometimes referred to as HCRA 2002, significantly increased Medicaid rates and included a variety of revenue and savings measures that would normally be included in the budget process.

General Fund Medicaid spending in the Department of Health is projected to total \$6.156 billion, representing an increase of only \$21 million. General Fund Medicaid spending growth of 0.4 percent is artificially depressed due to the following types of actions taken in HCRA 2002 or are proposed with the Executive Budget:

Offsetting revenues (\$289 million). HCRA 2002 included a 6 percent tax on the gross receipts of nursing homes. This tax is reimbursable through the Medicaid program. The Executive Budget estimates total revenues generated by the tax to be \$463 million. After accounting for the Medicaid reimbursable nature of the tax, the State is estimated to generate \$289 million in savings. This tax was phased out in fiscal year 1999-2000. It has been pointed out that this levy will not damage nursing homes because so many receive a high percentage of their revenues from Medicaid. However, some nursing homes, as encouraged by the State, redesigned services to diversify their revenue bases to include a significant rehabilitation component. For many of these homes, the imposition of this new tax will result in a net loss. In fact, it has been estimated that the revenue loss to nursing homes over the three-year period will exceed \$300 million.

New HCRA Budget Relief (\$73 million). This savings is attributable to transferring support for Medicaid expenditures for physicians and the working disabled program from the General Fund to HCRA funds. This provision is contained in the Governor's proposed Article VII legislation.

Federal Maximization (\$74 million). HCRA 2002 also provided for additional State savings resulting from actions designed to provide additional federal funding. They include: \$55 million from outpatient upper payment limits and \$19 million from higher intergovernmental transfers for public hospitals like the Health and Hospitals Corporation.

One-shots (\$72 million). Old NYPHRM accounts have a balance of \$238 million. The Executive budget includes \$72 million in one-time savings related to retaining \$72 million of \$238 million in old, bad debt and charity care fund balances from the State.

In addition, cost containment actions, extended in December 1999 until March 31, 2003, save the State more than \$800 million and local governments approximately \$300 million.

Department of Health Medicaid Spending: Executive Budget
(Millions)

	General Fund	Growth	State Special Revenue	Growth	Federal Funds	Percent Growth
1999-00	5,783		863		12,639	
2000-01	5,722	1.1%	1,134	31.4%	13,347	5.6%
2001-02 – Estimated	6,134 ⁹	7.2%	1,212	6.9%	14,203	6.4%
2002-03 - Proposed	6,165	0.4%	2,064	70.2%	15,433	8.7%

Source: OSC

State special revenue funds play an increasingly important role in Medicaid spending and are almost 2.5 times the level they were in 1999-00. In 2002-03, special revenue Medicaid spending will total more than \$2 billion, representing an increase of over \$850 million from the current fiscal year. The four primary special revenue sources are:

- T **Indigent care.** This provides funding for providers serving uninsured people. Spending is expected to total \$1 billion in 2002-03, an increase of approximately \$160 million. Part of the increase is attributable to the distribution of old NYPRHM balances and HCRA bad debt and charity care funds.
- T **Provider assessments.** This account receives the new 6 percent gross receipts tax on nursing homes and offsets General Fund spending. Estimated revenues are \$463 million.
- T **HCRA Transfer.** This account receives HCRA funding from the Tobacco Control and Initiatives Pool and offsets Medicaid costs. Spending is expected to total \$540 million, representing an increase of \$277 million. The bulk of the increase is due to the recently enacted increased Medicaid rates to provide funding for health care worker salaries along with costs associated with Medicaid expansions for the disabled.
- T **Tobacco Transfer.** This account receives \$91 million in funding from the Tobacco Settlement Fund – the same level as last year.

The Executive projects underlying growth in State Medicaid spending, before reflecting cost containment savings and offsets which reduce spending by approximately 7.2 percent in 2002-03. This growth rate better represents program trends, or underlying

⁹ This figure assumes a deficiency appropriation of \$180 million. Of this amount, \$139 million is attributable to legislative rejection of 2001-02 proposed cost containment and the remainder is related to federal court decisions affecting eligibility and increased enrollment associated with the Disaster Medicaid Relief program.

growth. Underlying growth is attributable to automatic inflationary adjustments to Medicaid rates for hospitals and nursing homes; prescription drug cost increases, and increased utilization. At the national level, the Congressional Budget Office projects federal Medicaid spending will grow 10 percent in federal fiscal year 2002 and 6.3 percent in 2003.¹⁰ 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.

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.¹¹ 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 wellbeing of New York's existing and growing aging population is at risk.

However, the recently enacted HCRA 2002 imposed a gross receipts tax on nursing homes. While the tax is Medicaid reimbursable, it still has a negative impact on some nursing homes bottom lines. In fact, some nursing homes contend that even after accounting for the increased Medicaid rates for salaries, the net effect is a loss. Surely, removing funding from nursing homes, particularly the homes that have been the most responsive in terms of diversifying their revenue bases, will not improve patient conditions. In fact, it could have the opposite effect and cause some homes to lay-off staff that are desperately needed to maintain high quality care.

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 family's 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.

¹⁰ The Budget and Economic Outlook: Fiscal Years 2003-2012. Congressional Budget Office, January 2002.

¹¹ See: Fragmented Services for Seniors: New Yorkers Deserve Better (June 2001), 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.

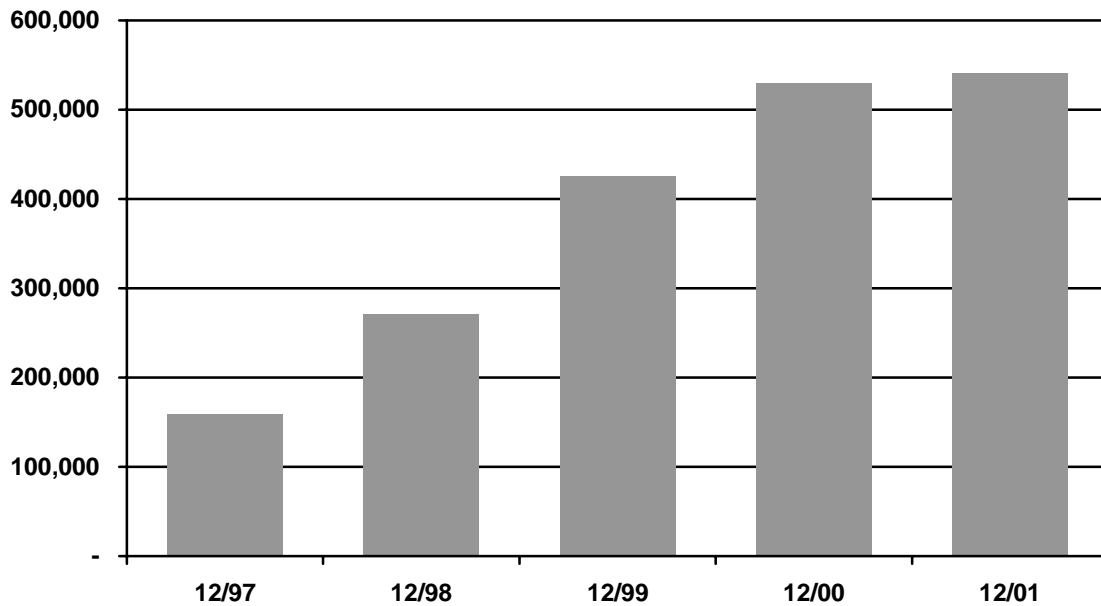
The federal Balanced Budget Act of 1997 included a new block grant program for states to provide expanded health insurance coverage for children. This funding, combined with existing State funding enabled the State, after some debate, to expand and improve the current program.¹² Legislation passed in 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 were set to expire on March 31, 2001 and they have since been extended to July 1, 2003. Chapter 1 of the Laws of 2002 also expanded benefits to include ambulance services.

