

*Report of the  
State Budget Crisis Task Force*

# NEW YORK REPORT







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**Paul A. Volcker and Richard Ravitch introduced the July 2012 Full Report of the State Budget Crisis Task Force with the following statement:**



## A Statement From the Task Force Co-Chairs

July 17, 2012

**CHAIRS:**

Richard Ravitch  
Paul A. Volcker

**MEMBERS:**

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Joseph A. Califano, Jr.  
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Our purpose in assembling the State Budget Crisis Task Force has been to understand the extent of the fiscal problems faced by the states of this nation in the aftermath of the global financial crisis. While the extent of the challenge varies significantly state by state, there can be no doubt that the magnitude of the problem is great and extends beyond the impact of the financial crisis and the lingering recession. The ability of the states to meet their obligations to public employees, to creditors and most critically to the education and well-being of their citizens is threatened.

The United States Constitution leaves to states the responsibility for most domestic governmental functions: states and their localities largely finance and build public infrastructure, educate our children, maintain public safety, and implement the social safety net. State and local governments spend \$2.5 trillion annually and employ over 19 million workers—15 percent of the national total and 6 times as many workers as the federal government. State governments are coping with unprecedented challenges in attempting to provide established levels of service with uncertain and constrained resources.

Within the limits of time and resources, we have examined the financial condition of six heavily populated states—California, Illinois, New Jersey, New York, Texas and Virginia. While each state varies in detail, a common thread runs through the analysis, supported by information available for states generally.

What we found will not be surprising to many knowledgeable observers, but the facts have never been assembled in a way that reflects the totality of the problems.

Certain large expenditures are growing at rates that exceed reasonable expectations for revenues:

- Medicaid programs are growing rapidly because of increasing enrollments, escalating health care costs and difficulty in implementing cost reduction proposals. At recent rates of growth, state Medicaid costs will outstrip revenue growth by a wide margin, and the gap will continue to expand.
- Pension funds for state and local government workers are underfunded by approximately a trillion dollars according to their actuaries and by as much as \$3 trillion or more if more conservative investment assumptions are used.

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- Unfunded liabilities for health care benefits for state and local government retirees amount to more than \$1 trillion.

The capacity to raise revenues is increasingly impaired:

- Untaxed transactions are eroding the sales tax base. Gasoline taxes are eroding as well, making it more difficult for states to finance roads, highways, and bridges.
- Income taxes have become increasingly volatile, particularly during and after the recent economic crisis.

The federal budget crisis will have serious spillover effects on state and local governments, and state actions will have spillover effects on local governments:

- Cuts in federal grant dollars, lower spending on federal installations, procurement, and infrastructure, and potential changes to the federal tax code all threaten states' fiscal stability.
- Pressures on local governments, caused by the weak economy and cuts in state aid, are constraining education spending, law enforcement, aid to the needy, and the institutions that make up the culture of our cities. Local government cuts pose a significant risk to the overall economic and social fabric of states.

State budget practices make achieving fiscal stability and sustainability difficult:

- While almost all states have constitutional or statutory balanced budget requirements, "revenue" and "expenditure" are not defined terms. The use of borrowed funds, off-budget agencies, and the proceeds of asset sales are not uncommon practices, often rendering balanced budgets illusory.
- The lack of financial transparency makes it more difficult for the public to understand the critical nature of problems such as pensions and other payment obligations. Temporary "one-shot" measures to avoid or delay hard fiscal decisions mask these underlying problems.
- Opaque and untimely reporting, coupled with nonexistent multiyear planning, severely hampers efforts to address these problems in a serious manner.

The Task Force is not in a position to propose changes in programmatic priorities, tax rates or structures to deal with budgetary problems. Such decisions are properly subject to the values and politics of a democratic society. Our essential goal is to inform the public of the gravity of the issues and the consequences of continuing to postpone actions to achieve structural balance. We do, however, believe that certain basic procedural approaches should be introduced and followed by all states and urge that prompt attention be given to financial relationships among all levels of government.

- The public needs transparent, accountable government. Individual states, existing associations of states, and advisory and standard-setting bodies should develop and adopt best practices to improve the quality and utility of financial reporting.



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- Multiyear planning and budgeting approaches should be a normal part of fiscal planning.
- States need better tools for managing over the business cycle. A priority for states should be better use of their existing counter-cyclical tools, including “rainy day” funds and repayment of debts in prosperous periods.
- Pension plans need to account clearly for the obligations they assume and disclose the potential shortfalls and risks they face. Legislators, administrators, and beneficiaries alike need to develop and adopt rules for the responsible management of pension plans and mechanisms to ensure that required contributions are paid. States should recognize and account for post-employment benefits, such as healthcare, that they intend to continue.
- Prompt attention is needed to the effects that federal deficit reduction and major changes in the federal tax system will have on states and localities.
- States that do not have suitable mechanisms to monitor and assist local governments experiencing fiscal distress should develop them.
- Looking ahead more broadly, the recurrent problems of state finances and the growing state fiscal imbalance suggest that more fundamental approaches require attention. Tax reform at the state level may be needed to achieve revenue systems that are adequate and predictable and that minimize volatility.
- The apparent growing gap between states’ spending obligations and their available financial resources points toward a need to reexamine the relationship between the federal government and the states.

The threats and risks vary considerably from state to state, but the storm warnings are very serious. Only an informed public can demand that the political systems, federal, state and local, recognize these problems and take effective action. The costs, whether in service reductions or higher revenues, will be large. Deferring action can only make the ultimate costs even greater.

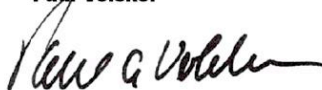
The conclusion of the Task Force is unambiguous. The existing trajectory of state spending, taxation, and administrative practices cannot be sustained. The basic problem is not cyclical. It is structural. The time to act is now.

Respectfully submitted,

**Richard Ravitch**



**Paul Volcker**



Chairmen



## *Foreword*

Former New York Lieutenant Governor Richard Ravitch and former Federal Reserve Board Chair Paul Volcker created the State Budget Crisis Task Force because of their growing concern about the long-term fiscal sustainability of the states and the persistent structural imbalance in state budgets, which was accelerated by the financial collapse of 2008.

After extensive planning and fundraising in 2010 and early 2011, Messrs. Ravitch and Volcker recruited a board of individuals with extensive and varied careers in public service and public policy. The Task Force was officially launched in April 2011.

In addition to the co-chairs, the board of the State Budget Crisis Task Force includes these members:

<b>Nicholas F. Brady</b>	<b>Joseph A. Califano, Jr.</b>
<b>Phillip L. Clay</b>	<b>David Crane</b>
<b>Peter Goldmark</b>	<b>Richard P. Nathan</b>
<b>Alice M. Rivlin</b>	<b>Marc V. Shaw</b>
<b>George P. Shultz</b>	

The executive director of the Task Force is Donald Boyd, on leave from his responsibilities as senior fellow at the Rockefeller Institute of Government. Ravitch and Boyd worked together to assemble a core team of experts with budget and financial planning experience at the national, state, and local levels and practical experience derived from the management of previous fiscal crises. The names of the full project team can be found on the Acknowledgements page at the end of this report.

The Task Force decided to focus on the major threats to states' fiscal sustainability. Since it was not feasible to study each of the fifty states in depth, we decided to target six states — California, Illinois, New Jersey, New York, Texas, and Virginia — for in-depth, onsite analysis. In each state, the core team worked closely with experts who were deeply familiar with the substance, structure, procedures, documents, and politics of the state's budget. The names of budget experts consulted in each state can be found on the Acknowledgements page at the end of this report. The core team and state experts conducted detailed inquiries into major issue areas including Medicaid, pensions, tax revenues, debt, the fiscal problems of local governments, and state budgeting and planning procedures. In doing so, the core team and state experts reviewed budget documents and data from the respective states and interviewed key budget officials.

The Task Force released its main report in July 2012, focusing on issues that cut across the six states. The Task Force also is preparing reports on individual states, including this report on New York.





## Summary

The State Budget Crisis Task Force's initial report in July 2012 analyzed six major fiscal threats and concluded that states cannot continue just "muddling through" without decisive actions. New York, as is the case with the other five states in the study, faces most of these threats. The Great Recession was a major shock and its impact still lingers, but the threats run much deeper: the recession laid bare the problems of structural deficits, poor fiscal practices, and unsustainable trends that existed before the downturn. These problems will not be reversed simply by improved economic circumstances. While the Task Force analysis of New York's fiscal condition highlights troubling trends, it also reveals efforts at corrective steps. These are important, but further determined political action is required.

New York's economy has experienced long term decline in older upstate cities, and sharp episodic shocks downstate. Buffalo, Rochester, and Syracuse have seen population losses of 55 percent, 37 percent, and 34 percent, respectively, since 1950. Meanwhile, New York City was ground zero for the terrorist attack on the World Trade Center on September 11, 2001, and in 2008, Wall Street suffered the greatest financial crash since the Great Depression. The New York City economy rebounded but the financial collapse and the Great Recession hit the state's fiscal condition hard because its finances rely extraordinarily on Wall Street. And in November 2012, New York City suffered the devastating effects of Hurricane Sandy.

For decades, regardless of the economy's strength, New York has had a structural budgetary imbalance, with recurring revenues insufficient to sustain ongoing spending. Rather than address the structural problems, New York lawmakers have struggled to wrench each upcoming year's budget into balance temporarily on a cash basis, through dependence on one-shot actions amounting to about \$25 billion in the past ten years alone. The New York State comptroller aptly termed this "The Deficit Shuffle," saying, "The State dips into dedicated funds here and shifts money over there, all to cover cash shortfalls and avoid making the difficult decisions needed...."

The 2012-2013 budget continues the use of temporary measures for balance. It contains \$4.5 billion in temporary resources, including temporary income tax provisions of \$2.6 billion, deferrals of business tax credits totaling almost \$1 billion, and borrowing for pension contributions of \$782 million. In addition, it counts on \$250 million in receipts from the conversion of health insurance carriers from nonprofit to for-profit status.

Temporary resources and gimmicks are natural elements in New York budgeting because the state budgets primarily on a cash basis and — despite quite sophisticated three-year projections — has paid little attention historically to long-run consequences when making annual budget decisions. Although New York State imposed strict rules on New York City during the 1975 fiscal crisis that require the city to balance its budget according to generally accepted accounting principles and to engage in serious multiyear planning, the state does not embrace those practices itself.

### **Medicaid Spending Crowding Out Other Needs**

One major fiscal threat facing all of the Task Force study states is rampant growth in Medicaid spending that may crowd out other needs. New York's Medicaid program is by far the largest, most extensive, and most expensive in the country. New York spends more of its own funds on Medicaid than Florida, Texas, and Pennsylvania combined. Its spending per enrollee at \$9,056 in 2009 was 69 percent higher than the national average of \$5,337. For many years New York created state

health care programs and leveraged the new entitlements into Medicaid to get 50 percent federal matching funds. Thus, the program provides greater access and more benefits than any other state.

The state's powerful "medical industrial complex" — providers, labor unions, and interest groups — promotes institutionalization of patients, which contributes to high provider costs. Nursing home care in New York City can cost well over \$100,000 per person per year. Similarly, in 2008 New York's cost per disabled Medicaid enrollee of \$30,267 was more than twice the national average of \$14,840. Several independent studies, as well as the state's budget division, indicate that the Affordable Care Act could generate a fiscal benefit for New York.

The state made reducing Medicaid spending growth a major priority in the fiscal year 2012 and 2013 budgets, enacting three novel provisions: (1) a statutory cap on growth in the Department of Health's state-funded Medicaid spending, linked to the ten-year average change in the medical component of the Consumer Price Index (CPI), recently about 4 percent; (2) a two-year appropriation for Medicaid that, if hewed to, reduces state funds spending in 2012 by \$2.2 billion from its trend, and would allow only a 4 percent increase from that level in 2013; and (3) extraordinary authority for the commissioner of health to make unilateral program changes to keep the Health Department's Medicaid spending within the cap. The state expects to achieve these savings through the efforts and proposals of its "Medicaid Redesign Team"; successful implementation of these savings relies upon federal approval of a large-scale waiver the state requested in August 2012.

The extent to which these provisions will control underlying health care costs, rather than simply shift costs to providers, and result in adverse consequences for quality or access to care remains to be seen. Also uncertain is whether the new technique of multiyear appropriations will continue.

### **Federal Deficit Reduction Threatens the Budget**

The federal government is poised to take significant action to rein in its budget deficit. This could affect New York and other states in three main ways: reductions or changes in grant programs could have direct adverse effects on state budgets; reductions in federal spending for procurement, the federal workforce, and other purposes could have adverse impacts on state economies; and changes in federal tax policies, such as eliminating deductions for state and local taxes or scaling back the tax exemption for interest on state and local debt, could dampen the state's ability to fund services and finance infrastructure. For example, the Congressional Budget Office reports that as of 2004, federally deductible taxes represented 27.8 percent of own-source revenues for the state of New York, compared to an average 17.4 percent for all state governments; such deductions represented an average 8.3 percent of adjusted gross income in New York, compared to 5.4 percent nationally. While some federal deficit reduction actions could have positive fiscal effects on states, particularly certain kinds of tax reforms that broaden the income tax base such as those adopted in 1986, the vast majority are likely to be negative.

New York is more vulnerable than most states to potential cuts in grants, particularly for social service programs, because it spends far more than the national average on such programs and receives much greater federal reimbursement. In the near term the biggest risk is sequestration of federal spending under the Budget Control Act, and Medicaid is exempted from that. But over the longer term Medicaid almost certainly will not be exempt from federal spending reductions, nor will other social programs. To illustrate the risk, if the federal government were to cut grants by 10 percent, New York State *and its local governments* would lose more than \$6 billion annually. New York's per-capita loss would be more than 50 percent

greater than the national average. Block granting Medicaid, as has been proposed by the Simpson-Bowles Commission and the U.S. House of Representatives, could have a significant and negative impact on New York.

## **Rising Retirement Costs**

Pension benefits in New York have strong constitutional and legal protections and create a binding legally enforceable contract between employer and employee, effective at the time of hire, the benefits of which cannot be diminished or impaired. New York's retirement systems are better funded than most, although the plans administered by New York City are not as well funded as the state administered ones.

Two unusual features of New York pension law and practice contribute to state administered plans that are well-funded under actuarial assumptions: the plans use a particularly conservative method for determining how much governments should contribute, and the law requires that governments pay what the pension systems request. This protects pensions but can stress governments: New York's Common Retirement Fund, which includes New York State and local governments outside New York City, increased employer contribution rates by 158 percent from 2010 to its scheduled 2013 payments; in total, employer contributions to the fund are increasing by more than \$3 billion annually. Other plans are raising contributions as well.

These strong funding provisions may be a reason why New York has resorted to gimmicks such as the euphemistically titled "pension amortization" law to stretch out rising contributions. Effectively, it allows the public employer to borrow from the pension fund to meet its contributions: governments can stretch out an annual contribution over ten years and be treated as if they paid their full contributions on time. Borrowing, by stretching out payments, results in a lower annual contribution in the short term and higher total payments over the longer term (with interest). Further, in 2012, the interest rate for such borrowing is 3.75 percent, which is lower than the 7.5 percent that the retirement system assumes it will earn on its assets. Not only is this a subsidy from the pension fund to the employer, it also puts some pressure on the fund to invest in higher risk assets in order to hit its overall target return. The overall impact on the retirement system of amortization is not major; the larger question is whether the system can earn 7.5 percent.

Reliance on "amortization" is a slippery slope from the perspective of the governments involved. In fiscal year 2013, the state borrowed \$782 million in this fashion, in addition to the total \$813 million in the prior two years. Nearly 150 other employers – mostly local governments – borrowed \$260 million in 2012 and 2013 combined. Further borrowings are likely. The work of the Task Force has shown that other states that have used such gimmicks year after year to finance or avoid pension contributions have created problems for their own finances and for their pension systems. New York governments should take heed from those experiences and not create similar problems here.

New York funds retiree health care costs, known as Other Post-Employment Benefits (OPEB), on a pay-as-you-go basis: that is, there are no reserves set aside for them. The state estimated that as of fiscal year 2012 total unfunded actuarial accrued liability in state plans was \$73.3 billion, including a state share of \$59.7 billion, a State University of New York share of \$12.4 billion, and a City University of New York share of \$1.2 billion. Unlike pension benefits, these benefits are not protected by the state constitution and can be changed; the costs are growing annually at about 8 to 10 percent. Unfortunately, the commitments and costs are not transparent or easily understood by most public officials or taxpayers and they constitute a potential major claim on future revenues.