Due primarily to eligibility expansions advanced by the State Comptroller, the Assembly majority and other advocacy organizations, CHIP enrollment has increased significantly – from 153,000 in November 1997 to 540,000 in December 2001. The 2002-03 Executive Budget estimates total enrollment of approximately 580,000 children at year-end.¹³ In addition, a Medicaid expansion to 133 percent of the federal poverty level will be financed by CHIP. This is an expansion that was included in the 1998 CHIP legislation that was contingent upon receiving the necessary federal approval or reaching a threshold of 50 percent Medicaid managed care enrollment. The State has now received federal permission to implement this provision and up to 80 percent of children now enrolled in CHIP (now called CHIP B) could be eligible for Medicaid benefits (now called CHIP A).

¹² 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.

¹³ Division of Budget states that estimated enrollment for 2002-03 is actually 620,000.

Monthly CHIP Enrollment



The Executive recommends total CHIP funding of \$1.05 billion in 2002-03, representing an increase of \$306 million over estimated 2001-02 levels or growth of more than 40 percent. This growth is attributable to enrollment growth of about 15 percent and the increased cost associated with the CHIP financed Medicaid benefit since Medicaid managed care rates are higher than CHIP rates.

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. 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. New York's full benefit of this reallocation was threatened last year but ultimately the redesigned reallocation provided \$435 million to New York from the 1998 unused funds. It is also estimated that New York would receive significantly more than \$300 million from 1999 unused funds.¹⁴

¹⁴ An estimated \$2 billion in federal 1998 SCHIP funding was unspent and set to be reallocated in October 2000. In April 2000, 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 than \$400 million in federal funding for New York in 2000-01. 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.

Through June 30, 2003, the State portion of CHIP funding comes from the Health Care Initiatives Pool contained in Health Care Reform Act of 2000 (HCRA 2000).

Child Health Insurance Program Summary
(Millions)

Program	Actual 2000-01	Estimated 2001-02	Proposed 2002-03	Difference	Growth
Federal Funds	450	419	619	200	47.7%
State Funds	267	325	431	106	32.6%
Total Spending	717	744	1050	306	41.1%

Source: OSC

Prescription Drugs

Drug costs have dramatically escalated in recent years. In 1999, drug spending increased 18 percent and has averaged more than 10 percent per year since 1995. During the same period, overall health care spending has increased only 5 percent. 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 65, does not generally cover prescriptions that are administered outside of a hospital setting. 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. For several years, there were eligibility expansions scheduled to take place that the Governor consistently proposed repealing. Each year the Legislature would agree to a temporary deferral of the program enhancements. In 2000, given the difficulties many seniors have had in purchasing needed prescriptions, the Legislature expanded the program. 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; and, 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. Program enrollment has increased from approximately 114,000 in January 2000 to 161,000 in January 2001 to 245,000 today.

Total funding for EPIC is projected to increase to \$458 million in 2002-03, representing an increase of \$47 million, or 11.7 percent. The increase is primarily

attributable to the program expansion, increased enrollment, and increasing drug costs and utilization.

Elderly Pharmaceutical Insurance Coverage (EPIC)
(Millions)

Program	Actual 2000-01	Estimated 2001-02	Proposed 2002-03	Change	Growth
General Fund Support	50	\$136 ¹⁵	\$0	(\$136)	(100%)
State Funds Support ¹⁶	38	\$95	\$111	\$6	6.3%
HCRA State Funds	137	\$170	\$347	\$177	104.1%
Total Spending	225	\$401	\$458	\$47	11.7%

Source: OSC

Chapter 1 of the Laws of 2002, included cost containment actions that reduce program spending by approximately \$44 million in 2002-03. These savings include: \$35 million from lowering the pharmacy reimbursement rate from 95 percent to 90 percent of the average wholesale price (AWP); \$6.6 million from bringing manufacturer's rebates in line with the Medicaid program; and, \$2 million from requiring private insurers that cover EPIC enrollees to match enrollee files to ensure that EPIC is the payer of last resort.

¹⁵ This figure assumes a \$40 million deficiency appropriation reflecting legislative rejection of the proposed cost containment.

¹⁶ Includes enrollment fees and drug rebates.

HEALTH CARE REFORM ACT (HCRA)

Summary

Chapter 1 of the Laws of 2002, sometimes referred to as HCRA 2002, is a three year plan¹⁷ that improves health care by addressing the workforce shortage, expanding coverage for women and the disabled, and by making some progress toward simplifying and streamlining the State's health insurance programs (see appendix 1 for details on all HCRA funding streams). These positive changes include:

T Health care worker recruitment and retention. Additional resources are provided through grants and higher Medicaid reimbursements that will be used to enhance direct care staff salaries in hospitals, nursing homes and home care agencies.

T Medicaid coverage for women diagnosed with breast cancer through the CDC. Medicaid coverage is expanded for women with incomes below 250 percent of the poverty level.

T Medicaid coverage for the disabled. Medicaid coverage is broadened to cover the disabled with incomes below 250 percent of the poverty level. Many disabled currently have to choose between work and health insurance coverage.

T Community Health Centers. The Governor's original proposal did not include funds that would allow clinics to increase worker salaries. At the Legislature's insistence, this was included in the final package. Clinics play a very important role in providing health care in many communities and it is vital that they be able to attract and keep health care staff.

T Health Care Foundation. The Governor's original proposal did not include the creation of a foundation to improve health care. At the Assembly's urging, the final package establishes a foundation that will receive five percent of the proceeds from the conversion of Empire to a for-profit company.

However, the legislation is disappointing in a number of ways:

T Empire Conversion. HCRA funding relies on this non-recurring resource. Proceeds from the conversion will fund HCRA beginning next year, for the next three years. A number of States have dedicated the all proceeds, or large portions, to fund permanent, independent, on-going health care foundations.

T Federal Medicaid increase (FMAP). The multi-year plan includes an increase in the federal share that is highly unlikely. Although HCRA has a built-in excess of

¹⁷ Rate increases for personal care services are provided for four years.

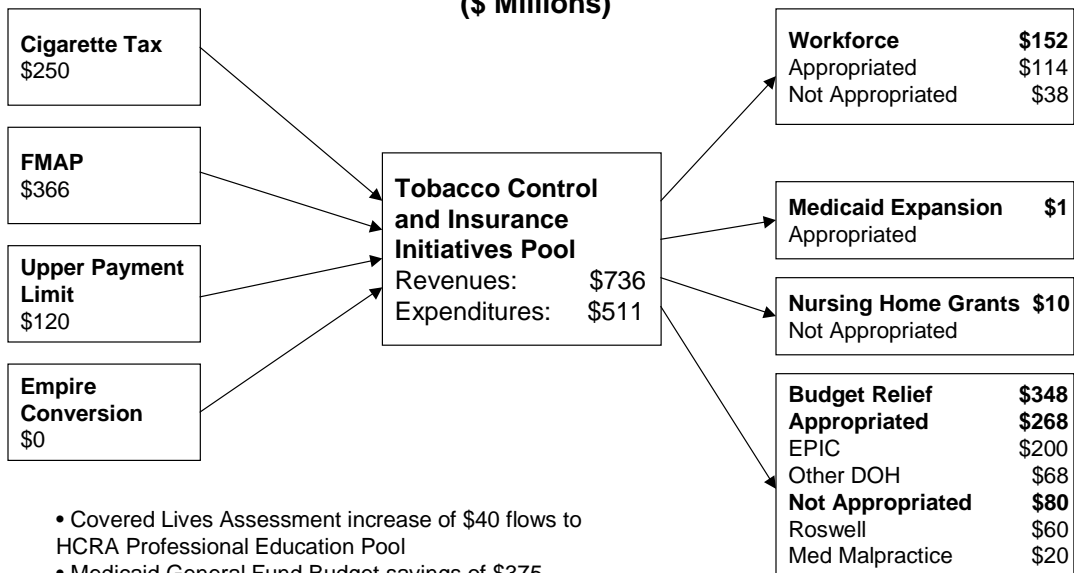
revenues over spending, this cushion is not sufficient to ensure funding for all HCRA programs if the FMAP increase is not obtained.

HCRA Budget Relief. Over the next three years, almost \$1 billion in new HCRA resources are used to pay for programs that were supported by the General Fund and do not support new health related programs.

Additional Budget Savings. Over the next three years, approximately \$1.3 billion in State budget savings is provided. These provisions would normally be proposed and acted upon as part of the normal budget process in the context of the entirety of all the State’s needs. The bulk of the savings is attributable to new revenues from a gross receipts tax on nursing homes, which has a negative impact on many nursing homes despite the Medicaid reimbursable nature of the tax.

Local Government Budget Impact. The Governor estimates that his proposed budget, combined with the HCRA amendments just enacted, has a positive impact on local governments. However, this positive effect is dramatically reduced if an increase in the FMAP is not achieved.

HCRA Amendments Estimated Fiscal Impact FY2002-03 (\$ Millions)



- Covered Lives Assessment increase of \$40 flows to HCRA Professional Education Pool
- Medicaid General Fund Budget savings of \$375
- EPIC cost containment savings of \$43

New Programs funded by HCRA

Workforce Recruitment and Retention Program

The proposal would provide funding to support recruitment and retention of non-supervisory workers at health care facilities or supervisory workers who provide direct patient care in the hospitals, nursing homes, free-standing clinics, and personal care. The funds are provided in three ways: increased Medicaid rates distributed proportionately Statewide based upon facilities total gross salary and fringe benefit costs; grants for public facilities distributed proportionately Statewide based upon facilities total gross salary and fringe benefit costs; and, Medicaid increases distributed through an RFP process to improve quality. The following table summarizes total funding.

New HCRA Workforce Funding on a Calendar Year Basis
(\$ millions)

Provider Type	2002	2003	2004	Three Year Total	Four Year Total
Non-Public Hospital Medicaid Rates	\$93.3	\$188.2	\$262.6	\$544.1	\$544.1
Public Hospital Grants	\$18.4	\$37.0	\$51.7	\$107.1	\$107.1
Hospital Medicaid Quality Demo	\$15.0	\$15.0	\$15.0	\$45.0	\$45.0
Non-Public Nursing Homes Medicaid Rates	\$53.5	\$83.3	\$115.8	\$252.6	\$252.6
Public Nursing Home Grants	\$7.5	\$11.7	\$16.2	\$35.4	\$35.4
Nursing Home Medicaid Quality Demo	\$62.5	\$62.5	\$62.5	\$187.5	\$187.5
NYC Personal Care Medicaid Rates	\$110.0	\$185.0	\$260.0	\$555.0	\$895.0
Non-NYC Personal Care Medicaid Rates	\$7.0	\$14.0	\$21.0	\$42.0	\$69.0
Clinic Medicaid Rates	\$13.0	\$13.0	\$13.0	\$39.0	\$39.0
Total	\$380.2	\$609.7	\$817.8	\$1807.7	\$2174.7

Source: OSC

The State share of these costs is estimated to be approximately \$630 million for the three-year period and \$777 million for the four-year period. In addition to the workforce program, the legislation also provides:

Nursing Home Financially Distressed Grants provide \$10 million annually over three years to nursing homes that demonstrate financial need in order to promote financial stability and quality improvement initiatives. These awards are not made on a competitive basis and no clear eligibility criteria are provided in law.

Medicaid Expansions for the Disabled and Breast and Cervical Cancer provides Medicaid coverage up to 250 percent of the Federal Poverty Level (FPL) to uninsured and underinsured women diagnosed with breast cancer or cervical cancer by the CDC and to disabled persons. These important expansions were contained in both the Governor's and the Legislature's proposed budgets last year but were not enacted. The expansion for women takes effect October 1, 2002; however, the expansion for the disabled does not become effective until April 1, 2003.

Existing Programs To Be Funded Through HCRA

Over the next three calendar years, almost \$1 billion in General Fund relief is provided because new HCRA dedicated revenues are replacing funding that had or would have come from the State's General Fund. This relief includes the following:

- T The transfer from the HCRA pool to the Elderly Pharmaceutical Insurance Coverage (EPIC) program is increased from \$189 million to \$307 million for April 1 through December 31, 2002 and from \$108 million to \$207 million for January 1 through June 31, 2003. When these increases are extrapolated for a full three calendar years the budget relief exceeds \$500 million.
- T The transfer from the HCRA pool to the Health Care Service Account for various public health programs is increased from \$41 million to \$81 million for April 1 through December 31, 2002 and from \$20 million to \$65 million for January 1 through June 31, 2003. When these increases are extrapolated for a full three calendar years the budget relief is over \$200 million.
- T Payments to Roswell Park Cancer Institute are increased from \$40 million to \$85 million for April 1 through December 31, 2002 and from \$20 million to \$43 million for January 1 through June 31, 2003. When these increases are extrapolated for a full three calendar years the budget relief is over \$130 million.
- T The Excess Medical Malpractice program for subsidized insurance for physicians is continued and expanded and funded by HCRA. The legislation provides HCRA funding of \$50 million for April 1 through December 31, 2002 and \$28 million for January 1 through June 31, 2003. When these increases are extrapolated for a full three calendar years the budget relief exceeds \$160 million. In prior years, funding for this program was non-General Fund; however, it is likely that the General Fund would have provided the additional resources.

Revenue Sources to Support HCRA

Empire Conversion proceeds are estimated at upwards of \$1 billion. HCRA receives 95 percent of the proceeds; the remainder is assigned to a charitable foundation whose mission would be to expand or to enhance access to health care for the uninsured or underinsured. The Empire conversion results in the issuance of stock, which is expected to be redeemed over three years, beginning next year.

Federal Medical Assistance Percentage (F-MAP) Despite New York's high need and high local tax burden, New York State has received the 50 percent federal Medicaid reimbursement rate for decades – the lowest possible federal share. Forty-one other states have higher matching rates. State savings resulting from an increase in the FMAP would support HCRA. The plan relies on approximately \$1.8 billion in State savings from a FMAP increase to 53 percent. In addition, local governments would receive an estimated \$900 million in savings over the next three years.

Cigarette Tax Increase of 39 cents, from \$1.11 to \$1.50 per pack. The increased cigarette tax is expected to generate about \$250 million annually over the next three years to fund HCRA programs. The tax increase takes effect April 1, 2002.

Increase Medicaid Upper Payment Limit to 150 Percent for inpatient and outpatient services of public hospitals. This would allow the State to maximize \$121 million in federal funding for one year.

Covered Lives Assessment scheduled decrease is eliminated resulting in an assessment increase of \$40 million in 2002 and \$60 million in 2003. This assessment supports the HCRA Medical education pool.