## Revenue Erosion and Volatility

New York faces the twin problems of revenue erosion and volatility faced by the other states studied by the Task Force. The state relies on the sales tax for 16.6 percent of its tax revenue, compared to 32 percent nationally, so although the tax is eroding, the problem is not as major as elsewhere. Volatility is the more significant problem: Moody's Investors Service noted recently that the state's most significant financial challenges include "volatile state finances, due to above-average dependence on income taxes." Capital gains constitute a large share of income for high income taxpayers. Between 2007 and 2009 this income fell by \$81 billion, causing a loss of \$4.9 billion of state tax revenue. New York relies heavily on a relatively small number of very high income taxpayers and has increased this reliance with steeply progressive income tax increases adopted in response to the recession.

## Local Government Fiscal Stress

One theme of the Task Force report is that fiscal stress runs downhill. As a result, local governments are badly strained. In New York, local government is a complicated, costly, sprawling, and confusing mix: citizens may live under one, two, or three layers of general purpose governments, consisting of fifty-seven counties, sixty-two cities, 932 towns, and 555 villages. Counties in New York, unlike in other states, play an important role in financing Medicaid, and school districts are responsible for delivering K-12 education. Aid to K-12 education is by far the biggest portion of state aid (\$23 billion) and is the largest state-financed item in the state budget.

Local governments face significant problems, including that:

- Pension contributions and retiree health care costs have been rising rapidly;
- Sales tax revenue declined dramatically during and after the recession and is recovering only slowly;
- School aid growth will be capped at approximately 4 percent annually; and
- Property tax caps limit the ability to raise their own revenue in response.

Several large governments, including Nassau County, Suffolk County, and the cities of Syracuse and Yonkers, face major fiscal problems. New York City, while benefiting from a more robust economy, has been struggling to cope with rapidly rising "uncontrollable costs" — largely pensions and OPEB. The city's plan to generate extensive temporary resources by selling 2,000 new taxi medallions — \$625 million in fiscal year 2013, \$365 million in 2014, and \$460 million in 2015 was declared null and void by a judge of the state Supreme Court. The city is appealing the ruling, which threw the city's budget out of balance. The November 2012 quarterly update of the financial plan delays the receipt of these revenues until fiscal year 2014 and beyond and this year's balance has been restored with additional one-time audit and fee revenues plus half a billion dollars in new agency cuts. Further adjustments are likely in January 2013.

These pressures call into question the ability of local governments to make communities safe and attractive, and to support economic growth. As the mayor of Rochester testified in 2012, "Before we get to the point of financial failure, we will do substantial damage to the cultural and social environment that makes ... cities an attractive place to live. Cultural and social bankruptcy precedes financial bankruptcy."

## Education Needs

New York State's public elementary and secondary school system is expensive: average per-student expenditure was \$18,618 in 2010-2011 compared to \$10,615 nationally. On average, the state pays about 41 percent of the cost, localities

pay 41 percent, and the federal government pays 8 percent. New York has a long history of increasing state education aid and total education spending significantly except in the worst of times; from 2004 to 2009 total education revenue increased by 5.3 percent annually, even while enrollment was falling. But the 2011-2012 and 2012-2013 state budgets capped annual increases in education aid at the ten-year average growth rate in state personal income (approximately 4 percent recently). While one legislature generally cannot bind another, this sends a clear signal to school districts that future increases may be limited.

New York's system of public higher education is large, and includes two independent comprehensive systems: the State University of New York (SUNY) and the City University of New York (CUNY). SUNY's state operated campuses derive almost 40 percent of their income from direct state appropriations, while almost 60 percent of the income of CUNY senior colleges is from direct state appropriations. The relative level of state financial support has declined from a peak of \$1.5 billion in 2007-2008 for SUNY to \$1.2 billion in 2010-2011. In general, the state has allowed the universities to raise tuition only when the state budget reduced its support sharply; higher tuition has not been allowed every year that state support was reduced. Under reforms adopted in 2011, SUNY and CUNY are required to develop master plans for tuition rates that will allow annual increases, and the state is subject to maintenance of effort (MOE) requirements. The guarantee of annual tuition increases will provide incremental revenue to SUNY and CUNY provided the state abides by the MOE requirement. Over time, however, state support may erode because the MOE requirement is not adjusted for inflation.

### **Vast Infrastructure Needs**

Hurricane Sandy exposed the fragility of New York's coastlines and the aged condition of its fixed rail mass transit system and its power grids. The public costs to address these vulnerabilities could be overwhelming. Even before the storm, New York's infrastructure needs far outstripped available resources. Total state government capital spending is projected to decline marginally from \$9.7 billion in 2011-2012 to \$9.5 billion in 2012-2013. Only \$3 billion of New York's \$63 billion of bonded indebtedness in support of capital projects comes from voter-approved general obligation borrowing, which a debt-averse electorate makes difficult to achieve. The state must replace the fifty-six-year-old Tappan Zee Bridge, which carries 138,000 vehicles daily between Westchester and Rockland counties and is an essential link between the upstate and downstate economies. The estimated cost is at least \$5.2 billion and full details of a financing package are uncertain.

The other challenge is adequate, dependable funding for the capital needs of the Metropolitan Transportation Authority (MTA), which has been undergoing a thirty-year rebuilding and currently cannot meet future needs. The current and future cost from the devastation wrought by Hurricane Sandy is not yet fully estimated. The MTA's outstanding debt is expected to rise from \$31.8 billion at the end of 2012 to \$40 billion in 2016. According to the state comptroller, this "heavy reliance on debt burdens the operating budget..." The MTA's revenue is volatile, and its largest nonfare source, the regional Payroll Mobility Tax, budgeted for \$1.5 billion in 2012 and rising to nearly \$1.8 billion by 2016, has been narrowed through legislative changes and recently declared unconstitutional. While the ruling does not force the state to stop collecting the tax and the MTA is appealing, if it is upheld, alternative permanent revenues will be required.

Meeting state, local, and MTA investment needs is complicated by highly decentralized decision making. The state has a five-year capital plan. However, there are no policies to establish statewide priorities in it. Further, the plan excludes local government and most public authority capital spending. The state does not mandate that local governments prepare and update a comprehensive capital plan. New York City, as a result of the reforms following the 1970s fiscal crisis, has a large,

organized, and well documented capital budget and financial plan grounded in a ten-year capital plan as well as an inventory of assets.

## Debt

New York uses debt extensively – to finance capital needs, occasionally to finance operating deficits, and it has used debt to finance local assistance. The state’s total long term debt, relative to the size of its economic base, is among the highest of any state. But, a mere 5 percent of this debt was issued as a general obligation of the state. Under the state constitution, the state only can issue general obligation (GO) bonds, which must be for a single purpose, if voters approve in a statewide general election. Transportation bond issues, for example, have widely varying regional benefits, which makes garnering voter support statewide difficult. In the last eighteen years only four GO bond proposals have been put before the voters, and only two were approved.

To expand its debt capacity New York has used moral obligation bonds, service contract bonds, and lease-backed bonds that do not require voter approval but depend on annual state appropriations for debt service. In recent years, New York has relied on other complex mechanisms to finance capital that also do not require voter approval. These mechanisms usually require a state public authority to issue debt that is secured by appropriations from a state revenue source, mostly the personal income tax. Avoiding voter approval also reduces accountability. In addition, by drawing on state tax revenue sources, these mechanisms constrain the state’s financial flexibility. Although only 5 percent of the state’s debt is general obligation debt, to respond proactively to the unavoidable lessons of Hurricane Sandy, the state may need to put infrastructure bonding before the electorate and make the case for broadly supported general obligation debt.

## Conclusions

In sum, New York has had a structural deficit, papered over with gimmicks, for decades. The state budget is very pro-cyclical: when the economy is booming, so is spending; when times are bad, revenues crash and spending remains. Spending is dominated by America’s most expensive Medicaid program and the highest education spending per pupil. Albany has increased dependence on a small group of very wealthy taxpayers to keep the state going, which worsens revenue volatility and budget instability and heightens the state’s exposure to risks outside its control. The state does not use the limited reserves it has to help it through difficulties nor has it successfully designed and built a reliable system of reserves. There is no assurance that the state’s structural deficit is sustainable.

Two challenges loom large: a huge, aged, and often obsolete physical infrastructure, particularly transportation, and a growing number of illiquid cities and counties with their own structural budget deficits bending under the weight of unique spending burdens such as the local share of Medicaid, legacy costs, and a new limit on property tax growth, coupled with declining population and economic dislocation. The state government is aware of threats to the solvency and dynamism of local governments and has taken some action, but much more needs to be done.

New York is one of only fifteen states that require local governments to contribute to Medicaid funding, and this funding is huge. Since New York provides some services that are not federally reimbursable, New Yorkers are paying for 55 percent of total Medicaid spending (rather than the 50 percent federal match rate). New York City (five counties) and the state’s fifty-seven other counties pay about 16 percent of the Medicaid total while the state pays the remaining 39 percent. In some rural counties the payment for Medicaid can exceed half of the entire budget. Over time, the state has been lowering the county share of this burden. Annual increases imposed on the counties are now capped at 3 percent per year. A provision of



the 2012-2013 budget reduces this cap to zero over *three years*, which will increase state spending by \$370 million by fiscal year 2015 if it is sustained.

The new legislated cap on Medicaid growth and the cap on school aid growth are significant changes that, if implemented as planned and sustained, could improve the *state government's* long term fiscal outlook markedly. But without further substantial reforms, these changes are not enough for state and local finances, more broadly, to be sustainable. The Medicaid cap shifts much of the risk of rapidly growing health care costs to providers in the short run, and perhaps to Medicaid beneficiaries over the longer run. It needs to be coupled with concerted sustained efforts to control and manage the underlying costs of delivering health care. The cap on the growth of education aid puts school districts on notice that they will have to control costs — costs driven in substantial part by hard-to-control spending on pensions and retiree health care. At the same time, the state has limited their ability to raise revenue. The education aid cap needs to be coupled with actions to make it easier for school districts to control costs, which are largely personnel, if revenue limits are not to result in service deterioration.

Finally, in recognition that local governments are facing a rapidly deteriorating fiscal future, the state comptroller has strengthened his oversight of them and instituted an early warning system of sorts. But, when the alarm bell rings, will New York have any adequate response?

## *Background*

The State of New York has been losing population and political power to the rest of the country over the past fifty years.<sup>1</sup> In 1960, the state was the first in the nation in population; it is now third (after California and Texas and only slightly ahead of Florida). In 1960, New York had the most jobs in the country: 6.2 million, 1.3 million greater than California (the next highest state); now it ranks behind California and Texas. Over the past fifty years, national (nonagricultural) employment grew by 142 percent, but New York's job growth was just 38 percent.

The state's center of gravity is the New York City region. Since 1960, New York added about 2.6 million people, with almost two million in the "downstate" metropolitan area.<sup>2</sup> The downstate economy is diversified and has strong global ties.<sup>3</sup> There is high income, with a high concentration at the bottom and the top. In 2008, the New York City metropolitan area generated about 80 percent of the state's personal income tax receipts and 72 percent of the state's personal income. The rest of the state generated about 24 percent of the state's personal income, 7 percent lower than its share of the population. The city continues to beckon immigrants and talent worldwide, benefiting the economy of the region and the state.

"Upstate" New York has fared less well. Two regions lost population: the Southern Tier (-0.3 percent), which borders Pennsylvania; and Western New York (-10.4 percent), where one-third of the decline consisted of people under the age of twenty-five. The loss of approximately 1.4 million manufacturing jobs from the state in the past fifty years has left its mark on a number of once vibrant cities. According to the state comptroller, Buffalo, Rochester, and Syracuse have seen population losses of 55 percent, 37 percent, and 34 percent, respectively, since 1950;<sup>4</sup> although their regional economies are healthier, the fiscal results for the central cities continue to worsen. Poverty in these three upstate cities is more than twice the national average.<sup>5</sup> While the state's economy has strong agricultural and recreational sectors, the state's budget is more dependent on Wall Street's volatile revenues than is the city.

Several major disruptive events have hit New York in recent years. New York City was ground zero for the terrorist attack on the World Trade Center on September 11, 2001. The destruction focused and diverted resources to lower Manhattan and the surrounding area. Political alliances in Washington and Albany ensured that the attack and the resulting economic slump did not leave a permanent mark on the local economy and the public fisc. Ten years later, however, the same cannot yet be said of the physical scars.

In 2008, Wall Street was ground zero to the greatest financial crash since the Great Depression, which brought the end of historic players Bear Stearns and Lehman Brothers, and staggered AIG. The Great Recession cost the state 364,000 jobs.<sup>6</sup> In 2009, personal income in New York fell by 4.8 percent, the first decline in seventy years;<sup>7</sup> it rose during 2010 and 2011 at an average annual rate of 4.3 percent, slightly less than the national rate. The unemployment rate in the state peaked at 8.9 percent at the end of 2009. It declined to a low of 8.0 percent in April 2011, but has edged up even as the national rate has fallen. The state's unemployment rate was 8.9 percent in September 2012, compared to the nation's 7.8 percent.<sup>8</sup>

The cumulative effects of the financial collapse and the Great Recession hit the state's fiscal condition hard. A \$10 billion gap was projected for the fiscal year 2011-2012 budget (April 1, 2011) and larger projected gaps after that due to the state's heavy dependence on an array of temporary actions to help weather the severe revenue crisis. Also, local

governments began to show the wear and tear of the recession, torn between mandated spending, falling property values, and the inevitable effects of bad fiscal practices.

## Budgetary Reform Efforts

The financial crisis uncovered deep structural budgetary flaws. In a departure from the norm, the fiscal year 2011-2012 budget included two-year appropriations for education aid and Medicaid, which are the two largest areas of state spending, and new provisions to track and monitor spending and balances. Although there were no fixed limitations on spending in the second year, the governor and legislature were free to add to already enacted appropriations. Nevertheless, this approach may enhance the likelihood of achieving budgetary balance, primarily by limiting spending growth. The administration indicated its intent to pursue two-year appropriations in following years.

Importantly, the legislature agreed to statutory limits on future growth in education and Medicaid expenditures and imposed a cap of 2 percent on annual increases in local property tax levies (with the exception of New York City):

- Annual increases in K-12 education funding were limited to a multiyear measure of the state's personal income growth;
- Annual increases in Medicaid were limited to the medical component of the Consumer Price Index;
- For 2012-2013 and years immediately following, these limits are 4 percent.

Generally, New York has not had statutory limits on expenditures or revenues.<sup>9</sup> The state constitution imposes certain limits on the taxing power of local governments but not on the state.<sup>10</sup>

Further, the legislature granted the governor sweeping authority to reduce Medicaid expenditures *during the fiscal year* if the Health Department's efforts to reach certain cost-saving targets were unsuccessful. This grant of authority represented a dramatic change from typical practice when the legislature influenced operational details of Medicaid and other programs. The change resulted from a combination of factors, including the incumbent's insistence on such authority, his political power, persistent medical cost inflation, and the legislature's general inclination to avoid politically painful decisions. It is unclear whether lawmakers will be willing to approve such broad grants of spending authority in the future.

All of these actions have made the state's budget, at least temporarily, more multiyear and less formula-driven in important areas. But the approach carries risks: Can the executive branch control spending? What happens if not? What will be the unintended consequences of the property tax cap? Will the legislature remain committed to the administration's new approach?

## *How Cash Budgeting Focused on the Short Term Enables and Encourages Structural Deficits*

The governor dominates budget making in New York State. Pursuant to Article VII of the state constitution, the governor has primary authority and responsibility for budget formulation, presentation, and execution, including: (1) exclusive power to initiate and shape negotiations on the annual budget by submitting to the legislature a complete plan of expenditures and revenues (the Executive Budget), which includes the power to originate budget bills for executive branch agencies, (2) authority to veto any spending the legislature adds to the Executive Budget, with the veto subject to legislative override, (3) implementation of the enacted budget, which includes broad discretion to reduce the size of the state workforce, although, significantly, not to reduce spending for local assistance.

The constitution requires the governor to propose an Executive Budget in which general fund projections of receipts and disbursements are balanced or are expected to be balanced on a cash basis. Although budget enactment and implementation are on a cash basis, state law requires financial plan estimates and retrospective financial reporting to be performed on both cash and generally accepted accounting principles (GAAP) basis. The Budget Reform Act of 2007 added a statutory requirement that the legislature “shall enact a budget for the upcoming fiscal year that it determines is balanced in the general fund.”<sup>11</sup> The latter represents roughly only 43 percent of the total 2011-2012 budget. There is no constitutional or statutory requirement that the overall budget, outside the general fund, be balanced when adopted and no requirement that the budget remain in balance throughout the fiscal year. This formulation of a balanced budget leaves significant room for manipulation, particularly within the context of budgeting on a cash rather than accrual or modified accrual basis.<sup>12</sup> Even the limited 2007 provision requiring enactment of general fund balance could be eliminated via legislation in any future year.