Additional Budget Relief

Nursing Home Assessments of 6 percent of gross revenues is re-established. The tax is reimbursable through Medicaid, which mitigates the impact for homes serving primarily Medicaid patients. However, for years the State has encouraged homes to maximize Medicare revenue and other private pay patients in order to reduce reliance on Medicaid. For many of these nursing homes that have diversified their revenue base, the nursing home assessment will have a very detrimental effect on their bottom line. It is possible that instead of increasing worker recruitment and retention, the imposition of the losses from this tax could result in staff layoffs and have exactly the opposite effect that the legislation intended.¹⁸

Medicaid Pharmacy Policy is changed to mandate generic substitution of brand name pharmaceuticals in Medicaid unless a physician secures prior approval from the department. This is estimated to save the State \$2.5 million in SFY 2002-03.

¹⁸ The Department of Health released estimates of the overall fiscal impact of HCRA 2002 on each facility. However, these estimates rely on assumptions that are incorrect for a number of homes. In fact, in some cases, the net positive impact projected by the State is actually a revenue loss.

Maximize Federal Medicaid Funding by increasing the Hospital Inter-Governmental Transfer (IGT) for public hospitals and updating the base year and extending the 100 percent Upper Payment Limit to outpatient Services.

Early Intervention program will require insurance companies to cover appropriate medical and therapeutic services. This is expected to result in savings of \$5 million.

Elderly Pharmaceutical Insurance Coverage (EPIC) program pharmacy reimbursement is reduced to mirror that of the Medicaid program and require private health insurers to match membership files to maximize third party coverage. This provides savings of \$43 million in SFY2002-03.

Fee Increases for Certificate Of Need (CON) applications and for copies of certain medical records.

Streamlining Child Health Plus, Family Health Plus and Medicaid

For years Comptroller McCall and the Assembly majority have been advocating for an overhaul of the enrollment and recertification process for the State's health insurance programs. There are approximately three million New Yorkers that do not have health insurance. A report released by the Office of the State Comptroller in July 2001, demonstrated that over half of New York's uninsured are currently eligible for free or low-cost health insurance in State programs. Many do not have health coverage because signing-up for these programs is complicated and difficult and the process for recertifying eligibility is also hard to navigate. Comptroller McCall made a number of specific recommendations that would breakdown some of these barriers and simplifies and streamlines these programs.¹⁹ HCRA includes some of these recommendations and provides for the following:

- T Eliminating the face-to-face interview during the recertification process for the Medicaid program;
- T Directing DOH to develop a simplified recertification form for persons renewing coverage in the Child Health Plus, the Family Health Plus, and the Medicaid Program; Allowing persons who are applying for community based Medicaid to self-attest to their resource level; and
- T Permitting individuals to self-attest to income during the recertification process in the Child Health Plus B program.

These are all very positive changes. However, more should be done. In fact, the transition of Disaster Relief Medicaid recipients to permanent programs could be made more smoothly if these changes were implemented sooner and the face-to-face interview requirement was suspended for new enrollments.

¹⁹ The Uninsured: More than 3 Million New Yorkers at Risk. Office of the State Comptroller. July 2001.

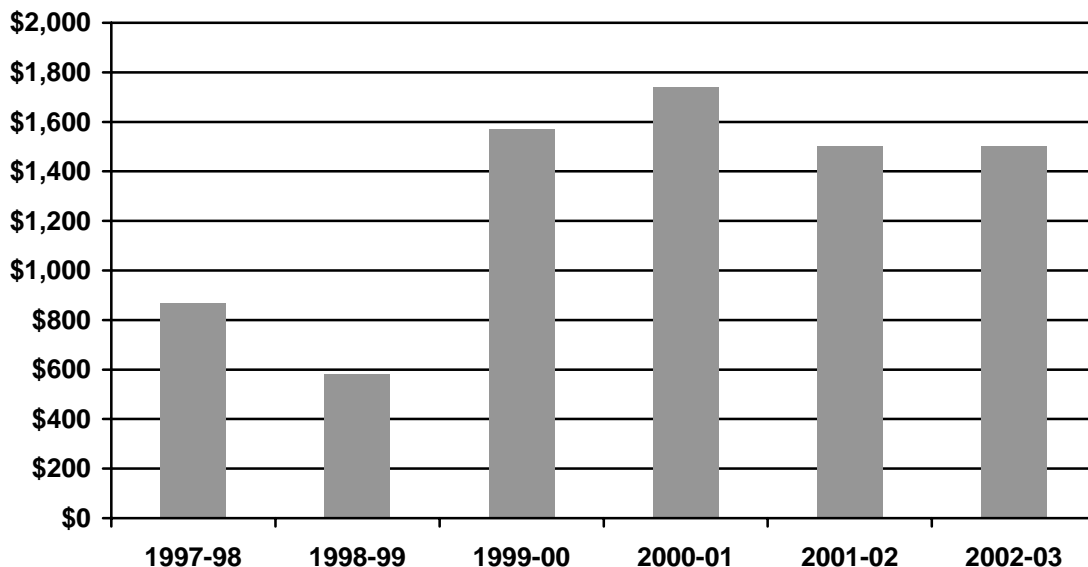
SOCIAL SERVICES

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.

Federal funding is provided to New York through an annual block grant of \$2.4 billion, which is based on 1995 public assistance caseloads. Since that time, caseloads have declined and less than half of the block grant is spent on direct family assistance. 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 2002-03, the Executive estimates that it will be \$1.5 billion.

**Available TANF Surplus Monies
(\$ Millions)**



The TANF block grant, which expires September 30, 2002, is up for federal reauthorization this year. Congress has indicated that they intend to debate the formula used to determine the amount of the block grant and evaluate how states used their TANF funds. Since enactment of federal welfare reform, the federal government has been

concerned about the degree to which states have supplanted their own spending with federal TANF funding and the amount left unspent by states.

Considering pending Congressional review of the program, New York must be careful making sure TANF funds are spent appropriately. A reduction in the size of the federal TANF block grant could force New York and its localities to either reduce funding for services or to increase their own spending to help families become self-sufficient.

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 requirement is split equally between the State and local governments. Both the State and local governments are not expected to reach the required MOE in 2002-03 and must therefore increase State and local spending to comply with the federal requirement.

TANF Surplus

In State fiscal year 2002-03, the Executive proposes \$2.4 billion in TANF surplus spending. This is based on this year's TANF surplus (\$1.5 billion), complete depletion of TANF reserves (\$885 million) accumulated over the past five years and use of other unspent TANF funds. Unlike prior years, the Executive Budget does not set aside funds for future needs.

The Executive proposes some new measures that provide federal funding for programs previously funded by the State's General Fund, including \$50 million to fund the Pre-Kindergarten program and \$345 million to fund the Tuition Assistance Program.

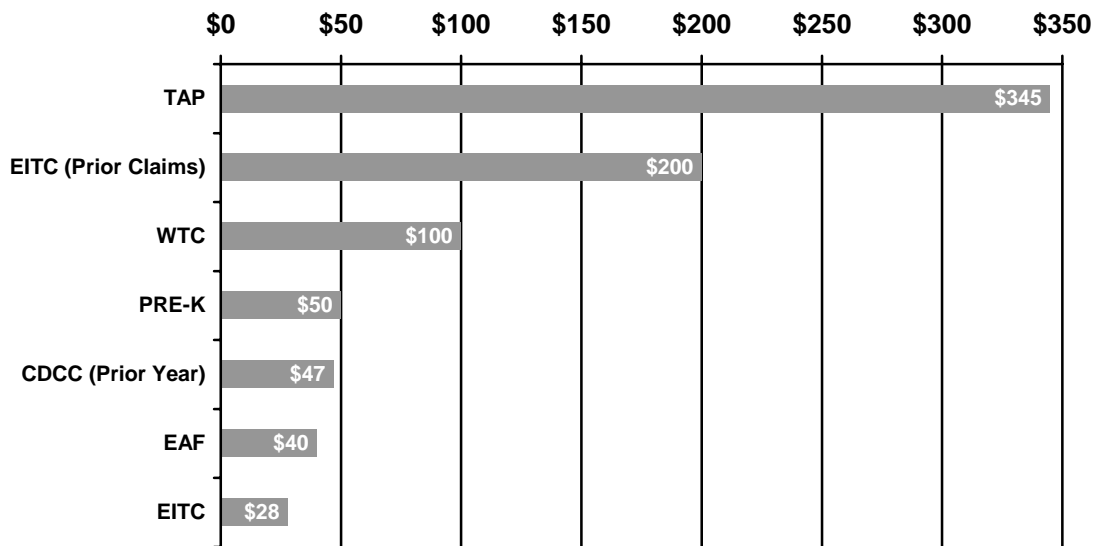
The 2002-03 Executive Budget calls for using \$1.7 billion in TANF funds to fund programs that would otherwise be paid for by the general funds of the State and local governments. The largest components include the Earned Income Tax Credit (EITC), a Social Services Block Grant (Title XX) transfer, Tuition Assistance Program (TAP) funding, and Pre-Kindergarten funding.

- T 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 \$323 million in 2001-02 and will grow to an estimated \$351 million in 2002-03. In 2002, the EITC was increased to 27.5 percent of the federal credit and will be further increased to 30 percent in 2003. The Executive is also claiming approximately \$200 million in prior year EITC costs. By the time the expansion of the EITC is fully implemented, it should be fully funded with resources made available from federal funding.
- T The World Trade Center MOE relief provides \$100 million in State and local General Fund relief by reducing the State and local MOE requirements from \$1.7 billion to \$1.6 billion. These savings are contingent upon federal legislation being introduced and passed.

- T 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. In 2002-03, the Governor plans no funding increase for the program and keeps spending at \$241 million.

- T The Tuition Assistance Program (TAP) awards money to low-income eligible college students to help pay tuition. The Governor's proposal does not expand eligibility or increase the amount of the award, but instead replaces \$345 million in General Fund spending with federal funds. In addition, the Governor proposes deferring one-third of the TAP award until the college student graduates (see section on Higher Education).

**Proposed Allocation of TANF Surplus
Significant Funding Changes
(\$Millions)**



Other uses of the TANF surplus include:

- T \$304 million to the child care block grant. As has been the case for two years, TANF funding remains the same as the current fiscal year.

- T \$125 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). While this represents a net gain, the Governor eliminates funding for certain programs in order to increase the employment block grant. TANF funding is eliminated for

transportation, drug screening treatment, DV screening, and the Youth Enterprise programs.

- T \$119 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).

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

Program	2002-03
Child Welfare (Title XX, local JD/PINS, NYC foster care tuition)	\$547
Earned Income Tax Credit (EITC)	\$351
Tuition Assistance Program (TAP)	\$345
Child Care	\$304
Prior Year MOE Reconciliation/Audit Recoveries	\$216
Earned Income Tax Credit (Prior Year Claims)	\$200
Employment/Transitional Initiatives	\$125
Services/Education/Health	\$119
World Trade Center MOE Relief	\$100
Child and Dependent Care Credit (CDCC)	\$87
Pre-Kindergarten Program	\$50
Child and Dependent Care Credit (Prior Year Claims)	\$47
Total	\$2,491

* Includes \$991 million in funding from prior years
Source: Division of Budget

Program Elimination

The Executive also proposes eliminating TANF funding for certain programs, including:

- T Transportation initiatives. Last year, \$10 million was spent on helping low-income families to go between their homes and work by providing low interest car loans, assisting in getting driver’s licenses and car insurance.
- T Drug Screening programs. Last year, \$15 million was provided to help treat individuals with drug and alcohol addiction.
- T Domestic Violence screening. Last year, \$8 million was spent on helping local districts screen, assess, and provide referrals.

Caseloads

Between 1995 and November 2001, public assistance caseloads in New York have fallen by 58 percent. Unlike in years past, caseloads are now projected to increase.

The Executive projects that in 2002-03 caseloads will increase slightly as a result of the downturn in the economy.

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 61,000 recipients, who have met the 60-month limit, will transition from family assistance to safety net programs in fiscal year 2002-03.²⁰ In 2002-03, the Executive projects the number of family assistance recipients will increase slightly by 1.4 percent to 570,620 and the number of safety net recipients will increase by 4.7 percent to 116,838.

Temporary Assistance Caseloads

Program	2001-02	2002-03	Change	Growth
Family Assistance	562,820	570,620	7,800	1.4%
Safety Net	111,644	116,838	5,194	4.7%
Subtotal	674,464	687,458	12,994	1.9%
SSI	619,693	625,612	5,919	9.6%
Total	1,294,157	1,313,070	18,913	1.5%

Source: Division of Budget

In 2002-03, General Fund spending for safety net programs is expected to increase 6.5 percent to \$265 million, in part to meet the required MOE. The State share of Supplemental Security Income (SSI) is estimated to remain the same.

Assistance Programs: General Fund

(\$Millions)

Program	2001-02	2002-03	Change	Growth
Family Assistance	\$421	\$282	(\$139)	(33.0%)
Safety Net	\$248	\$265	\$17	6.9%
State Share of SSI	\$623	\$633	\$10	1.6%
Total	\$1,292	\$1,180	(\$112)	(8.7%)

Source: Division of Budget

²⁰ 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.

Child Care

The proposed 2002-03 budget increases total funding for the Child Care Block Grant by \$37 million to \$877 million, which includes a market rate adjustment for child care providers that went into October 1, 2001. It also supports an increase of 3,500 in child care subsidized slots to fund a total of 177,500. As was the case last year, the Governor proposes using \$304 million of the TANF to fund the grant. 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.

LOCAL GOVERNMENTS

The following section of this report examines the Executive Budget's treatment of municipal and county governments; school districts are addressed in the education section.

Unrestricted Aids

At \$562 million, General Purpose Local Government Assistance (Revenue Sharing) funding remains unchanged from last year. The \$22 million aid program for counties is continued.

A \$6.1 million reduction in Supplemental Municipal Aid is proposed, affecting 62 towns and villages and 3 counties. Other emergency aids (Emergency Financial Assistance to Eligible Municipalities and Emergency Financial Assistance to Certain Cities) continue at 2001-02 levels.

Other Actions

The Executive Budget proposes several mandate relief measures, including: An exemption to the multiple contracting requirement of the Wicks law, for school districts and BOCES; and revised binding arbitration guidelines that would give greater consideration to a municipality's ability to pay.

The Governor also proposes the creation of a task force to study local government efficiency. A similar task was undertaken in 2000-01, when an appropriation of \$250,000 funded a study of state mandates by the Institute for Local Government and Regional Growth. The Institute recommended increases in revenue sharing and highlighted the need for an inventory and in-depth review of all State mandates. It is questionable whether another study at this time will be helpful to New York State's local governments.