The constitution provides the legislature with the authority to reduce or strike out (but not add to) any Executive Budget appropriation. The legislature may not substitute its broad policy choices for those of the governor. Nor may it use subsequent appropriations to change significant elements of the governor’s appropriations.

A 2005 ruling by the state’s highest court, in litigation between the governor and the legislature, enhanced gubernatorial budget making power by giving the governor authority to include statutory changes of substantive law in proposed appropriation bills.<sup>13</sup> The voters rejected the legislature’s attempt to amend the constitution and reverse the court ruling on this issue by a two to one margin in 2006, thereby solidifying executive power.

While New York is required to enact a balanced budget, there is no requirement that the budget remain in balance. This deprives the governor of the ability to control spending without legislation mid-year as economic reality changes. The executive’s constrained ability to make intrayear budget corrections, together with New York’s focus on cash budgeting, invites stop-gap measures that push problems into subsequent year(s) and shapes the context in which a persistent and perhaps unsustainable structural budget imbalance resides.

## The Structural Deficit

In the midst of the Great Recession, the state managed to end fiscal year 2009-2010 with a positive fund balance intact only because the governor delayed \$1.1 billion in payments on the last day. A total of \$2.9 billion in state payments and tax refunds was delayed from fiscal year 2009-2010 into 2010-2011.<sup>14</sup>

Trying to bring balance to an unbalanced budget puts cash manipulation at the fore. Running out of cash was a recurring nightmare during the Great Recession. *For the first time since 1981, the general fund ended a month, December 2009, with a negative balance. This was repeated in June 2010, reflecting the legislature's refusal to enact budget gap closing measures proposed by the governor.*<sup>15</sup> Temporary loans from the state's Short Term Investment Pool (STIP) were used repeatedly.<sup>16</sup>

Fiscal year 2010-2011 began on April 1, 2010, without a budget in place. To achieve one, the governor exercised his power to submit temporary budget legislation that the legislature could not amend. The interim budget bills were needed to pay salaries and certain other expenses to prevent the state from shutting down, but the governor added program cuts to the bills,<sup>17</sup> leaving the legislature little choice but to pass them.<sup>18</sup> This enhanced gubernatorial budget making power stands in stark contrast to the limited ability of the governor to adjust spending once the budget has been passed without legislative cooperation. *New York's governor cannot impound state aid to local governments that has been appropriated, including aid to school districts or Medicaid.*<sup>19</sup>

In the budget finally enacted in late June 2010, after eleven weeks of interim bills, were *provisions through which the state effectively "borrowed" over several years about \$3.5 billion from other sources to cover the cost of operations.* For instance, \$2 billion was to be realized over the four-year period 2010-2011 through 2013-2014 by deferring tax credits owed to businesses; this amount will be repaid, without interest, over the three years from fiscal year 2013-2014 onward. In addition, the state was to "save" \$1.5 billion over three years by stretching out over ten years its required contributions to the state pension fund. The legislation authorizing the pension fund stretch-out requires the state to pay interest (although at below-market rates) and authorized the state to continue the practice beyond 2015. Since local governments participate in the state's pension systems, this borrowing arrangement applied to them as well.

In the teeth of the recession, the state rolled a structural deficit from one year to the next. With slow revenue growth, it continues that behavior. The fiscal year 2011-2012 general fund budget contained \$8.4 billion (15 percent) in temporary actions, many of which were repeats from prior years (federal stimulus spending, high income personal income tax surcharge).<sup>20</sup> Just months after the budget was adopted, a worsening revenue outlook increased the projected budget gaps for fiscal years 2012-2013 and 2013-2014.<sup>21</sup>

The loss of the temporary income tax receipts was the single most significant factor causing the projected budget deficit for 2012-2013. Accordingly, in December 2011 the legislature passed a broad tax package that included higher taxes on upper income filers but slightly lower rates for most others. Effectively, the new rates readjusted the prior temporary rates (imposed on incomes above \$300,000) to new rates on incomes above \$500,000, increasing both progressivity and volatility. The new top rate is temporary, expiring on December 31, 2014.

The fiscal year 2012-2013 Executive Budget included projections through 2015-2016. Since baseline spending growth for the state's two largest programs, education aid and Medicaid, had been limited and spending locked for two fiscal years,

the budget’s multiyear projections reflect “savings” in these two programs as if they have actually happened. But, the out-year gaps will be larger if these savings fail to be realized. Many of the policy choices required to achieve those savings are yet to be determined.

The reliance on revenues from the temporary higher tax rate on upper income New Yorkers, as well as pension contribution and tax credit deferrals and other temporary measures, artificially produce a budget scenario that looks rosier than the condition reflecting permanent law.

The projected budget gap in 2013-2014 is described by the state’s Division of Budget (DOB) as the smallest second-year budget gap in decades. However, the projected gap is smaller only because approximately \$3 billion in resources will be available through temporary measures. Excluding the temporary actions, the fiscal year 2013-2014 gap rises to \$4.5 billion; in future years excluding them will result in projected gaps in 2014-2015 rising from \$3 billion to \$5.2 billion, and from \$3.7 billion to \$4.3 billion in 2015-2016. These are “structural” gaps.

New York’s long term budget outlook under permanent law remains persistently unbalanced.

**Table 1 | Budget Gap Comparisons:  
Before Actions vs. Structural Imbalance**

	Amounts in \$ millions			
	2012-2013	2013-2014	2014-2015	2015-2016
Reported Gaps Before Actions	(\$5,014.0)	(\$5,229.0)	(\$6,139.0)	(\$4,246.0)
Structural Imbalance	(\$4,142.0)	(\$4,458.0)	(\$5,223.0)	(\$4,275.0)
<b>Source:</b> Reported gaps are from the DOB Executive Budget.				

### Nonrecurring Resources and Gimmicks

Budget balance is an interesting concept in New York State. For decades, regardless of the strength of the economy, recurring revenues have been insufficient to sustain ongoing spending. This defines a *structural imbalance*.<sup>22</sup> Not only are revenues inadequate to sustain spending at a given point in time, but revenues typically increase more slowly than spending, creating a diverging path into the future. The combination of high spending and a volatile revenue structure has not been addressed, so the imbalance gets worse. This growing structural imbalance took years to accumulate; it will take more than one year to eliminate.<sup>23</sup>

Rather than address the structural problems, New York lawmakers have struggled to wrench the upcoming year’s budget into balance temporarily and on a cash or checkbook basis, through heavy dependence on one-shot actions (about \$25 billion in the past ten years), making the next year’s balancing even harder.<sup>24</sup> Common practices in Albany are to transfer “excess” revenues from other state funds and public authorities; refinance outstanding bonds without creating new assets while realigning debt service payments to achieve front-loaded savings; roll or delay payments to suppliers and contractors, localities, and school districts from one fiscal year to the next; and delay payment of tax refunds into the following fiscal year. Such machinations are only possible because of cash accounting.



As a result of this reliance on cash manipulations and one-shot transactions, the typical budget projections associated with the enacted budget will show that the adopted spending plan is in balance, but projections for future years will show ever-growing potential budget gaps. Projections are always difficult. In the state of New York, revenue projections are even more difficult because the fiscal year begins on April 1st, prior to the April 15th filing deadline for the personal income tax — the state’s largest tax source, producing more than one-quarter of total state revenue.<sup>25</sup> To construct an accurate budget, of course, it is helpful to have accurate revenue forecasts. Forty-six states have fiscal years beginning on July 1st, which is well after income tax filings and generally coincides with school budgets. New York is the only state using April 1st. In addition, state law requires only that the budget’s general fund be balanced; it only accounts for about 43 percent of all state spending, so is no longer an accurate representation of the state’s spending and revenues, much less illustrative of priorities, as a budget is classically described.

Further adding to difficulties is the learned behavior generating these persistent and growing gaps.<sup>26</sup> The state spends out of hundreds of accounts within four main groups of funds: the general fund; special revenue funds (with dedicated taxes, fees, tuition, patient revenue, fines, federal aid, etc.); capital projects funds; and debt service funds. The general fund, which is the main operating fund, receives all miscellaneous and undedicated revenues, and has traditionally been thought of as the main “budget.” However, special revenue funds have grown 351 percent — to more than 720 separate accounts — since 1985, resulting in a diminution of the general fund’s share of state resources.

With a system of cash accounting and multiple fund accounts, “balance” becomes a game of timing, involving decisions about which receipts to count and which bills to choose to pay when. With the legal requirement for balance at enactment applying only to the general fund, there is every incentive to transfer resources into and spending out of it in ways to create the illusion that it is balanced. The comptroller aptly named it “The Deficit Shuffle” and describes New York’s budgeting as: “The State dips into dedicated funds here and shifts money over there, all to cover cash shortfalls and avoid making the difficult decisions needed...”<sup>27</sup>

The ploy of transferring revenues from other accounts to support general fund spending is done with “sweeps.” These have been rampant: \$1.8 billion in the three years preceding fiscal year 2011.<sup>28</sup> The Environmental Protection Fund has been “swept” of almost a billion dollars over ten years and severely impaired in meeting its original programmatic intentions.<sup>29</sup> A traditional “sweep” involves budget bill language that specifies the transfer of a designated sum of money from a specified fund or account. “Blanket sweeps” now authorize the budget division to transfer moneys it determines are not needed for operations from undesignated funds or accounts, with only the aggregate amount of the sweep stated in the budget. The choice of particular funds “swept,” or denuded of their earmarked revenues, on the other hand, is *opaque*, without any required public disclosure upon enactment.

The tactic of artificially lowering general fund spending by shifting the costs elsewhere is known as “off-loading.” The off-loading of ordinary state costs into the Dedicated Highway and Bridge Trust Fund, for example, has made it “effectively bankrupt,” according to the comptroller.<sup>30</sup> Initially envisioned to provide revenue to pay for capital improvements on the state’s roads and bridges, its “dedicated” revenues now pay for many other things, including ferries, airports, snow and ice removal, bus inspections, and the entire department of motor vehicles. The trust fund also pays a huge amount of state obligated debt service on a variety of transportation-related bonds issued by the New York State Thruway Authority. Not surprisingly, the dedicated fund no longer has the funds necessary for its stated purpose of capital improvements without a

direct subsidy from the general fund, which exceeds \$500 million and is growing, contributing to the state's projected budget gaps.<sup>31</sup>

New York has relied on temporary resources even as the economy has been recovering. The Office of the State Comptroller notes that the 2012-2013 budget contains \$4.5 billion in nonrecurring or temporary resources;<sup>32</sup> and the actions carry into the future. In addition to the temporary income tax provisions of \$2.6 billion, the largest and most notable actions include deferral of certain business related tax credits amounting to almost \$1 billion (approximately \$970 million) annually in fiscal years 2013 and 2014;<sup>33</sup> and the amortization of pension contributions (\$782 million in 2012-2013; \$771 million in 2013-2014; \$916 million in 2014-2015; and \$554 million in 2015-2016). *In 2016-2017, the state will be paying \$216.5 million more than it otherwise would have without the amortization.*<sup>34</sup> In addition, the state is counting on receipts from the conversion of health insurance carriers from nonprofit to for-profit status amounting to \$250 million in 2012-2013, \$300 million in 2013-2014, and \$300 million in 2014-2015.<sup>35</sup>

### **Planning, Budgeting, and Reporting: Managing Over the Business Cycle**

Budget behavior is part of a wider “culture” that reflects different attitudes to rules, deadlines, transparency, borrowing, saving, temporary actions, relying on help, and more. The culture is as pervasive as the atmosphere around us.

Interestingly, participants are aware of this and acknowledge that budgeting is more than obeying the rules. It is part history and part precedent; part learned behavior and part professionalism; part ethics and part getting things done and meeting deadlines. The “budget culture” differs from place to place; it also changes over time.

The Task Force report provided the current state of best practices in budgeting, and noted four major shortcomings in budgeting practices among the six states studied: cash-based budgeting; lack of meaningful multiyear financial plans; inadequate reporting of future liabilities; and lack of transparent budgeting. A number of the best practices in budgeting can improve the likelihood of producing sustainability in the future.

New York knows what best practices look like, since the state effectively imposed them by law and through a control board on the city of New York in 1975. Among those which are particularly appropriate for the state itself are:

- A multiyear financial budget plan, on modified accrual basis and aggregated to the level of all “state funds,” which projects revenues, expenditures, and budget gaps/surpluses, covering at least the budget year plus four more.
- Mandatory quarterly revisions of the plan, requiring spending and revenue actions (by the executive and the legislature) if necessary to keep the current year budget in balance and the out-years of the financial plan closely linked to current reality.
- Budgeting by accrual accounting, which requires recognition of revenues when they are actually earned and expenditures when the liability is incurred. (This contrasts with the state's cash accounting, which recognizes receipts when a check is received and disbursements when a check is cut.)
- Required levels of reserves, with sensible rules and transparency for use.

A multiyear financial planning process provides a longer term focus, which counters the all-too-human preference for the short term. In practice, one of the *most valuable elements* in New York City's management has been the *mandatory quarterly budget reviews and the rebalancing process*, which highlights the implications of a worsening situation in time for elected officials to take actions to prevent an emerging fiscal problem from turning into a crisis. This requires rules that

force action; it would be new behavior for the state, which does not have a legal requirement that the budget finish the fiscal year in balance.

“Revenue” is a flexible term in a cash system and can cover, for example, never-to-be-repeated receipts from selling assets or from discounting future revenue, effectively pulling income streams forward. Similarly, “expenditures” can change as a payment date is adjusted by a few days. New York’s attachment to cash-basis budgeting has resulted in repeated use of next year’s receipts to pay for this year’s disbursements. To get through a tough year, expenses are rolled into the next year. While seemingly benign and easy to understand, cash budgeting allows the state to postpone refunds to taxpayers, payments to contractors/suppliers, aid to local governments, and paychecks to employees. Since accrual accounting requires revenues to be recognized when they are actually earned, and expenditures to be recognized when the liability is incurred, the ability to blur the borderline between fiscal years becomes much harder. Accrual rules as represented in GAAP are the standard for accurate financial reporting in both the public and private sectors, but they are harder to employ in a budgeting context. The rules are not immutable and may be modified to allow for emergencies.

GAAP is not an unknown quantity; the state already reports its financial statements on a GAAP basis, and the division of the budget provides an accounting “cross-walk” from the cash budget to the GAAP financial statements at year’s end. When the state imposed strict GAAP requirements on New York City in the 1970s, the city did not employ any version of GAAP accounting; it did not even have a properly functioning financial management system. Yet the city achieved an independently audited financial statement and a balanced budget under GAAP within three years.

Perhaps the easiest issue for the state to address would be the creation of rainy day funds (RDFs) that work as counter-cyclical tools to help stabilize the budget: they close a temporary gap in state budgets, not fill a structural hole. The use of reserves to cover emergency spending demands or continue services in the face of plunging revenues is uncontested. There is no one-size-fits-all model. Good RDFs include rules which enforce savings in good times. Good rules also establish that the size of the fund relates to the size and fluctuation of the budget revenues; deposits are not optional; withdrawal rules are practical; and replenishment is required at a pace related to the recovery of revenues.<sup>36</sup> The Task Force report provided two quite different models of constitutionally mandated reserves — those of Texas and Virginia — which work effectively and have provided meaningful cushions during downturns, helping to generate sustainability.

*New York has two state RDFs and did not use either of them in the Great Recession.* It has been almost twenty years since the state tapped into its *Tax Stabilization Reserve Fund*, which is funded by general fund cash surplus and reached its cap in fiscal year 2007. Because of the stabilization fund’s stringent rules of withdrawal, in 2007 the state created the *Rainy Day Reserve Fund*, with a starting deposit of \$175 million (and more stringent provisions). New York has yet to use these funds for more than covering a quick short-term cash flow shortfall with immediate repayment prior to the last day of the fiscal year, thus avoiding the strict repayment rules.<sup>37</sup> Both the comptroller and the Citizens Budget Commission (CBC) have made proposals to improve the reserves, but nothing has been adopted.<sup>38</sup>

Finally, the state issues a lot of financial information. However, the government of New York is a complicated entity, with hundreds of authorities, each having its own sets of financial reports and information. Much of the reporting is not terribly useful without an expert to guide one through the adjustments and manipulations. The 2009 Public Authorities Reform Act established the Authorities Budget Office, whose mission is to increase accountability and transparency, which it does through auditing and reporting on both state and local authorities.<sup>39</sup> As the Task Force report indicated, comprehensive

annual financial reports (CAFRs) have become so huge and complex that their accessibility and ease of use for the nonexpert is limited. The state comptroller produces annually a simpler and more accessible financial report, the State of New York Financial Conditions Report, which serves the broader purpose of simple transparency.

## *Medicaid: The Most Extensive and Expansive Program in the Nation*

New York's Medicaid program is by far the largest, most extensive, and most expensive in the country. New York spends more of its own funds on Medicaid than Florida, Texas, and Pennsylvania combined. And its spending per enrollee at \$9,056 in 2009 was 69 percent higher than the U.S. average of \$5,337.

For many years the state enlarged its Medicaid commitment by creating new state health care programs that went beyond existing eligibility and benefit limits. The state then leveraged the new entitlements into the federal Medicaid program to get the 50 percent federal matching funds. As a result the New York program provides more access and more benefits than any other state. The state also has a very powerful "medical industrial complex" of medical providers, labor unions, and health care interest groups that promote institutionalization and keep provider costs high. Nursing home care in New York City, for example, can cost well over \$100,000 per year, and the cost per disabled Medicaid enrollee is more than twice as high as the U.S. average.

Reduction in the growth of state spending on Medicaid was a major priority in the fiscal years 2012 and 2013 enacted budgets. These new cost control efforts could change the direction of Medicaid in New York from "Medicaiding" to program reform for cost-efficiency and bring the state closer to alignment with national spending levels.

### **Reform**

In January 2011 the state projected a 13 percent increase in the state's Medicaid funding for fiscal year 2012, reflecting an 8.4 percent increase in total Medicaid spending and the loss of more than \$2 billion as federal stimulus funds from the American Recovery and Reinvestment Act (ARRA) expired. Three major provisions to limit state Medicaid spending were enacted:

- 1 A statutory cap on the annual growth in state DOH Medicaid spending linked to the ten-year average change in the medical component of the Consumer Price Index (approximately 4 percent).
- 2 A two-year appropriation for Medicaid, providing \$2.2 billion in reductions from the trend in state funds' growth in fiscal year 2012 and a 4 percent increase from that new base (using the CPI linked growth measure ) for fiscal year 2013.
- 3 Extraordinary authority for the New York State commissioner of health to make unilateral program changes if needed to keep DOH Medicaid spending within the CPI-related cap.

The state has created a Medicaid Redesign Team (MRT) to develop and manage cost-saving steps in Medicaid. The fiscal year 2012 budget included seventy-eight discrete MRT initiatives with estimated savings of \$973 million in fiscal year 2012 and \$1.1 billion in 2013. More than fifty of these initiatives require federal approval of changes in the state's Medicaid plan. According to the state comptroller, "the Department [of Health] held its Medicaid spending growth to the legislated limit of \$15.3 billion in SFY 2011-12, without invoking the extraordinary power the legislature granted to the Commissioner of Health to reduce reimbursements if necessary to close the budget gap. To date, there has been little information on the service impacts of such restraint in health care spending."<sup>40</sup>

Since many of the projected savings depend on timely federal approvals and the willing participation of health care industry stakeholders, there can be no assurance that savings will be achieved.<sup>41</sup> The *New York Times* and others have pressed the federal government for support and evaluation.<sup>42</sup> Assuming successful implementation of the reforms, total Medicaid spending growth in New York could be brought under control as shown below:

**Table 2 | Total Medicaid Spending, New York State**

Funds	Amounts in \$ billions		
	2011-2012	2012-2013	2013-2014
State Funds	\$21.1	\$21.8	\$22.8
DOH	15.3	15.9	16.6
Other Agencies	5.8	5.9	6.2
Federal Funds	24.5	24.2	26.1
Local Funds	8.6	8.0	8.5
<b>Total</b>	<b>\$54.2</b>	<b>\$54.0</b>	<b>\$57.4</b>

**Source:** NYS Department of Health.

Most mental health and developmental disability programs are not subject to the CPI-related cap on spending growth; nonetheless, the state is eliminating automatic cost-of-living adjustments and trend factor increases for all nonprofit mental hygiene providers.

Federal funds account for about 45 percent of total Medicaid spending (rather than the 50 percent federal match rate), since the state provides some services that are not federally reimbursable. New York is one of only fifteen states that require local governments to contribute to Medicaid funding. New York City (five counties) and the state's fifty-seven other counties pay about 16 percent of the total while the state pays the remaining 39 percent. In some rural counties the payment for Medicaid can exceed half of their entire budget, so there is constant pressure to reduce or cap county Medicaid contributions. Annual increases imposed on the counties are now capped at 3 percent per year. A provision of the 2012-2013 budget reduces this cap to zero over three years, which will increase state spending by \$370 million by fiscal year 2015.

New York is in discussions with the federal government for the state to assume administrative and fiscal responsibility for 700,000 Medicare/Medicaid "dual eligibles" in the state. This population now consumes 45 percent of all Medicaid dollars in the state and 41 percent of all Medicaid expenditures. New York proposes an integrated managed care program for "dual eligibles," and has tested such an approach in pilot initiatives. Savings to both the state and federal government could be substantial — \$18.8 billion over five years for the federal government alone, according to the state's estimates. But the state also would be assuming financial risks for any losses in the managed care program, which could be substantial. Some federal proposals would convert Medicaid to a block grant program, which could have a devastating impact on New York.

### **Impact of Implementing the Affordable Care Act (ACA) in New York**

The New York State Division of Budget (DOB) expects that the net positive impact of the ACA will be more than \$1 billion per year in the near term. The analysis of state spending by the Kaiser Commission on Medicaid and the Uninsured showed increases in annual spending averaging 2.9 percent nationwide by 2019; New York State spending would increase by only 1.2 percent, primarily because some of the enrollees now funded by New York will be eligible to be funded mostly by the



federal government under ACA.<sup>43</sup> Under assumptions used by the Lewin Group in its analysis of the national plan, New York State spending would actually decrease by 5.3 percent.<sup>44</sup>

In sum, New York has been adept at growing a very large Medicaid program leveraged by federal dollars. It is now tackling the more difficult task of reforming its sprawling Medicaid edifice, characterized as “an unwieldy and overly decentralized structure that serves contradictory goals and provides perverse incentive.”<sup>45</sup> The state has a start on reform and cost control by improving efficiency with only marginal reductions in access, benefits, and payment levels. The ambitious effort to redesign Medicaid is still in early stages and unproven. Further cost reductions that would bring New York State Medicaid spending more in line with spending in other states may require cutbacks in eligibility, benefits, and payment levels. Such action is likely to be resisted by the various powerful stakeholders that have supported expansion of public health care programs.

## Federal Deficit Reduction Threatens State Finances

The federal government is poised to take significant action to rein in its budget deficit. This could affect states in three main ways: reductions or changes in grant programs could have direct adverse effects on state budgets; reductions in federal spending for procurement, the federal workforce, and other purposes could have adverse impacts on state economies; and changes in federal tax policies, such as scaling back deductions for state and local taxes or scaling back the tax exemption for interest in state and local debt. While some actions could have positive effects on states, the vast majority are likely to be negative.

Federal aid varies dramatically across states, ranging from \$1,327 per capita in Virginia in 2010 to \$4,657 in Alaska.<sup>46</sup> New York had the highest federal aid among the study states, at \$3,163 per capita. New York is more vulnerable than most states to potential cuts in grants, particularly for social service programs, because it spends far more than the national average on these programs and receives much greater federal reimbursement. In the near term the biggest risk is sequestration of federal spending under the Budget Control Act, and Medicaid is exempted from that. But over the longer term Medicaid almost certainly will not be exempt from federal deficit cutting, nor will other social programs.

To illustrate the risk, the potential impact on each study state of a 10 percent cut in grants is shown in the table below, drawn from the task force's July report. It shows potential impact in billions of dollars by major grant category and in dollars per capita for the total.<sup>47</sup> The programs shown below were chosen because they are the largest grant programs that flow to states. Four of them provide services to needy individuals, while Highway Trust funding is a major source of revenue for construction and maintenance of highways.

As the table shows, New York State and its local governments would lose more than \$6 billion annually – a per capita loss of \$317, which is more than 50 percent greater than the national average loss of \$201.

**Table 3 | Potential Impact of a 10 Percent Reduction in Federal Grants**

State	Potential Cuts (\$ millions)						Potential Cuts (\$ per capita)
	Total	Medicaid & Selected Other CMS Programs	Highway Trust Fund	Temporary Assistance to Needy Families (TANF)	Title 1 Education Programs	Child Nutrition Programs	
United States	\$62,074	\$27,804	\$3,027	\$1,987	\$1,811	\$1,628	\$201
California	6,657	2,925	188	425	224	199	179
Illinois	2,319	984	86	73	83	62	181
New Jersey	1,631	684	62	61	35	33	186
New York	6,134	3,274	163	274	152	100	317
Texas	4,373	2,010	161	67	181	191	174
Virginia	1,065	422	85	17	28	24	133

**Source:** Task Force analysis of data from U.S. Census Bureau, "Federal Aid to States for Fiscal Year 2010."

## *Pensions and OPEB*

### **Pensions**

Pension benefits in New York have strong constitutional and legal protections and create a binding, legally enforceable contract between employer and employee, effective at the time of hire.

#### ***The Structure of the State Administered Pension Systems***

New York's public employee retirement systems are consolidated: there are two large systems administered at the state level and eight administered locally. While New York has only 0.3 percent of the nation's 3,400 public employee retirement systems, these systems hold 11 percent of all public retirement system assets.<sup>48</sup>

The state's largest system is the New York State and Local Employees' Retirement System (ERS), which was established in 1921; together with the State and Local Police and Fire Retirement System (PFRS), which was established in 1966, they form the assets of the Common Retirement Fund, which is managed by the Division of Pension Investment and Cash Management in the Office of the State Comptroller. The comptroller is the sole trustee of these funds. Most local governments outside New York City participate in this system. New York also has a state administered Teachers Retirement System (TRS) in which school districts outside of New York City participate. TRS has an independent board of trustees.

New York City administers the other large retirement systems in the state. The largest New York City systems are the Employees' Retirement System (NYCERS) and the Teachers' Retirement System (NYCTRS), which together account for about a fifth of combined state and local retirement system assets in the state. NYCERS is the largest municipal public employee retirement system in the country.

#### ***Funded Status***

New York's retirement systems are better funded than most, although the New York City plans are not as well funded as the state administered plans. Table 4 demonstrates that the plans in the six states studied by the Task Force account for approximately 85 to 90 percent of the assets of the nation's 3,400 systems. New York is the best funded of the study states and is well above the national average. Table 5 shows the funded status of the state's individual retirement systems.

New York's pension law and practice set it apart from most other states in two important ways that encourage conservative funding and high employer contributions: use of the aggregate cost method and the requirement for governments to pay the amount requested by the pension system — generally the annual required contribution (ARC). (The ARC is the amount determined by the actuary as needed to fund the system fully.)

**Table 4 | Funded Status of Major Retirement Systems  
Nationally and in Study States**

State and Local Government Retirement System Funded Status Major State Plans and Local Plans Amounts in \$ billions					
Plan Name (Asset Value Year)	Actuarial Liabilities	Market Value of Assets	Unfunded Liability (Surplus) Using Market Value of Assets	Funded Ratio Using Market Value of Assets (%)	Unfunded Liability (\$ per capita)
United States Totals, 126 Plans	\$3,442.8	\$2,551.2	\$891.5	74.1%	\$2,882.1
Totals for Six Study States	\$1,542.2	\$1,156.0	\$386.2	75.0%	\$3,459.2
California	\$597.4	\$461.6	\$135.8	77.3%	\$3,635.9
Illinois	\$187.6	\$95.0	\$92.5	50.7%	\$7,205.7
New Jersey	\$120.2	\$77.6	\$42.6	64.6%	\$4,838.6
New York	\$348.0	\$301.2	\$46.8	86.6%	\$2,411.8
Texas	\$214.0	\$167.7	\$46.3	78.3%	\$1,835.2
Virginia	\$75.1	\$52.9	\$22.2	70.4%	\$2,770.1

**Source:** Public Fund Survey ([www.publicfundsurvey.org](http://www.publicfundsurvey.org)) for actuarial liabilities, accessed June 19, 2012; market value of assets provided by the National Association of State Retirement Administrators, June 19, 2012; unfunded liabilities and funded ratios calculated by the Task Force.

**Table 5 | Funded Status of Major New York Retirement Systems**

State and Local Government Retirement System Funded Status Major State Plans and Local Plans Amounts in \$ billions					
Plan Name (Asset Value Year)	Actuarial Liabilities	Market Value of Assets	Unfunded Liability (Surplus) Using Market Value of Assets	Funded Ratio Using Market Value of Assets (%)	Unfunded Liability (\$ per capita)
United States totals, 126 plans	\$3,442.8	\$2,551.2	\$891.5	74.1%	\$2,882.1
Totals for Six study states	\$1,542.2	\$1,156.0	\$386.2	75.0%	\$3,459.2
NY State & Local ERS (2011)	\$133.6	\$127.2	\$6.4	95.2%	
New York State Teachers (2011)	\$88.3	\$89.9	(\$1.6)	101.8%	
New York City ERS (2011)	\$55.1	\$35.4	\$19.7	64.2%	
New York City Teachers (2010)	\$48.0	\$26.4	\$21.6	55.0%	
NY State & Local Police & Fire (2011)	\$23.0	\$22.4	\$0.6	97.2%	
New York Total	\$348.0	\$301.2	\$46.8	86.6%	\$2,411.8

**Source:** Public Fund Survey ([www.publicfundsurvey.org](http://www.publicfundsurvey.org)) for actuarial liabilities, accessed June 19, 2012; market value of assets provided by the National Association of State Retirement Administrators, June 19, 2012; Unfunded liabilities and funded ratios calculated by the Task Force.

**Aggregate cost method:** The plans administered at the state level are among a few in the nation that use the actuarial method for estimating liabilities and computing annual costs known as aggregate cost. The method is not transparent, but it is conservative.<sup>49</sup> The method calculates the total liability and aims to fund fully that amount within the current members' working careers. This is what makes the method conservative: it attempts full funding of all benefits before all employees retire rather than, for example, amortizing costs over thirty years. Furthermore, this method spreads the contributions as an even percentage over the current population's payroll, which decreases over time, rather than over an increasing payroll as is done in other methods. The aggregate cost method can lead to large swings in contribution rates, which has happened in recent years.<sup>50</sup> Interestingly, it can result in there being no required contribution if the actuarial assets exactly equal the total liability, which happened in 2000 and 2001, when ERS paid almost zero percent of payroll.<sup>51</sup>

**The requirement to pay requested contributions:** As a result of litigation, the state and its local governments generally must pay the annual required contribution requested by state administered pension systems.<sup>52</sup> The state comptroller chooses the actuarial methods and the state and local governments are required to contribute amounts requested by the comptroller.<sup>53</sup> New York employer contribution rates had reached historic low levels in the late 1990s but were rising significantly by 2004.<sup>54</sup> Under the aggregate cost method, contributions can rise extremely rapidly after investment income shortfalls. New York's Common Retirement Fund increased employer contribution rates by 158 percent from 2010 to its scheduled 2013 payments, protecting pensions but stressing local budgets. Pension contributions for the fund are increasing by more than \$3 billion annually; and other plans are raising contributions as well. Given that New York local governments must pay these contributions, the state faces pressure to find ways to provide budgetary relief from pension contribution increases.

*New York's full funding practice is in sharp contrast to all five other states in this study, which have had extended periods in which employers underpaid contributions substantially.* Employers in California made contributions into the State Teachers Retirement System at statutory rates that were far below actuarially determined amounts; Illinois established a statutory contribution "ramp" that allowed it to underpay actuarially required contributions year after year; New Jersey habitually underpaid or skipped annual required contributions; Texas pays contributions according to a statutory schedule that currently falls below actuarially required contributions; and Virginia underpaid contributions in response to the recent crisis.<sup>55</sup> And, so, New York has clearly benefited from its more prudent funding behavior.