Budget Impact

The 2002-03 Executive Budget proposal claims savings of nearly \$707 million for local governments, but the majority of this estimated impact is questionable. The savings break down to a net benefit of \$179 million for counties, \$509 million for New York City, and \$25 million for school districts. As mentioned previously, a number of towns and villages will lose about \$6.3 million—most of which is attributed to cuts in their Supplemental Municipal Aid.

A large portion (\$219 million) of the savings estimated for local governments is identified as school aid. Of this, \$214 million is offered in the form of a loan against accumulated liabilities for prior year school aid claims. This is a budgetary gimmick, which does not reflect a new aid payment.

Another \$27 million in savings is tied to the proposed E911 surcharge. The plan would take current cellular fees (\$0.70 monthly) and allow them to support homeland defense activities. Counties (including New York City) would then be allowed to collect up to \$0.30 more in monthly surcharges on cellular and other wireless devices. The revenue generated from the new surcharge would be used to help cover local costs associated with emergency response. This proposal does not provide any real fiscal relief to local governments.

Another \$187 million of anticipated savings for local governments were calculated as part of the State's recently approved multi-billion dollar healthcare plan. However, the details of the proposal cause concern over the likelihood that benefits will be realized to the extent projected in the Executive Budget.

The plan, an expansion of HCRA legislation, provides additional funding for increases in healthcare worker staffing and salaries (along with a number of other healthcare initiatives), but at significant cost to local governments—nearly \$300 million over the next three years. The plan includes several revenue resources. However, the largest of these resources is contingent on Congressional approval of an increase (from 50% to 53%) in the federal medical assistance percentage (FMAP). That increase translates to nearly \$166 million of the \$187 million in estimated savings in SFY 2002-03. These changes to federal Medicaid reimbursement are not guaranteed, in fact, they may not even be likely. Yet, within the context of this budget proposal, they figure prominently in the ability to avoid a cost shift to local county governments.

Citing the impact of the World Trade Center attack, the State also seeks to lower its TANF Maintenance of Effort requirement by \$100 million. Despite the fact that such action is contingent on federal approval, budget documents claim a savings of \$50 million. Clearly, this is money local governments should not count on.

Once we account for all of those savings that, in all likelihood, will not materialize, and for those items that are inappropriately classified as savings (E911, school aid) the net benefit to local governments could fall to \$245 million—significantly lower than the relief claimed in the budget proposal.

Additional savings noted in the budget are tied to the spin up of prepaid cigarette tax payments, a lowering of the electronic transfer threshold, and the additional revenues generated by the increased sales tax on cigarettes.

DEBT AND CAPITAL

The capital plan submitted with the 2002-03 Executive Budget, compared to the prior capital plan, decreases the amount of non-federal capital paid for with State cash from 41.5 percent in 2002-03 to 38.6 percent. By 2006-07, State cash will finance only 32.6 percent of non-federal capital needs.

The new plan proposes to increase State-supported debt by \$3 billion over five years, from \$39.2 billion in 2002-03, to \$42.3 billion in 2006-07. State supported debt service will grow to \$4.8 billion by the end of the plan, an increase of approximately \$1 billion from 2002-03, (27 percent).

While there have been several positive developments that contribute to this year's capital plan, the State has continually passed by opportunities to incur debt responsibly. This capital plan continues the trend by reducing the use of pay-as-you-go and voter-approved General Obligation financing, while increasing State-supported debt for uses that will not provide the State with any material asset. While the use of personal income tax backed revenue bonds may materialize into lower debt costs, at this point it is unclear if the new bond structure will provide any savings at all. Furthermore, the Debt Reform Act of 2000 will not have a significant impact on borrowing practices for decades. In short, despite six years of prosperous economies and multi-billion dollar surpluses, the State currently holds 34 percent more debt than it did in 1995.

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 \$3.0 billion over a five-year period, from \$39.3 billion in 2002-03 to \$42.3 billion in 2006-07. The capital plan that was released following enactment of the 2000-01 budget assumed smaller growth in debt – an increase of \$2.6 billion from \$38.1 billion in 2001-02 to \$40.8 billion in 2005-06.

Projected State Supported Debt Outstanding
2002-03 Executive Budget Compared to November 2001 Capital Plan
 (Billions)

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
2002-03 Capital Plan	\$37.7	\$39.3	\$40.3	\$41.2	\$41.8	\$42.3
November 2001 Plan	\$38.1	\$39.1	\$39.9	\$40.4	\$40.8	NA

Source: Division of the Budget

Projected growth in debt service declines slightly when compared to the November capital plan update. The new capital plan projects that debt service expenses will grow from \$3.8 billion in 2002-03 to \$4.8 billion by 2006-07. These projected debt service figures compare to the latest actual figure of \$3.8 billion for 2000-01, which has increased 26 percent over the past six years.

Projected State Supported Debt Service
2002-03 Executive Budget Compared to November 2001 Capital Plan
 (Billions)

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
2002-03 Capital Plan	\$4.3	\$3.8	\$4.0	\$4.4	\$4.6	\$4.8
November 2001 Plan	\$3.9	\$4.2	\$4.2	\$4.3	\$4.4	NA

Source: Division of the Budget

Capital Spending

Total capital spending over the life of the new plan increases by about \$1.9 billion over the prior plan. Year-to-year spending under the new plan increases by \$501 million in 2002-03, \$342 million in 2003-04 and \$68 million in 2004-05, before declining in the last two years of the plan by \$400 million in 2005-06 and \$249 million in 2005-06.

Projected Capital Spending
2002-03 Executive Budget Compared to November 2001 Capital Plan
 (Millions)

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
2002-03 Capital Plan	\$4,553	\$5,054	\$5,396	\$5,464	\$5,064	\$4,815
November 2001 Plan	\$4,917	\$4,756	\$4,933	\$4,654	\$4,629	NA

Source: Division of the Budget

State Pay-As-You-Go

State pay-as-you-go spending, that portion of the capital plan paid for in cash with State dollars, is funded at a lower level than in the November plan. Under the new five-year plan, total State pay-as-you-go decreases by \$550 million as compared with the prior plan, thus continuing the trend of decreasing the use of State cash. Since 1995, the use of State cash to fund non-federal capital needs has dropped as low as 35 percent. The use of the Debt Reduction Reserve Fund temporarily increased the level to approximately 40 percent. The proposed capital plan will again reduce the proportion of State cash for non-federal capital financing from 38.6 percent in 2002-03 to 32.6 percent in 2006-07.

The largest year-over-year decrease of \$159 million occurs in 2004-05. This is primarily due to a decrease in State cash supported transportation spending, which also experiences an increase in federal support in that same year.

General Obligation Debt

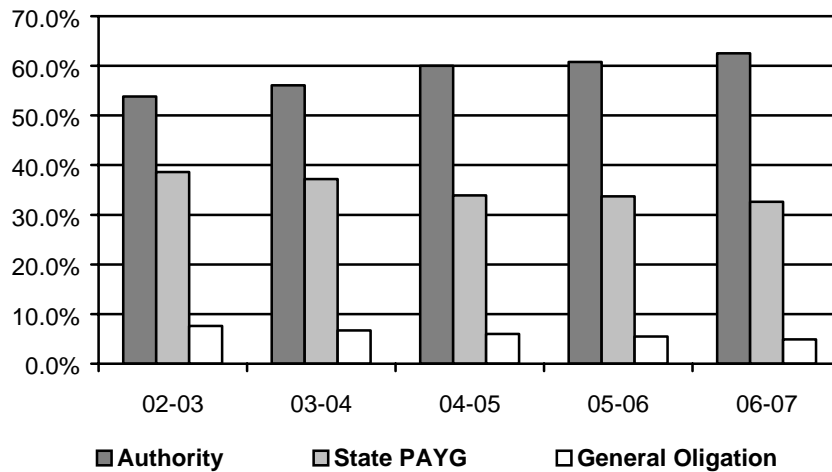
The proposed capital plan continues to reduce the use of voter approved, General Obligation financing to support its capital needs. Since 1995, the percentage of total outstanding State-supported debt that is voter approved has decreased from 22.7 percent to 12.6 percent in 2001-02.²¹ This capital plan continues the trend by reducing voter-approved debt to only nine percent of outstanding State-supported debt in 2006-07. On a yearly basis, in 2002-03, voter approved debt makes up 7.6 percent of non-federal capital financing. In 2006-07, this is reduced to only 4.9 percent.