### **Benefit Changes<sup>56</sup>**

Benefits are set in law. New York's constitution provides that pension benefits for state and local government workers and retirees may not be "diminished or impaired."<sup>57</sup> Starting in 1973 and four times thereafter, the Legislature has enacted statutes to reduce benefits on a prospective basis for new employees, with each new benefit structure being designated a new "tier." The retirement plan created through legislation enacted in 2009 is known as Tier V, while further changes enacted in 2012 created the Tier VI plan.<sup>58</sup>

In general, the Legislature improves pension benefits following periods in which pension fund assets have grown consistently and strongly and in response to pressure from public employees, retirees, and their unions to "share out the market gains." The Legislature's most recent act to provide major enhancements in pension benefits came more than a decade ago, in 2000. The improvements included an end to employee contributions after ten years of service; institution of

annual cost-of-living increases; and enhanced provisions for early retirement. These came after several years of significant growth in assets and subsequent reductions in employer contributions, both driven by sharp increases in market values of stocks and other financial assets.<sup>59</sup> In 2000, combined employer contributions to ERS and PFRS fell to \$165 million, the second-lowest level since the early 1980s. The improvements are deemed constitutionally protected pursuant to New York state jurisprudence; legally, there is no mechanism for employees' deferred compensation to share in the state's downside economic risks.

Between 2000 and 2009, the Legislature enacted dozens of individual laws adversely affecting the New York State and Local Retirement System. Most of the new statutes enhanced benefits.<sup>60</sup> By December 2008, a backlash against rising pension costs and the onset of the Great Recession had changed the state's fiscal outlook dramatically.

A new Tier V, which applies to employees who joined the ERS (on or after January 1, 2010) and employees who joined the state PFRS (on or after January 9, 2010), was enacted. The significant changes included (but are not limited to): requiring employee contributions for all years of service, rather than the initial ten; requiring vesting after ten, rather than five, years; and limiting overtime pay that can be included in the final average calculations.<sup>61</sup> DOB estimates the new tier would provide more than \$35 billion in state and local taxpayer savings over thirty years.

A new Tier VI, affecting workers hired on or after April 1, 2012, was enacted with the fiscal year 2012-2013 budget. Benefit changes result in an employee who works thirty years retiring with a pension of 55 percent of final average salary, compared to 60 percent under Tier V.<sup>62</sup> To protect local governments from future cost increases and discourage the state from enacting future enhancements in benefits, the statute requires the state to pay localities' shares of any new costs from future changes. The Tier VI changes, if left intact over time, could reduce future state and local government costs by an estimated \$80 billion, according to the governor's office. (The comptroller's office did not comment on the accuracy of this estimate.) Moody's characterizes the long term budgetary relief for the state as "modest."

### ***Pension Contribution "Amortization"***

Over time, the state has eased the burden of contributions on itself and local employers by what is known euphemistically as "amortization," which, in effect, is a form of borrowing from the pension fund itself that allows governments to be credited for paying the ARC.<sup>63</sup> Under this law, governments can pay qualifying annual contributions over ten years and be treated as if they paid full contributions on time. Under certain conditions, when an employer's outstanding "amortizations" have been paid, it will be required to pay additional monies into reserve funds to help offset future contributions, partially stabilizing cash flow. As the DOB observes, "Amortization temporarily reduces the pension costs that must be paid by public employers in a given fiscal year, but results in higher costs overall when repaid with interest."<sup>64</sup> Amortization of pension liabilities has become more common.<sup>65</sup> A spike in actuarially required employer contributions following the recession and terrorist attacks of 2001 led to legislative approval of similar steps in 2004, 2005, and 2006. The state's decision to stretch out 2004 payments over five years cost an estimated \$101 million in interest, according to a Senate staff report.

Currently, amortization is legislatively authorized beyond 2015. For amounts borrowed in 2012, the interest rate is 3.75 percent. This is lower than the 7.5 percent that the retirement system assumes it will earn on its assets, which increases the amount it must earn on other assets to hit its overall target. The impact on the retirement system is not major — the larger question is whether the system can earn 7.5 percent.<sup>66</sup> The amortization is more significant from the perspective of the governments involved. In fiscal year 2013, New York State borrowed \$782 million in this fashion, in addition to

borrowings of \$813 million in 2011 and 2012 combined. Nearly 150 other employers — mostly local governments — borrowed \$260 million in 2012 and 2013 combined.<sup>67</sup> Further borrowings are likely. The work of the task force has shown that other states that have used such gimmicks year after year to finance or avoid pension contributions have created problems for their own finances and for their pension systems. New York governments should take heed from those experiences and not create similar problems here.

### **Pension Obligation Bonds**

Pension obligation bonds (POBs) are not general obligation debts. New York was among the first states to issue pension obligation bonds, with a \$770 million borrowing in 1996. The bonds had a final maturity of 2003.<sup>68</sup> While this has been the state's only use of pension obligation bonds, local governments in New York have used such bonds frequently. "A greater number of POBs (roughly 85) have been issued by the state and local governments in New York over the past decade than by any other state."<sup>69</sup>

### **Outlook and Risks**

New York's employer contributions have increased significantly in response to investment income shortfalls. They will have to rise further, assuming the pension systems meet their investment income targets and other assumptions. *According to analysis for the Task Force by the Center for Retirement Research at Boston College, annual contributions for ERS, PFRS, and TRS combined would have to rise from about \$8.1 billion in 2013 to \$10.6 billion in 2015, an increase of 31 percent, or \$2.5 billion.* This will impose additional stress on the state and its local governments, but it is not particularly significant relative to the size of New York's economy. Unfortunately, if liabilities were discounted not at the rates used by actuaries but at the more conservative rate of 5 percent used by many academic analysts, the annual contributions to the three systems would have to rise by an additional \$14.8 billion, according to the Center for Retirement Research. This provides additional insight into the potential longer term financial risk facing the state if the funds assume their assets will earn higher rates of return than the rates of return achieved in the last decade.

### **OPEB<sup>70</sup>**

The state of New York, as an employer, historically has provided comprehensive health care benefits for employees and retirees. These include the right of retiring workers to carry part of the value of unused sick time into retirement in the form of state funded payments for what otherwise would be the retiree's share of health insurance premiums. In 2009, active and retired state agency employees were required to share in the cost of Medicare Part B premiums. Total state costs for employee and retiree health benefits in 2009 were around \$2.7 billion.<sup>71</sup>

Such costs were estimated at just over \$3 billion for fiscal year 2012, and for 2013, \$3.3 billion. With no change in institutional arrangements, health insurance costs are expected to increase another 25 percent over the coming four years.<sup>72</sup> As part of major union contracts negotiated in early 2012, premium contributions were increased.<sup>73</sup> The 2012-2013 budget extends Medicare Part B premium sharing to public authorities. These actions are estimated to save \$11 million annually.

The state's most recent estimate of its unfunded actuarial accrued liability for post-employment health care benefits (including the State University of New York [SUNY] and the City University of New York [CUNY]), which are growing annually at about 8 to 10 percent, is \$73.3 billion as of fiscal year 2012. The state share of that total is \$59.7 billion, the SUNY portion is \$12.4 billion, and CUNY is \$1.2 billion.<sup>74</sup> These numbers represent a liability that can be affected by changes in



public policy but is not transparent or easily understood by the most public officials or taxpayers. OPEB costs are funded on a pay-as-you-go basis.

Although local government OPEB liabilities are not the focus of this report, they are considerable in New York. New York City has the largest unfunded OPEB liability in the nation, at \$84 billion as reported in its 2011 CAFR — larger than that of any state — and it is growing at more than \$5 billion a year.<sup>75</sup> The public cost of the city’s employee benefits package may not be affordable in the future and significant efforts to scale them back are likely. Other local governments in New York also have significant unfunded OPEB liabilities.<sup>76</sup>

*In sum, the New York state-level retirement systems are more conservative than most others in calculating liabilities, and better funded than most.* The flip side is that after periods of investment shortfalls, contributions rise substantially and can create considerable stress for local government budgets. Perhaps as a result, New York has devised alternative means to avoid full payment of contributions out of current resources, such as the pension “amortization” law that effectively allows governments to borrow from pension funds. This temporary balm, however, does not relieve longer term burdens and leaves many local governments extremely stressed. As a result, efforts to scale back benefits are likely to continue.

## Revenue Erosion and Volatility

The state of New York is the third largest taxing jurisdiction in America, collecting more than \$66 billion from a large variety of taxes and fees. The revenue structure is dominated by the personal income tax (PIT), which will provide 61 percent of the state's tax revenue this fiscal year. The general sales tax, the state's second-largest source, is expected to produce 18 percent. A host of other taxes contribute billions of dollars in single digits: tobacco tax revenues are \$1.6 billion and the corporation franchise tax is almost \$3 billion.<sup>77</sup>

The state's overall tax structure is broad. The state has a modestly progressive income tax; a state-level sales tax (which like most state sales taxes covers a relatively narrow segment of the economy); both a general corporate income tax and industry-specific taxes for certain sectors; and a range of other taxes on incomes, consumption, and business activity. Overall, state tax collections in New York are comparatively higher than those in most states on a per-capita basis, reflecting generally higher incomes; but when adjusted for personal income, New York's state-level taxes are around the national average.<sup>78</sup> (New York's status as a high tax state results primarily from its municipal and school taxes.)

### Narrowing Tax Base

The breadth of the tax base, and erosion over time, is an issue with respect to the state's sales and corporate income taxes. The corporate income tax is subject to the same types of credits, deductions, and interstate actions as in many other states; as a proportion of total tax revenue in New York, it is close to the national average. There is ongoing debate as to whether the size and scope of the New York economy, particularly New York City and its suburbs, allows for a greater role for the corporate tax.<sup>79</sup> To the extent that the breadth of the revenue base is an issue in New York, the sales tax is clearly the most important focus. The breadth of the income tax base is not a primary concern. While New York is more generous than many states in exempting pension income, its overall system of deductions, credits, and exemptions is in the mainstream of income tax states.

Examples of recent actions the Legislature has taken to narrow the overall tax base include the 2010 enactment of a five-year extension and expansion of the tax credit for film production in New York, at an annual cost to the state of \$420 million.<sup>80</sup> Expansion of the tax base has included 2007 and 2008 legislation that eliminated certain business tax preferences and tax planning activities, restricted certain personal income tax exemptions and credits, and applied sales tax to certain online sales. These steps increased annual revenue to the state by more than \$2 billion.<sup>81</sup>

The state relies to a lesser degree on the sales tax than most other states: as of 2010, it brought in 16.6 percent of the state's tax revenue, compared to 32 percent for all states. Compared to most other states, New York's sales tax has relatively narrow tracking to the state's economy: a mere 26 percent of personal income compared to the national median of 34 percent in 2010.<sup>82</sup> Sales tax bases nationwide have shrunk in relation to the economy in recent decades: the 2010 measure of sales tax breadth was roughly one-quarter lower than in 1970.<sup>83</sup> A number of observers believe that erosion of the revenue base over time has not been as extensive in New York as in many other states.

### Income Tax Volatility

State policymakers and independent observers alike have written extensively on New York State's economic and fiscal dependence on high income earners, and increasingly on their capital gains income, and the resulting volatility in the

state's revenue system. Nonetheless, the most recent changes to the PIT, which resulted in significant gap-closing revenues to the budget, create even greater dependence on a small number of high income payers. In December 2011, the Legislature created a longer and thinner tail to the top of the income tax. A new top rate of 8.82 percent applies to individuals with taxable income above \$1 million and married couples above \$2 million and does so in a more concentrated way than has occurred previously.<sup>84</sup> Further, this "millionaires" bracket brings increased dependence on a relatively small number of taxpayers (estimated to be 31,000), roughly half of whom live outside the state.<sup>85</sup> The economic fortunes of less than one-half of one percent of taxpayers will have especially significant implications for the state's fiscal stability over the next three years.<sup>86</sup> Moody's Investors Service noted recently that the state's most significant financial challenges include "volatile state finances, due to above-average dependence on income taxes."<sup>87</sup>

One major source of volatility in New York's revenue stream is capital gains income. Both the dollars and the swings involved are large.<sup>88</sup> The amount of such income reported on New York State tax returns peaked in 2007 at more than \$106 billion, nearly double the level of capital gains in 2005, and approached 17 percent of all New York adjusted gross income. The following year, 2008, capital gains fell by more than half; in 2009 taxable capital gains were less than one-quarter the 2007 level. The \$50 billion-plus increase in capital gains (from 2005 to 2007) translated into \$3 billion in new state revenue. When taxable gains fell by \$59 billion from 2007 to 2008, the state's revenues took an estimated \$3.5 billion hit in a single year; the two-year (2007-09) decline in taxable capital gains of \$81 billion meant a loss of \$4.9 billion in state revenue.<sup>89</sup> The higher "millionaires" rates set the stage for wider swings (for a given change in capital gains income). With the top statutory PIT rate of 8.97 percent in effect from 2009 through 2011, it is likely the average effective tax rate on all capital gains during that period has been about 8 percent. The top statutory rate for 2012 through 2014 is 8.82 percent, meaning that the average effective rate on capital gains likely remains about 8 percent. New York will remain far more heavily dependent on volatile capital gains revenue than most other states.

*In sum*, New York's largest budget revenue, the personal income tax, illustrates the trade-off between tax equity and revenue volatility. A growing reliance on a small number of high income taxpayers, many of whom live outside the state, means New York's ability to pay for ongoing services to residents is increasingly vulnerable to forces outside of its control: the economic cycle; gains and losses in financial markets; and employment location decisions by the most affluent. Note also that New York City taxes much of this same base with its own progressive income tax.<sup>90</sup> But the city's budget, which also relies on a large property tax, is less dependent on it and less vulnerable.<sup>91</sup> Outside experts have warned that, at a minimum, dependence on such high income individuals should be matched with changes in budget policy — including larger and more flexible reserves, multiyear planning, and additional more stable revenues — but movement in that direction is small and slow.<sup>92</sup>

New York is known as a high tax state, but not all of its tax liability is borne by its residents. It is likely a "net exporter of tax burdens relative to other states." A large number of workers from New Jersey and Connecticut pay income and sales taxes while in the state; a large tourism economy is taxed through sales and excise taxes; and corporate income apportionment as well as bank and insurance taxation may benefit from headquarters location. Further, the ability to deduct state and local taxes from federal income taxes means that New York taxpayers, particularly those in higher tax areas of the state and with high incomes, receive a significant offset to their total tax burden. This offset is borne by the federal budget. Reducing or eliminating the federal deduction for state and local taxes, as has been presented as part of broader federal tax reform or structural deficit reduction, would have a significant negative impact for New York.<sup>93</sup> As of 2004, federally deductible

taxes represented 27.8 percent of own-source revenues for the state of New York, compared to an average 17.4 percent for all state governments, according to the Congressional Budget Office.<sup>94</sup> Such deductions represented an average 8.3 percent of adjusted gross income in New York, compared to 5.4 percent nationally.

## Local Government Risks

Local government in New York is a complicated, costly, sprawling, and confusing mix where citizens may live under one, two, or three layers of general purpose entities consisting of fifty-seven counties, sixty-two cities, 932 towns, and 555 villages. School districts have independent authority to levy the property tax outside the state's five biggest cities, as do many fire districts and certain other entities such as library districts. *School districts as a class raise more local tax revenue, receive more state aid, and spend more overall than any of the other types of local government entities.* New York City, which has more than 40 percent of the state's population, is unusual as a single government carrying out the functions performed elsewhere by cities, counties, school districts, and often fire districts, all with independent taxing authority.

While New York is considered a home rule state, the state plays critically important roles in shaping local government revenues and expenditures. Through constitution and statute, the state limits both the types of taxes localities may impose and the rates. The *property tax* is by far the largest revenue source for local governments in the state (other than New York City), amounting to 56 percent of locally generated revenue for these jurisdictions in 2010. Before 2012, local governments could impose property taxes at the level of their choice, subject only to constitutional limits on property tax levies as a percentage of property values. A new law enacted in 2011 limits the annual increase in property taxes to 2 percent or the inflation rate (whichever is lower), with certain exemptions such as debt service. After adjusting for such exclusions,<sup>95</sup> the effective tax cap is between 3 and 4 percent. Other than the property tax, the local component of the combined state-local *sales tax* is the most important revenue source for local governments, generating for localities \$14 billion in 2010. According to state law, this source is available to cities and counties; counties share it within their borders with other jurisdictions to varying degrees. Twenty-three counties in the state impose a *local mortgage recording tax*; these taxes experienced great growth between 2000 and 2005 but cratered thereafter, contributing to current fiscal difficulties of Rockland County, Yonkers, and some other downstate municipalities. Local governments in the state have virtually unlimited authority to impose user fees for certain basic municipal services.

*State general aid* to local governments is moderate (\$873 million in 2010), and is procyclical, increasing when state revenues are strong and remaining flat or decreasing during downturns. Aid to K-12 education is by far the biggest portion of state aid (\$23 billion) and is the largest item in the state budget.

### State Policies

State policies impose significant costs on counties and municipalities that they would be unlikely to incur by their own choosing in three areas: *Medicaid, public employee benefits, and limitations on local taxing authority.*

**Medicaid:** *New York is one of a handful of states that require local governments to pay a significant portion of Medicaid costs, something the counties in New York regard as "reverse revenue sharing."* They have been trying for many years to divest this burden, formerly half of the state Medicaid match, and have made considerable progress. New York localities are now paying 16 percent (\$8.6 billion) in Medicaid while the state pays 39 percent and the federal government pays 45 percent. In 2007 the Legislature provided that any increase in the local share of Medicaid costs above 3 percent would be paid by the state, and it is proposed to freeze local costs at the 2015 level.

**Retirement Benefits:** As previously discussed, the state Legislature determines the level of pension benefits that all state and local governments must support through mandatory contributions to the state pension system. Although localities decide the level of health coverage for employees and retirees, state mandates regarding negotiation of employee contracts influence both the current cost and the long term liabilities associated with such coverage. These benefit costs have been rising rapidly. The adoption of several new tiers of less expensive pension benefits for newly hired employees, with the general exception of public safety officers, promise future restraint on pensions, although savings are very small in the near term. A number of localities are, through negotiations, increasing employee and retiree cost-sharing for health benefits.<sup>96</sup>

**Limitations on local taxing authority:** The recently enacted cap on property tax increases further complicates the fiscal picture for school districts, which rely on growing property tax revenues to fund increasing school expenditures driven by personnel costs and (in some cases) enrollment levels. Districts with significant declines in the market value of property and rising enrollment levels will face a new problem. In order to exceed the 2 percent cap, they need 60 percent of the voters in the district on proposed school budgets to approve such an increase. Municipalities can exceed the cap by approval of a majority of their governing body.<sup>97</sup>

Local government fiscal distress has grown in recent years, at least regarding serious cases. According to the state comptroller, in August 2012, “The liquidity of local governments is deteriorating.” He documented that “more than 100 ... do not have enough cash on hand to pay even 75 percent of current liabilities ...; almost 300 ... ended either fiscal years 2010, 2011, or both, in a deficit situation; and 27 appear to have not only drained, but spent more than what they had in their rainy day funds.”<sup>98</sup> Further, the Office of the State Comptroller (OSC) report expressed particular concern about cities, that “have been losing population for decades, along with stagnant property assessments, higher poverty rates than surrounding towns, and older and decaying infrastructure.”<sup>99</sup>

While the state has had no comprehensive system in place to monitor the fiscal position of all local governments on a real time basis, the OSC audits every municipality periodically and OSC regional offices maintain a general awareness of the financial condition of local governments in their areas, undertaking more intense review in cases of significant fiscal stress. OSC also establishes financial reporting requirements for all local governments; and regional staff provides extensive technical assistance to local officials, including a well-developed template for multiyear financial planning. Citing a “growing number of local governments facing significant fiscal stress,” the state comptroller announced plans for an early warning monitoring system to begin corrective action “sooner and give local officials and the public sufficient time to discuss options for turning things around.”<sup>100</sup>

The state has no legal requirement to assist local governments in fiscal distress and the local finance law allows a municipality to file for bankruptcy under Chapter 9 with the approval of the Legislature. However, no local government in the state ever has done so and none have defaulted on a debt obligation in modern history (except, arguably, New York City in 1975).

Even though New York does not have a legal structure or fixed procedure for dealing with distressed local governments, it has been among the more active and involved states in confronting and intervening in local fiscal crises. In 1975, the state shepherded New York City through its famed fiscal crisis and created the control board mechanism for helping localities resolve their fiscal crises; the Legislature has created control boards for Yonkers, Troy, Buffalo, Nassau County, and Erie County. But *each local anomaly is addressed by separate, ad hoc, state legislation*, specifying what the state will or will not

do to address the local problem. Not all control boards have the same powers; most have authority to create a multiyear financial plan to achieve budget balance and the ability to enforce local adherence to the plan, including close monitoring and oversight. In a few other cases the Legislature has given the state comptroller special authority to monitor and influence local budgetary choices. Despite these efforts, the state has not had a great record of success in restoring local governments to fiscal sustainability on a long term basis, other than New York City. Yonkers, Buffalo, and Nassau County have been in and out of state supervision over periods of more than a decade.

## Recent Events

*As of mid-2012, at least a half dozen cities and counties faced fiscal distress severe enough to make state intervention likely within the coming year. They expect baseline expenditures to continue rising at a rate significantly higher than growth in local tax revenues and state aid. Many of these local governments already have made drawdowns from reserves and taken other actions that are not sustainable. As the state comptroller notes, some “are likely to be confronted with current year deficits that, if left unaddressed, could lead to difficulty in continuing normal operations. The decades-long economic and fiscal challenges facing New York’s cities have reached a new and critical point requiring serious public discussion.”<sup>101</sup>*

*The state often grants permission to local governments to issue deficit reduction bonds to cover operating deficits. From 2004 to January 2012, the Legislature authorized 21 bond issuances to finance local government operating deficits, according to DOB. Among these jurisdictions was the town of East Hampton, one of the wealthiest in the state, which received such authorization in 2008, 2009, and 2010.<sup>102</sup> In the closing days of the legislative session, four localities were authorized to borrow to cover deficits generated by the need to pay separation costs to retiring workers, which, according to the Citizens Budget Commission, may be a trend toward forms of “excusable” borrowing.<sup>103</sup>*

*The state also accelerates state aid payments (“spin-ups”) to help close fiscal gaps.<sup>104</sup> In the 2012-2013 budget, “fourteen cities will receive ‘spin-ups’ of future State assistance or other payments to help balance municipal budgets in the current year. Such advance payments will be reduced from future State assistance to the participating localities.”<sup>105</sup> As the comptroller notes, these fourteen cities are *one indicator* of the significant fiscal stress facing municipalities and school districts across the state; another is the large number of jurisdictions that are drawing down reserves to balance budgets.*

Several downstate local governments now threatened by fiscal crisis miscalculated or misread the continuing impact of the recession on their revenues and took no action to recognize the structural components of their imbalances. These governments (for example, the city of Yonkers) have the prospect of attaining long term fiscal sustainability, but may require temporary state action, possibly some form of credit assistance. Had there been a comprehensive, systematic state monitoring system in place, at least some of these fiscal problems might have been addressed before becoming serious enough to require state attention.

## New York City

New York City is *sui generis*. Comprised of five counties, it performs city and county responsibilities and has been granted greater tax raising leeway than other local governments: state authority for a local resident income tax (about 20 percent of its tax revenue) and a variety of other taxes and fees on business and consumers (including nonresidents). The property tax (the only tax whose rate is within the city’s control) accounts for only about 40 percent of total revenue.



The imposition of the Emergency Control Act on New York City in 1975 resulted in the establishment of professional budget, accounting, and planning systems. By law the city must end the fiscal year on June 30th with a budget balanced according to the strictest standards: GAAP. As a result of these reforms, since it re-entered the credit markets in 1982, the city has produced thirty-one years of balanced budgets.<sup>106</sup> At the beginning of fiscal year 2013, the city has the highest credit ratings in its history.<sup>107</sup> It produces quarterly an updated four-year financial plan, which is monitored by several state and city entities. The budget tied to that plan reports and closes any anticipated gap for the current fiscal year (July 1 to June 30) with their carryover effects into future budget years. The city has a large and very transparent multiyear capital budget (based on a ten-year capital plan which is revised in alternate years), within which the city's funds for projects are largely borrowed long term.

Since the end of the emergency in the 1970s, whether during economic growth or recession, New York City's financial plan has demonstrated an ongoing structural imbalance between revenues and expenditures. Budgeting has generally focused on efforts to reduce anticipated gaps in out-year budgets through containing costs and providing longer term revenues. Currently, the city is struggling to cope with rapidly rising "uncontrollable costs" — largely pension and OPEB costs.<sup>108</sup>

The sluggish economy, weak revenues, and unrelenting mandated expenses present *increasing risks to future budgets*.<sup>109</sup> At the end of June 2012, the city adopted a \$68.5 billion budget for fiscal year 2013, which was balanced. However, it relied to an unusual degree upon temporary resources, particularly resources related to taxi medallions discussed below. The financial plan presented gaps of \$2.5 billion in fiscal year 2014, growing to more than \$3 billion in each of fiscal years 2015 and 2016. In order to balance fiscal year 2013, the city had to close a projected \$4.6 billion gap and address new needs in excess of \$1 billion. It reduced some ongoing spending, but mostly it relied on nonrecurring actions: using up its surplus and other reserves.<sup>110</sup> The depletion of the Retiree Health Benefits Trust in 2013 and 2014 marks a regression in sound behavior. This trust was established to start dealing with the unfunded OPEB liability, and, as the control board points out, "the city needs to develop a plan on how to deal with this growing cost."<sup>111</sup> (See the OPEB section.)

On August 17, 2012, a judge of the state Supreme Court declared null and void the city's plan to sell 2,000 new taxi medallions. This program was budgeted for revenue over three years: \$625 million in fiscal year 2013, \$365 million in 2014, and \$460 million in 2015. The ruling threw the city's budget out of balance; the city is appealing it. The November 2012 quarterly update of the financial plan delays the receipt of these revenues until fiscal year 2014 and beyond and restores budget balance in fiscal year 2013 with some additional one-time audit and fee revenues and a further half a billion dollars in agency cuts.<sup>112</sup> Further adjustments are likely in January 2013.

The pressures local governments face call into question their ability to make communities safe and attractive, and to support economic growth. As the mayor of Rochester put it in testimony early this year, "Before we get to the point of financial failure, we will do substantial damage to the cultural and social environment that makes ... cities an attractive place to live. Cultural and social bankruptcy precedes financial bankruptcy."<sup>113</sup>

## *Education: Long Term Needs and Risks*

*With regard to the formal and legal structure of state education,*<sup>114</sup> Article XI of the New York Constitution requires the legislature to “provide for the maintenance and support of a system of free common schools, wherein all the children of the state may be educated.” Section 2 provides constitutional status to the Regents of the University as the governing body of the state’s system of common schools. The regents are responsible for public and nonpublic elementary, secondary, and postsecondary institutions, a number of cultural institutions, and major professions; they select the commissioner of education, who serves at their pleasure. “Comparative research has found no other state in which a single education authority has been assigned, either by constitution or by statute, the breadth of responsibilities assigned to the Board of Regents/Commission of Education.”<sup>115</sup>

### **K-12 Education**

Responsibility for the actual delivery of public education services lies with 697 local school districts.<sup>116</sup> New York ranks third, behind California and Texas, in student enrollment.<sup>117</sup> For the 2010-2011 school year, approximately 2.69 million students were enrolled in K-12 public schools, a number estimated to have decreased by 138,393 (approximately 11 percent) the following year, and expected to fall slightly further in the 2012-2013 year (by approximately 3,000).<sup>118</sup>

New York’s public school system is expensive. According to the 2010 Census of Elementary and Secondary Schools data, it was second to the District of Columbia in cost, having been the highest in the prior year. The average per student expenditure for public schools in the United States in the 2010-2011 school year was \$10,615; it was \$18,618 in New York.<sup>119</sup> New York’s system is supported by a mix of federal (approximately 8 percent), state (approximately 41 percent) and local (approximately 51 percent) funds. Most state aid (about 74 percent) comes from the general fund; the remainder is raised through lottery receipts (approximately 14 percent)<sup>120</sup> and via the School Tax Relief (STAR) program, through which the state takes on a portion of the local property tax burden. Local funds are generated primarily through property taxes, with cities able to levy up to a 4 percent sales tax, a portion of which may be shared with school districts.<sup>121</sup>

*In recent trends,* education funding in New York rose by roughly twice the rate of inflation from 2004 to 2011, whether measuring state aid to local school districts or total public school revenues.<sup>122</sup> Total revenues rose at least modestly every year, despite state aid reductions in 2009-2010 and (depending on the measure) in 2004-2005. From 2004 through 2009, total revenues to New York school districts rose by an average annual compounded rate of 5.3 percent, according to New York State Education Department data; in 2010, total revenues increased by just less than 3 percent. Enrollment declined modestly (3.5 percent), so per-pupil revenues rose by an additional several percentage points. Inflation over the period, as measured by the Consumer Price Index, was around 19 percent.

As part of the 2011-2012 and 2012-2013 state budgets, annual increases in total state aid to school districts are capped at the ten-year average change in statewide personal income, which recently has been around 4 percent. Table 6 provides the projection of state school aid into the future five school years, starting in the current year as presented in the Executive Budget for fiscal year 2012-2013.

**Table 6** | Projected State-Funds School Aid Disbursements,  
School Years 2012-2016

	Amounts in \$ millions				
	2012	2013	2014	2015	2016
School Aid	\$19,507	\$20,312	\$21,023	\$21,864	\$22,870
\$ Increase from Previous Year	N/A	\$805	\$711	\$841	\$1,006
% Increase from Previous Year	N/A	4.1%	3.5%	4.0%	4.6%
<b>Source:</b> NYS Division of Budget, 2012-13 Executive Budget Multi-Year Financial Plan Projections.					

*Fiscal stress is evident:* In a recent survey by the New York State Council of School Superintendents, 95 percent of school district leaders said they were drawing on reserves to pay for recurring operating expenses, with two-thirds indicating they were “very concerned” at the extent to which they were doing so. Compensation costs represent 70 percent of school district budgets, but contractual cost relief is difficult. Few districts are negotiating contracts with zero across-the-board increases. Built-in annual step increases remain in place; increases in pension and health care costs are in the double digit range. Further, the savings from the generational turnover of teachers seems to have peaked.<sup>123</sup> *All other things remaining constant, status quo contractual terms and ordinary retirements will drive larger average annual salary increases than in the recent past.* Add to that any increase in costs other than compensation.

Public schools in New York have been in retrenchment mode for the past two years. Overall K-12 employment in the state peaked in 2009 at 516,000, based on annual average figures from the Bureau of Labor Statistics. The 2011 annual average employment of 501,000 represented a decline of just less than 3 percent from the peak. *Total school employment is now around the level it was in 2004.* Statewide enrollment has declined modestly over the period, so that on a per-pupil basis, school employment remains relatively high by historical standards. Still, many school districts are eliminating highly valued, often longstanding educational and extracurricular programs in response to the current fiscal challenge.

The New York State Council of School Superintendents projects rising gaps between school districts’ overall revenues and baseline expenditure trends over at least the next five years.<sup>124</sup> Revenues — state aid and local property taxes — will likely rise by 3 to 4 percent annually in many districts, while the combination of salary increases and employee benefits (the bulk of expenditures) will rise at perhaps twice that rate, before actions to eliminate employee positions and other costs.

The approach of restraining both state and local funding sources for K-12 education faces little serious challenge. Even the Board of Regents in its state-aid proposals for 2012-2013 kept its requests within the limit of the statutory cap enacted in 2011.<sup>125</sup> From the perspective of the state’s structural budget balance, the aid limit linked to the growth of personal income represents a significant improvement.

## Higher Education

New York’s system of public higher education is the largest in the United States. It includes the State University of New York (SUNY) and City University of New York (CUNY), each being independent systems, comprehensive in scope. Enrollment in these institutions is expected to grow in the coming years by an estimated 5.5 percent for SUNY and 1.8 percent for CUNY.<sup>126</sup>

SUNY is comprised of sixty-four institutions, accommodating about 468,000 students and employing more than 88,000 faculty and staff.<sup>127</sup> Of SUNY's campuses, thirty-four are fully state operated and the other thirty are community colleges, sponsored by local governments, under SUNY's supervision.<sup>128</sup> There are also research centers, medical schools, hospitals, and a law school. CUNY encompasses twenty-four institutions, including senior colleges and a law school, educating more than 172,000 students (91,000 in community colleges).<sup>129</sup> Members of the SUNY Board of Trustees are appointed by the governor with the advice and consent of the state Senate; a majority of CUNY trustees is appointed in the same way, while a minority is appointed by the mayor of the city of New York, with the Senate's approval. The trustees appoint the respective chancellors.