Authority Financing

The use of authority-financed debt continues to increase. In 2002-03, “back-door” borrowing will make up 87.4 percent of outstanding State-supported debt. By 2006-07, this will increase to 91 percent. Although back-door borrowing has increased throughout the last 30 years, its level has increased by 144 percent during the last 10 years while outstanding debt has grown by only 88 percent. Throughout this capital plan, back-door borrowing increases on a yearly level beginning in 2002-03 at 53.8 percent of total non-federal capital financing to 62.4 percent in 2006-07.

²¹ The State borrowed \$5.3 billion between 1991 and 1996 through the Local Government Assistance Corporation (LGAC) to eliminate the need for spring borrowing (short-term tax and revenue anticipation notes). There is approximately \$4.6 billion outstanding. While it is State-supported, it is not included in outstanding State-supported debt when considering different financing proportions because it would falsely inflate the level of authority debt on a yearly basis.

Capital Plan - Financing Sources Non-Federal Capital Needs



Federal Funds

Federal funds spending is also projected to grow under the new capital plan, as a result of the 2003 Transportation Act and funding related to the attacks on September 11. Federal spending under the new plan would increase by a total of \$236 million, a decrease of \$73 million from the prior plan. Over the first three years of the plan, the projected increase in federal funds totals approximately \$444 million. Federal aid is projected to decrease \$214 million in 2005-06 and slightly increase by \$6 million 2006-07.

A factor contributing to the growth lies with certain 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 each year of the Department of Transportation’s (DOT) Capital Plan (which covers the years 2002-03 through 2006-07).

Capital Program

Specific areas of capital program spending are highlighted below. Transportation is the largest area of capital spending, accounting for approximately 57 percent of total spending, while environment, education and public protection also have significant capital programs.

- T Capital spending for transportation will average \$2.9 billion per year over the life of the plan. This includes over \$1.3 billion for local capital programs, \$80 million for the continuation of rail freight and passenger programs to improve rail systems, and \$31 million for DOT maintenance facilities and equipment.

- T Mass transit programs throughout the State are provided \$2.6 billion of State support, including \$2.5 billion for the Metropolitan Transit Authority provided through the Dedicated Mass Transportation Trust Fund.
- T Capital appropriations and reappropriations for the balance of the \$1.75 billion for the Clean Air/Clean Water Bond Act and \$125 million yearly appropriation from the Environmental Protection Fund, including a deficiency appropriation for SFY 2001-02. A proposed \$45 million in new appropriations for the Hudson River Park Trust Fund is for continued planning, design and construction of the Hudson River Park.
- T Capital appropriations and reappropriations totaling \$5.2 billion for SUNY/SUNY capital needs including health and safety needs, handicapped support, continuing infrastructure needs, and dormitory renovations.
- T New appropriations and reappropriations of \$1.8 billion for the Department of Correctional Services for maintaining existing facilities.
- T New appropriations and reappropriations of over \$1 billion for construction and preservation of the State's low- and moderate-income housing stock.
- T New appropriations and reappropriations of \$2 billion for mental hygiene capital projects.
- T Continued support to the Office of General Services for the renovation of existing State office facilities, including the Alfred E. Smith State Office Building, with a new appropriation of \$21 million for construction of parking facilities.
- T Redirection of \$60 million in Community Enhancement Facilities Assistance Program (CEFAP) bonding toward a total of \$250 million in resources to fund Centers for Excellence as well as research facilities, business incubators, and other high tech initiatives.
- T Up to \$750 million over the life of the plan for the new Empire Opportunity Fund for the purpose of financing economic development projects that either create or retain jobs in all areas outside of New York City.
- T Continued funding to replace the Harlem Valley Youth Facility.

Capital Spending by Function: 2002-03 Capital Plan
(Millions)

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Transportation	\$2,826.8	\$2,936.9	\$3,030.3	\$2,951.7	\$2,923.8	\$2,879.6
Environment						
Clean Water/Clean Air, EPF, Remedial Transfer Program	\$294.2	\$399.8	\$399.2	\$369.2	\$369.2	\$369.2
Federal/Other	\$413.1	\$407.0	\$404.7	\$433.7	\$421.4	\$413.5
Education	\$332.5	\$416.6	\$432.9	\$401.7	\$436.7	\$427.7
Public Protection	\$201.7	\$210.7	\$209.5	\$220.6	\$229.6	\$223.8
Mental Hygiene	\$180.3	\$200.9	\$202.5	\$181.7	\$171.7	\$171.3
Housing/Eco. Dev.	\$196.6	\$291.3	\$342.0	\$501.0	\$425.2	\$260.2
Other	\$108.7	\$191.2	\$375.5	\$404.6	\$86.1	\$72.6
Total	\$4,553.7	\$5,054.4	\$5,396.5	\$5,464.0	\$5,063.7	\$4,814.9

Source: Division of the Budget

Other Proposals

The Executive Budget includes statutory changes that the Division of the Budget expects will generate reductions in debt service and borrowing costs.

The Executive budget proposes expanded authority to issue variable rate debt and enter into interest rate exchange agreements. Currently, the Local Government Assistance Corporation, the Dormitory Authority, the Urban Development Corporation (in certain circumstances), and the Metropolitan Transit Authority (MTA) have the authority to enter into interest exchange agreements. The Executive's proposal will expand the authority to any other entity with the power to issue State-supported debt. It limits the combined total amount of variable rate State-supported debt and notional amount of interest rate exchange agreements to 15 percent of total principal amount of State-supported debt outstanding.

In defining "interest rate exchange or similar agreement", the proposal includes the use of swaps as an instrument to increase the State's variable rate exposure. Any authority authorized to issue State-supported debt is authorized to enter into such agreements.

The Executive proposal goes on to amend the existing statute regarding certificates of participation (COPS), currently used by the State to purchase or lease equipment. The proposal authorizes the use of revenue bonds in a similar structure for such purposes. COPS are issued as a pooled resource that is distributed via the Office of General Services. This proposal would work in much the same manner, but the new "pool" would be the proceeds of the newly created Revenue Bond, as created in Chapter 383 of the Laws of 2001, with debt service paid from the Revenue Bond Tax Fund.