SUNY's state operated campuses derive almost 40 percent of their income from direct state appropriations, while almost 60 percent of the income of CUNY senior colleges is from direct state appropriations. State appropriations supply about 30 percent of the income for community colleges in both systems. The other income sources are tuition and fees, local and federal funds, and miscellaneous sources.<sup>130</sup>

*Because the systems' revenue must be appropriated, the two systems have not been allowed, in practice, to set their own tuition policies.* This has been especially damaging to their general budget condition, since the relative level of state financial support has declined over decades — falling from a peak of \$1.5 billion in 2007-2008 for SUNY to \$1.2 billion in 2010-2011.<sup>131</sup> In general, the state has allowed the universities to raise tuition (through raising the appropriation level) only when the budget has included a sharp reduction in state support. Imposing higher tuition has not been allowed every year when state support has been reduced.<sup>132</sup>

*Recent developments* include, in 2011, reform of the tuition-setting process and efforts to enhance the economic development activities of campuses. *SUNY and CUNY trustees now can increase residential undergraduate tuition rates.* SUNY and CUNY are required to submit to the Legislature and budget director a *master plan for tuition rates over the next five years*, with revisions required to be submitted each year. Further, SUNY may impose a *differential tuition rate for nonresident undergraduate students at the four university centers* (Albany, Binghamton, Buffalo, and Stony Brook). Increases in these rates are limited to not more than 10 percent of the prior year's rate and must be approved by the governor. The four SUNY university centers are authorized to set aside a portion of their increased tuition revenue to provide financial aid to resident undergraduate students whose annual income exceeds \$80,000.

Under this reform, the state is subject to provision for "*maintenance of effort*" (MOE), whereby *state support for both university systems must be at least equal to the level of funding provided to them in the prior state fiscal year.* There are several catches, however. The MOE can be suspended if the governor declares a fiscal emergency. Additionally, this support includes funding for the operating budget and fringe benefits, so state support can remain flat (conforming with the MOE) at the same time as university costs rise to cover collective bargaining/fringe benefits (controlled by the state), effectively consuming much or all of the added revenue from the tuition increases.

A legislative initiative to leverage SUNY's role as an economic development catalyst authorizes the *four university centers* to submit long range economic plans using *coordinated public and private funding*.<sup>133</sup> with the ability to claim \$35 million in capital funding included in the state budget which can be used for campus expansion. There is no comparable program for CUNY.

The budget for 2012-2013 reflects the additional spending anticipated under the “rational” tuition increase plan adopted by the SUNY trustees in 2011 and by CUNY.<sup>134</sup> The budget provides \$30 million in capital funding, with \$30 million additional provided by SUNY. SUNY’s 60 nonuniversity centers will be eligible to compete for three \$20 million grants. The guarantee of annual tuition increases will provide incremental revenue to SUNY and CUNY, provided the state abides by the MOE requirement.

## Infrastructure

Publicly owned infrastructure in New York State is extensive by any measure. All levels of government (state, local, school districts, and authorities) own elements of the public infrastructure. The responsibilities for maintaining these assets, financing them, and reporting on their condition are similarly distributed.

The state's capital assets are valued at \$93.2 billion, with a net increase of \$2.5 billion over the past year, including:

- **Infrastructure** (primarily roads and bridges) \$66.1 billion
- **Buildings** (includes higher education and health) \$10.7 billion
- **Construction in progress** \$7.2 billion
- **All others** (land, equipment, etc.) \$9.2 billion.<sup>135</sup>

The capital assets of the city of New York are valued at \$46.5 billion, with a net increase of \$3 billion over the past year, including:

- **Infrastructure** (primarily roads and bridges) \$10.8 billion
- **Buildings** (schools, parks, hospitals, cultural sites, etc.) \$27 billion
- **Construction in progress** \$4.9 billion
- **All others** (land, equipment, etc.) \$3.7 billion.<sup>136</sup>

Unfortunately, there is no central assessment of New York's capital needs. The Federal Highway Administration reports 37 percent of bridges are structurally deficient or functionally obsolete; only 29 percent of all highway roads are in good or very good condition.<sup>137</sup> In 2009, the OSC determined a total of \$250 billion investment needs across the state over the next twenty years (\$175 billion for transportation, \$36 billion for municipal wastewater, and \$39 billion for clean water). It also projected that at current spending rates, New York's local infrastructure needs may be underfunded by as much as \$80 billion.<sup>138</sup> While the average American dam is about fifty-three years old, New York's average dam is more than seventy-five years old, representing an often overlooked risk.<sup>139</sup>

The New York State Department of Transportation (NYSDOT) has projected \$175.2 billion largely to maintain existing infrastructure over the next twenty years, excluding the Metropolitan Transit Authority (MTA), the New York State Bridge Authority (NYSBA), and the New York State Thruway Authority. Under current funding formulas and with current projected revenues, NYSDOT cannot fund half of this amount.<sup>140</sup> Between 2010 and 2015 alone, the state estimates that \$12 billion is needed to keep state highways and bridges in a state of good repair, with another \$300 million necessary for local bridges.<sup>141</sup> NYSBA has a twenty-year capital plan of \$603 million; from 2012 to 2016, the capital improvement plan proposes to spend \$159 million.<sup>142</sup> It estimates a cost of \$1.4 billion to replace structures.<sup>143</sup> The Thruway Authority and New York State Canal Corporation approved an \$850 million capital program for 2012 through 2015; originally the program called for \$1.1 billion in capital spending.<sup>144</sup>

Over the twenty-year period 2010 to 2029, the MTA, responsible for the downstate region's transportation network, estimates needs of \$129 billion to rebuild the existing system, which includes replacing assets and maintaining those already repaired. A significant backlog of assets needing rehabilitation and many assets restored in past programs will

reach the end of their useful lives during this twenty-year period, requiring replacement. The needs amount to \$84 billion for the subways; \$16.4 billion for the Long Island Railroad (LIRR); \$11.8 billion for Metro-North; \$12.4 billion for the bridges and tunnels; and the remainder for buses and security.<sup>145</sup>

*The state's water system also need attention:* The Federal Environmental Protection Administration estimates New York's twenty-year infrastructure need to be \$27 billion for drinking water and \$30 billion for wastewater.

## How to Pay for It?

New York's infrastructure needs far outstrip the resources available. Further, prioritization of those needs is highly decentralized. For example, the state prepares a five-year Capital Program and Financing Plan (CPFP), which is updated each year. The major elements of the CPFP are spending projections for each agency. Information is summarized by major program within each department, as well as financing sources and information on debt. Agencies must submit their capital budget requests in priority order but no central set of policies guides decision makers as they establish the state's priorities for capital spending. Local government and most public authority capital spending are not included in the CPFP. New York State does not mandate that local governments prepare and update a comprehensive capital plan, although New York City produces a ten-year capital plan.

About half of the fiscal year 2011-2012 capital budget of \$9.6 billion went to transportation projects.<sup>146</sup> To pay for these projects, the state planned to use \$4.7 billion in financing arrangements with public authorities, \$2 billion in federal funds, \$2.4 billion in funds on hand or received during the year, and \$484 million previously authorized general obligation bond proceeds.

The state's Executive Budget for fiscal year 2012-2013 proposes five-year total infrastructure spending of \$43 billion, with 49 percent for transportation and 22 percent for education. The NY Works proposal (\$3 billion) covers what was termed new capital investments, mainly for transportation, economic development, and higher education. More than half (\$1.64 billion) is the acceleration of projects from fiscal years 2015-2016 and 2016-2017; the majority (\$917 million) is federal funds; only \$723 million is state funds. Notwithstanding the capital plan's emphasis on accelerating infrastructure investments, total capital spending is projected to decline from \$9.7 billion in 2011-2012 to \$9.5 billion in 2012-2013.

State support for capital projects comes in part from voter-approved general obligation borrowing, which is difficult to achieve from a debt adverse electorate. Existing borrowing authority is fully committed. Available outstanding debt capacity under the state's debt cap is projected to decline from \$3.1 billion in fiscal year 2011-2012 to \$314 million in 2013-2014, before rising again to \$2.4 billion in 2016-2017. The cap (a function of state personal income) contracted during the recession and will begin increasing with economic growth.

For fiscal year 2012-2013, new debt issuances of \$5.1 billion are planned to finance new capital projects. The bond issuances will finance \$1.8 billion for education, \$1.6 billion for transportation, \$633 million for health and mental hygiene, \$508 million for economic development, \$332 million for facilities and equipment, and \$314 million for the environment.<sup>147</sup> Over the five-year plan, new debt issuances are projected to total \$21.8 billion.

The city of New York has a large, organized, and well documented capital budget and financial plan grounded in a ten-year capital plan (modified in alternate years). Over the past decade, the city has spent an average \$8.25 billion annually — about 80 percent its own funds — for capital investments, financed by debt.<sup>148</sup> The capital budget for the city's Department



of Environmental Protection (water and sewer improvements, including the huge multiyear third water tunnel) is financed through debt issued by the New York City Municipal Water Finance Authority, which levies user charges.

The city's capital commitments over fiscal years 2012 to 2016 total \$39.5 billion. The program is about 40 percent traditional infrastructure: water and sewer tunnels and pipes, roads, bridges, sanitation, and mass transit; 27 percent on schools; and 35 percent on housing, criminal justice, and a host of city services, including technology, museums, libraries, hospitals, and public buildings. To pay for this, the city's current financial plan projects \$32.3 billion of long term borrowing for fiscal years 2012 to 2016, which will be paid back from tax revenues and user fees (water and sewer charges).<sup>149</sup>

### Transportation Challenges

*Two large infrastructure challenges require special discussion.* The state is committed to the replacement of the vital fifty-six-year-old *Tappan Zee Bridge (TZB)*, about twenty miles north of Manhattan, which carries 138,000 vehicles daily between Westchester and Rockland counties, about 40 percent more than the design intended. The TZB is a crucial link between upstate and downstate economies. The replacement bridge is among fourteen projects that the president is speeding through the federal approval process and is expected to be open to traffic in 2018. *The estimated cost is at least \$5.2 billion.*<sup>150</sup> *Full details of a financing package for a new bridge are uncertain.*

The existing TZB is operated by the Thruway Authority and supported only by toll revenue. According to the state, the Thruway Authority plans to issue from \$2.3 billion to \$2.7 billion in bonds backed by bridge tolls.<sup>151</sup> *The authority's ability to do such a large financing is in doubt according to its consultants.* By 2015 and 2016, the ability of the authority's revenues to cover its debt service will fall below its own guidelines.<sup>152</sup> Both Standard & Poor's and Moody's lowered the Thruway Authority's credit outlook to negative in June 2012. The recently reauthorized federal transportation funding (MAP-21) allows the Federal Highway Administration to issue \$17.5 billion in Transportation Infrastructure Finance and Innovation Act (TIFIA) loans nationwide, covering as much as 49 percent of a project's cost.<sup>153</sup> Reportedly, the state is requesting a TIFIA loan of as much as \$2.9 billion.<sup>154</sup> This would reduce the amount of toll-backed bonds the Thruway Authority would have to issue, thus limiting the necessary size and frequency of toll increases. Tight competition for the TIFIA loans is expected, with creditworthiness given a high priority. *Most observers agree that it is hard to envision the TZB replacement going forward without a significant commitment of federal money (and perhaps even private investment). All options would impose increased toll burdens.*<sup>155</sup>

*The other challenge is adequate dependable funding for the capital needs of the MTA, which has been undergoing a thirty-year rebuilding.*<sup>156</sup> Over this period, as grants from the federal, state, and city governments have declined in importance, borrowing has become the prominent source of funding and accounts for 60 percent of the money going into the 2010-2014 capital program — twice the share as in the first ten years.<sup>157</sup> Although it receives capital grants, the MTA has borrowed significantly. MTA debt is serviced from current revenues and whatever savings it can generate by refinancing previous debt.

The largest source of revenues (funding operations and debt service) are fares (42 percent), followed by dedicated taxes and fees (40 percent), with tolls providing less than 15 percent and other revenues less than 5 percent. Unfortunately, *the MTA's revenues are not as consistent and predictable as hoped.* Fare and toll revenues are affected by changes in ridership and commuter volumes, which fluctuate with the economy, although they could meet budgeted targets if the rates were to be raised.<sup>158</sup> *The dedicated tax and fee revenues, however, have demonstrated significant volatility.*<sup>159</sup> The ups and downs

of the property transfer taxes in particular have been far steeper than changes in the economy as a whole: from a peak of \$1.6 billion in 2007, total transfer taxes plummeted 75.4 percent in just two years. Also, taxes with a limited history of collections are hard to forecast accurately. Further, the state Legislature since 2009 has approved three reductions to dedicated tax and fee revenue that had already been appropriated. *Crucially, the largest dedicated revenue — the Payroll Mobility Tax, budgeted for \$1.5 billion in 2012 and rising to nearly \$1.8 billion by 2016 — has been ruled unconstitutional.*<sup>160</sup> The ruling does not force the state to stop collecting the tax. The MTA is appealing; if the ruling is upheld, alternative permanent revenues will be required.

The MTA's outstanding debt is expected to rise from \$31.8 billion at the end of 2012 to \$40 billion in 2016. According to the state comptroller, such a "heavy reliance on debt burdens the operating budget..."<sup>161</sup> If the MTA wins approval from the federal government for a \$3 billion low-interest loan (to bring the LIRR access to Grand Central), debt service would reach \$3.2 billion in 2018. As a share of revenue, debt service could rise from 15.9 percent in 2011 to 22 percent in 2018.<sup>162</sup> However, these estimates do not include the next capital program, scheduled to begin in 2015. *The comptroller estimates that the MTA could require at least \$20 billion for the 2015-2019 core capital program, and the MTA has not identified funding sources.* If the MTA were required to bond a similar share of the 2015-2019 capital program, as it has in the current program, debt service could reach \$4.4 billion by 2024 and its ability to issue debt backed by dedicated transit taxes could be restricted by coverage requirements.<sup>163</sup>

As the Permanent Citizen's Advisory Committee to the MTA notes, "... the significant financial needs for regeneration and modernization of the MTA transit system are not going to go away anytime soon. Policy makers and elected officials must take heed."<sup>164</sup> The state has failed to enact legislation to generate revenues for the MTA from congestion or cordon pricing to the Manhattan central business district or from tolls on the East River and Harlem River bridges.<sup>165</sup> In October 2012, the Citizens Budget Commission proposed a "25-50-25" formula to allocate the costs of operation and maintain the MTA infrastructure among users and taxpayers. It is based on the principles that auto users should fully fund, through bridge and tunnel tolls, those structures and also subsidize about one-quarter of the costs of mass transit; mass transit fares should cover about half of their operating costs; and that state and local taxpayers should subsidize about one-quarter of mass transit operations and capital investment, bringing the system to a state of good repair.<sup>166</sup>

None of the foregoing takes into account the devastating impact that Hurricane Sandy wrought in November 2012. The storm demonstrated the fragility of the state's coastlines and the aged condition of its fixed rail mass transit systems as well as the vulnerability of its power grids. The immediate economic impact of the hurricane has been enormous, but the public and private costs to modernize and protect essential infrastructure is not currently estimated.

To address the unavoidable infrastructure consequences of Sandy, the state may be required to make the case to the electorate that voter approved, politically supported incurrences of new general obligation debt will be necessary.

*In sum*, the infrastructure investment needs in the state are staggering. This is particularly true in the downstate region, whose economy is the state's engine of growth. *Adding together the infrastructural needs of the state government, the state authorities, the MTA, and New York City, the costs of these projects, which last generations, are huge and overwhelm today's annual revenue flows that are available to support new debt.* Borrowing to pay for such long-lived assets makes sense. As a result of extensive borrowing, debt has grown; more borrowing is being counted on to fund future investments throughout New York. The imperative to pay the interest and principal on the future borrowing, though, is taking a mounting

share of tax, fee, toll, and fare revenue and eats into funds available for the general operations of government. The ability to raise taxes, fees, fares, and tolls to cover the debt service and the operations confronts the reality of creating additional burdens for taxpayers, residents, straphangers, and commuters, each with a single pocket from which to pay.

Transportation is essential to a dynamic economy. In order to sustain New York's economic health and to promote economic growth, the state's vast transportation infrastructure requires continuing adequate investment. An expanding economy can finance transportation investment in projects like the TZB and the MTA, but if transportation investment were to lag, so would the economy.