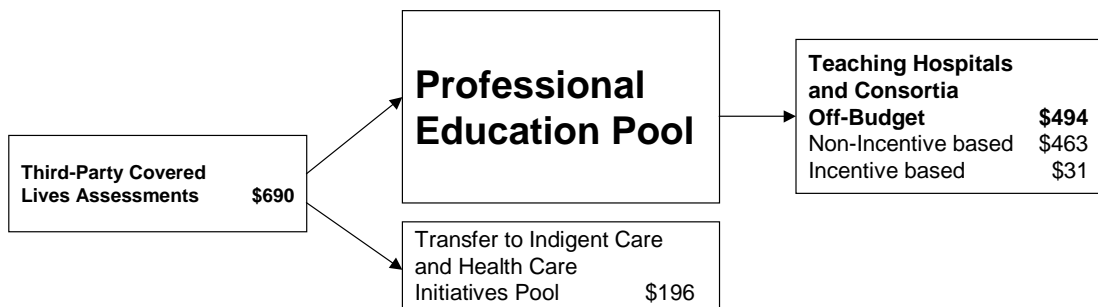
As part of the effort to close the projected \$5.7 billion gap, the 2002-03 financial plan depends on these proposals to provide the State with debt service savings. However, they are dependent on market conditions and the economy. While these proposals will certainly provide flexibility, actual savings are unknown.

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 four percent of personal income; the cap on debt service for new debt issued at five 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, ensure that one-half of all new debt is approved by the voters, and authorize multiple general obligation bond act proposals.²²

²² The Comptroller has called for constitutional debt reform since taking office. 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. The Comptroller's proposal goes further by providing meaningful debt caps, the creation of a debt management board, a ban on back door borrowing, and a public hearing requirement for the proposed capital plan.

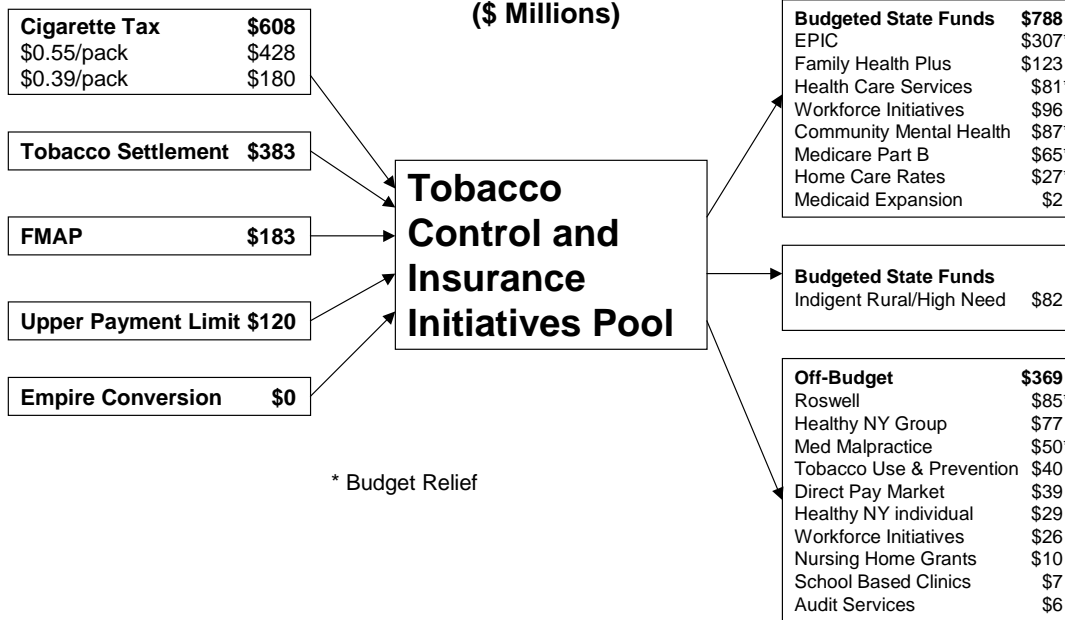
Appendix 1 – HCRA FUNDING STREAMS

HCRA 2000 Professional Education Pool CY2002 Annual State Funding (\$ Millions)



HCRA 2000 continued a professional education pool that receives monies from a regional covered lives assessment levied on third party payers that raises approximately \$690 million in calendar year 2002. HCRA 2000 amendments increased the Covered Lives Assessment by \$40 million in calendar year 2002 and \$30 million for the first six months of 2003. This funding supports graduate medical education for teaching hospitals and consortia (\$494 million). The remaining \$196 million is transferred the Indigent Care and Health Care Initiatives Pool. All of this funding is off budget and is not appropriated.

HCRA 2000 Tobacco Control and Insurance Initiatives CY2002 (\$ Millions)



The Tobacco Control and Insurance Initiatives Pool provides approximately \$1.3 billion in revenues for various health care initiatives or budget relief. However, these resources include an estimated \$183 million from additional federal Medicaid funds attributable to an increased FMAP. This funding is uncertain and if it does not materialize, some programs may be jeopardized in the short term.

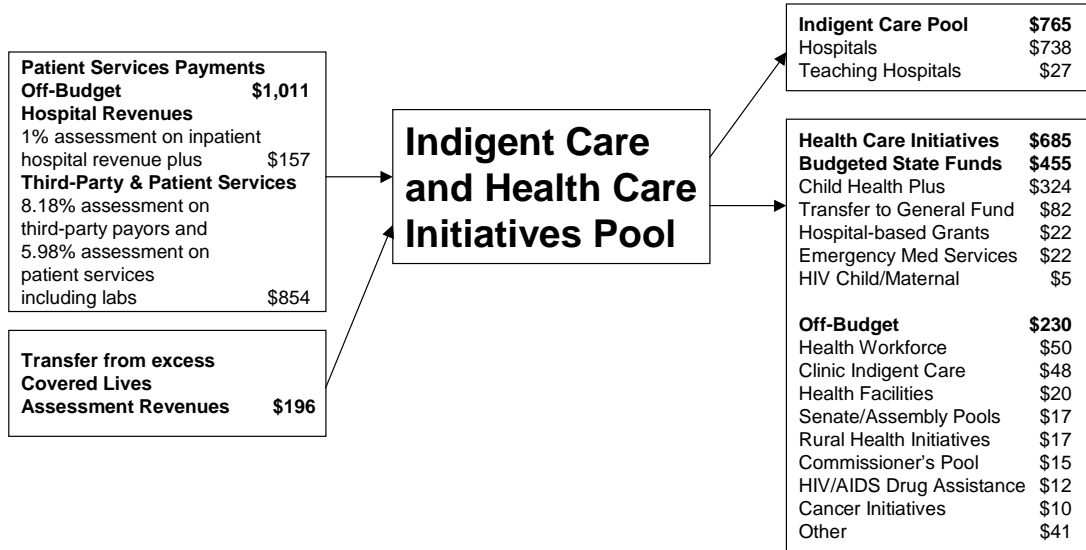
The Tobacco Control and Insurance Initiatives Pool provides funding for important programs like Family Health Plus, anti-smoking initiatives, workforce wage enhancements, and direct pay market subsidies. It also provides sizable budget relief totaling over \$700 million in calendar year 2002. Almost \$400 million in spending is not appropriated and is off-budget. Off-budget spending is subject to less oversight and public accountability.

HCRA 2000

Indigent Care and Health Care Initiatives Pool

CY2002 Annual State Funding

(\$ Millions)



The Indigent Care and Health Care Initiatives Pool is funded from two main sources: A transfer from excess Covered Lives Assessment revenues (\$196 million), and Patient Services Payments (\$1.01 billion). Expenditures from this pool go toward the Indigent Care Pool for hospitals and teaching hospitals (\$765 million) and health care initiatives (\$685 million). Off-budget items for workforce retention, health facilities, rural health and cancer initiatives are also included. These important initiatives include Child Health Plus and HIV/AIDS drug assistance. More than \$200 million in funding is off-budget and not appropriated.

**This report was prepared by the State Comptroller's
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