## Debt

Each of the states studied by the task force has both constitutional and statutory provisions that on their face authorize, control, and limit the amounts and type of debt that can be issued. These provisions all have evolved, and adherence to them, either strict or nominal, is a reflection of the governmental and spending cultures of the particular states. In New York, where there has been a sustained embrace of expansive government and spending activism, debt is widely used. Many forms of debt and debt issuers not envisaged in the state constitution have been devised by Wall Street to avoid limits and to facilitate government energy. *No effective institutional mechanisms exist to limit debt in New York.*

**Table 7 | Comparative Increases in All State and Local Debt Outstanding, 1969-2009**

		US	CA	IL	NJ	NY	TX	VA
Real Long-Term Debt Outstanding (\$ millions)	1969	583,969	72,253	26,865	18,313	88,384	31,011	9,195
	2009	2,638,954	372,538	127,870	88,996	287,341	223,163	58,575
	% change	352%	416%	376%	386%	225%	620%	537%
	1969 rank		2	5	9	1	4	21
	2009 rank		1	5	8	2	3	12
Real Per Capita Debt	1969	2,912	3,666	2,434	2,581	4,882	2,808	1,993
	2009	8,619	10,079	9,992	10,164	14,883	8,998	7,390
	% change	196%	175%	311%	294%	205%	220%	271%
	1969 rank		9	30	24	4	21	37
	2009 rank		7	9	6	1	15	27
Debt as Percent of Personal Income	1969	16%	17%	12%	12%	23%	18%	12%
	2009	22%	24%	24%	21%	32%	25%	17%
	% change	39%	43%	106%	70%	42%	40%	45%
	1969 rank		19	37	36	7	17	38
	2009 rank		9	10	24	2	7	36
Debt as Percent of GDP	1969	13%	14%	9%	11%	17%	13%	10%
	2009	19%	20%	20%	19%	26%	19%	14%
	% change	47%	41%	117%	75%	51%	45%	45%
	1969 rank		16	41	33	6	20	37
	2009 rank		11	10	19	2	16	39
Debt as Percent of General Own-Source Revenues	1969	130%	119%	116%	113%	149%	160%	108%
	2009	141%	148%	166%	133%	158%	173%	124%
	% change	9%	25%	44%	17%	6%	8%	15%
	1969 rank		27	29	31	16	12	35
	2009 rank		14	6	23	10	3	29
Population (in thousands)	1969	200,543	19,711	11,039	7,095	18,105	11,045	4,614
	2009	306,179	36,961	12,797	8,756	19,307	24,802	7,926
	% change	53%	88%	16%	23%	7%	125%	72%
	1969 rank		1	5	8	2	4	14
	2009 rank		1	5	11	3	2	12

**Source:** Analysis of Census Bureau and Bureau of Economic Analysis data.

**Note:** Dollars are adjusted to inflation using overall GDP index.

*New York has used debt to finance its extensive capital needs, occasionally to finance operating deficits, and to provide local assistance.*

The long term debt of the state of New York is among the highest of any state in the nation as shown in Table 7.

New York's total outstanding debt burden is displayed in Table 8.

### **Long Term General Obligation Debt**

New York is very restrictive with respect to general obligation (GO) debt. Article VII of the constitution requires that GO full faith and credit debt can only be issued if approved by the electorate at a general election. A proposed bond issuance must be for a single purpose and only one bond proposition can be considered per election. Bond proposals often have been defeated: in the last eighteen years only four GO bonding proposals have been put before the voters, and only two have been approved. As a result, no more than about \$3 billion of New York's approximately \$63 billion of outstanding long term debt is constitutionally prescribed GO debt; the balance is revenue or appropriation backed debt exclusively issued by state authorities. Accordingly, the intent to impose strict obstacles to the incurrence of debt as reflected in the constitution has been completely frustrated.

In order to expand its debt capacity, New York variously has used moral obligation bonds, service contract bonds, and lease-backed bonds, all of which depend on annual state appropriations for debt service. These forms of debt are no longer employed, although much of such debt remains outstanding. Two major types of debt that were employed but are no longer issued were appropriations/lease debt<sup>167</sup> and moral obligation bonds.<sup>168</sup> More than \$11 billion of appropriations/lease debt remains outstanding. Outstanding moral obligation debt currently totals \$20.4 million.

### **Non-GO Long Term (Revenue and Conduit) Debt**

Because of the severe constitutional limits on GO debt and voter antipathy to debt, New York created an extraordinarily complex set of mechanisms through which it finances its capital programs. *The state's primary financial disclosure document, the Annual Information Statement (AIS),<sup>169</sup> lists more than eighty individual bonding programs for which some element of state revenue is used to pay debt service or make payments to independent public authorities for that purpose.*

Beginning around the 1960s, New York began expanding the number of state created authorities, nearly all of which are empowered to issue revenue based debt. Currently, New York has more than 500 authorities. Some of the authorities, e.g., the Thruway Authority, issue revenue bonds, the proceeds of which are used to build or maintain capital facilities; the authority imposes tolls sufficient to provide a revenue stream to service the bonds. Other authorities, however, serve only as conduits or vehicles for the purposes of financing state capital assets. Their debt is commonly referred to as "backdoor borrowing."

*The state now relies almost exclusively on revenue bonds issued by selected authorities and backed by state taxes or fees such as the personal income tax and the sales tax. While authority revenue debt is legally deemed not to be state debt, if the debt is supported by state appropriations, it is viewed by investors and the credit rating agencies as appropriation debt and a function of the state. The State Finance Law Section 67a provides that bonds or notes issued by a state public benefit corporation (authority) for which the state is contractually obligated to pay debt service subject to appropriation is "state supported debt."*

**Table 8 | Debt Outstanding: New York (\$ thousands)**

	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012
<b>State Full Faith and Credit (G.O.)</b>						
Transportation	1,164,160	1,250,226	1,499,742	1,748,187	2,034,540	2,163,924
Econ Dev/Housing	90,240	120,741	105,256	90,240	77,497	65,520
Parks/Environ.	1,561,543	1,879,698	1,706,425	1,561,543	1,423,290	1,286,577
<i>Total</i>	<i>2,815,943</i>	<i>3,250,665</i>	<i>3,311,423</i>	<i>3,399,970</i>	<i>3,535,327</i>	<i>3,516,021</i>
<b>Approp/Lease – All Issuers</b>						
Education	6,550,897	6,017,394	5,801,231	5,418,226	5,057,428	4,779,278
Health/Hospitals	54,759	53,645	50,570	47,365	44,000	40,485
Transportation	4,161,450	3,936,350	3,763,485	3,551,895	3,353,885	3,116,910
Econ Dev/Housing	1,365,164	1,260,130	1,167,524	1,063,097	939,186	833,050
Parks/Environ.	222,393	193,412	171,662	160,171	137,781	119,075
Other	3,573,307	3,395,470	3,225,003	3,030,013	2,784,084	2,574,020
<i>Total</i>	<i>15,927,970</i>	<i>14,856,401</i>	<i>14,179,475</i>	<i>13,270,767</i>	<i>12,316,364</i>	<i>11,462,818</i>
<b>Revenue Debt</b>						
<b>PIT Bonds – All Issuers</b>						
Education	3,400,725	4,332,365	5,450,889	6,833,585	8,304,755	9,391,555
Health/Hospitals	0	66,045	156,265	1,142,350	1,369,255	1,933,409
Transportation	1,389,375	1,645,285	1,933,235	2,268,590	2,520,350	2,735,365
Econ Dev/Housing	1,415,705	2,387,182	2,856,191	4,130,180	4,438,600	4,652,612
Parks/Environ.	535,835	675,275	884,751	1,075,260	1,015,675	1,256,751
Other	1,673,695	1,908,085	2,429,839	2,738,990	3,337,200	3,610,270
<i>Total PIT Bonds</i>	<i>8,415,335</i>	<i>11,014,237</i>	<i>13,711,170</i>	<i>18,188,955</i>	<i>20,985,835</i>	<i>23,579,962</i>
<i>Sales Tax Bonds – LGAC</i>	<i>4,203,951</i>	<i>4,036,522</i>	<i>3,848,498</i>	<i>3,638,940</i>	<i>3,334,038</i>	<i>3,118,923</i>
<i>Highway Trust Fund – Thruway</i>	<i>5,983,265</i>	<i>6,559,957</i>	<i>6,857,843</i>	<i>7,536,955</i>	<i>7,267,105</i>	<i>7,680,719</i>
<b>Other – All Issuers</b>						
Education	752,200	873,355	974,760	1,043,710	1,139,920	1,364,250
Health/Hospitals	4,072,215	4,260,505	3,999,935	3,243,470	3,035,215	2,894,811
<i>Total Other</i>	<i>4,824,415</i>	<i>5,133,860</i>	<i>4,974,695</i>	<i>4,287,180</i>	<i>4,175,135</i>	<i>4,259,061</i>
<i>Total – Revenue Debt</i>	<i>23,426,966</i>	<i>26,744,576</i>	<i>29,392,206</i>	<i>33,652,030</i>	<i>35,762,113</i>	<i>38,638,665</i>
<i>Total – State-Supported Debt</i>	<i>42,170,879</i>	<i>44,851,642</i>	<i>46,883,104</i>	<i>50,322,767</i>	<i>51,613,804</i>	<i>53,617,504</i>
<b>Moral Obligation – All Issuers</b>						
Hospitals	7,955	3,605	3,255	2,880	2,480	2,035
Econ Dev/Housing	53,546	46,676	41,463	27,665	23,101	18,364
<i>Total</i>	<i>61,501</i>	<i>50,281</i>	<i>44,718</i>	<i>30,545</i>	<i>25,581</i>	<i>20,399</i>
<b>Other Debt</b>						
<i>Tobacco Securitization</i>	<i>4,084,470</i>	<i>3,839,480</i>	<i>3,550,525</i>	<i>3,256,805</i>	<i>3,011,900</i>	<i>2,718,275</i>
<b>Contingent/Guaranteed</b>						
Health/Hospitals	793,355	748,970	682,125	637,025	585,410	534,670
Eco Dev/Housing	57,410	37,350	32,470	27,745	23,220	18,940
<i>Total</i>	<i>850,765</i>	<i>786,320</i>	<i>714,595</i>	<i>664,770</i>	<i>608,630</i>	<i>553,610</i>
<i>Bond Bank – School Aid</i>	<i>484,455</i>	<i>463,685</i>	<i>442,065</i>	<i>419,475</i>	<i>395,775</i>	<i>370,910</i>

**Notes:** Most data from Mid-Year Update and Capital Program and Financing Plans. STARC, BARB data from state comptroller. The comptroller views STARC debt (\$2.246MM in 2011-2012) and BARBs (\$4.430MM) as state funded debt. DoB and CAFR treat these as NYC debt. The comptroller does not recognize moral obligation or state guaranteed/contingent obligation debt while DoB does.

Since the state relies so heavily on debt financing, and because it has demonstrated that there are many and varied ways to issue debt to circumvent the constitutional constraints, there developed a sense that debt was becoming out of control. In response, in 2000 the state promulgated the Debt Reform Act. The act limits all state-supported debt issued after April 1, 2000, to less than 4 percent of the total personal income of the state for the preceding fiscal year. Further, debt service cannot exceed 5 percent of general fund revenue. Debt issued and outstanding prior to 2000 is exempt from the act, as is authority debt that is not supported by state appropriation, as well as Tobacco Settlement securitization bonds.

The Debt Reform Act is legislation and, therefore, could be changed. Moreover, given the creativity of the financial industry to devise new forms of debt; given the state's historic reliance on debt and continued advocacy for new debt; and given that the Legislature can declare certain debt to be outside the purview of the act, the Debt Reform Act is far from an effective debt limitation.

DOB, however, provides strong oversight of debt practices and reports to the governor. A check on gubernatorial power is the Public Authorities Control Board (PACB), which is composed of the governor, the speaker of the Assembly, and the majority leader of the Senate. The PACB must approve major capital projects of certain authorities by unanimous vote. The Public Authorities Reform Act of 2009, which became effective in 2010, may serve as an additional check in that authority board members are to be insulated from political direction and are to exercise their fiduciary duty to the mission of the authority they serve, and not to those who appoint them.

### **PIT Bonds**

Beginning around 2001, the state has financed its capital requirements exclusively with long term revenue bonds backed by the proceeds of the personal income tax. *Five state authorities are authorized to issue PIT bonds: the Dormitory Authority, the Thruway Authority, the Urban Development Corporation, the Housing Finance Authority, and the Environmental Facilities Corporation.* PIT bonds are secured by a lock box mechanism into which 25 percent of PIT proceeds are diverted and deposited annually. These deposits provide excellent coverage for annual debt service needs. The Legislature is required to appropriate amounts necessary for annual debt service and reserves. When it does, the rest of the deposited proceeds are released to the general fund. If the Legislature were to fail to appropriate debt service requirements, the bond trustee may utilize the locked box funds for debt service, but funds remaining could not be released to the state. The Legislature never has failed to appropriate necessary PIT proceeds for debt service and PIT bonds enjoy high ratings.

While the use of PIT bonds provides the state with a large and legally invulnerable source of capital financing, the device remains a means of avoiding the onerous constitutional prescription for the issuance of GO debt. Further, the PIT bonds constitute the diversion of operating funds for the servicing of long term debt. That places a natural and cyclical, as opposed to an ineffective legal, limit on the state's ability to incur long term debt. It also continues the proliferation of authority debt without taxpayer control.

### **Variable Rate Debt**

New York State has a declining exposure to potential disruptions associated with variable rate instruments and swaps and other interest rate exchange agreements. A statutory cap limits the amount of variable rate debt to 15 percent of the total amount of outstanding debt. Variable rate debt totals \$2.7 billion, down sharply from the 2008 level of \$8.1 billion.



**Table 9** Variable Rate Debt and SWAPs: New York

Fiscal Year	SWAPs		Variable Rate Debt	
	Amount (\$ millions)	% of Debt	Amount (\$ millions)	% of Debt
2011-2012	\$2,248	4.1%	\$445	0.8%
2012-2013	\$2,234	4.0%	\$426	0.8%
2013-2014	\$2,202	3.9%	\$664	1.2%
2014-2015	\$2,115	3.8%	\$642	1.1%
2015-2016	\$2,008	3.6%	\$618	1.1%
<b>Source:</b> NYS Enacted Budget Capital Program & Financing Plan for FY 2012 (May 2011).				

### Local Government Assistance Corporation

Prior to 1990, the state was compelled to issue billions of dollars of short term tax and revenue anticipation notes each spring following the adoption of its budget and the beginning of its fiscal year at April 1. This was in order to finance local education aid and other obligations due before the state had received tax revenues on April 15th and also before school district and local governments received property tax payments payable after June 1st or July 1st (the starts of their fiscal years). The annual spring borrowings often drove the timing of state budget adoption decisions.

In 1990, the state established the Local Government Assistance Corporation (LGAC) to issue bonds to eliminate the long-running spring cash flow imbalance. LGAC included strict provisions to prevent a reoccurrence of the seasonal borrowings; New York has not issued seasonal borrowing notes since LGAC was established. The amount of LGAC bonding was permanently capped at \$4.7 billion and no new bond issuances are authorized.

LGAC uses the state's revenue backed bond model<sup>170</sup> (see the PIT Bonds section) whereby the proceeds from one-quarter of the state's annual sales tax receipts are "lock-boxed" and dedicated to pay debt service on revenue bonds issued by LGAC. Sales tax revenues that are not required for annual debt service are released to the state.

Table 10 displays New York's projected debt service obligations.

**Table 10** Debt Service: New York (\$ thousands)

	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016
Full Faith and Credit	\$500,442	\$494,906	\$493,490	\$492,581	\$485,802
PIT	\$2,172,507	\$2,453,326	\$2,658,971	\$2,881,742	\$2,997,609
Other Revenue Debt	\$1,736,459	\$1,819,358	\$1,892,591	\$1,887,054	\$1,941,158
Appropriation/Lease	\$1,442,379	\$1,546,739	\$1,476,114	\$1,372,486	\$1,293,715
Debt Management Strategies	\$0	\$0	(\$16,980)	(\$29,006)	(\$41,860)
<b>Subtotal, State-Supported Debt</b>	<b>\$5,851,787</b>	<b>\$6,314,329</b>	<b>\$6,504,186</b>	<b>\$6,604,857</b>	<b>\$6,676,424</b>
Tobacco	\$446,289	\$437,734	\$450,064	\$443,516	\$443,150
Moral Obligation	\$6,991	\$6,540	\$6,503	\$3,894	\$1,256
Other	\$129,668	\$128,902	\$129,855	\$126,609	\$127,074
<b>Total, State-Related Debt</b>	<b>\$6,434,735</b>	<b>\$6,887,505</b>	<b>\$7,090,608</b>	<b>\$7,178,876</b>	<b>\$7,247,904</b>

**Source:** Mid-Year Financial Plan Update, FY 2012 through FY 2015 (November 2011).

**Note:** Excludes debt service on STARC and BARBS.

## Conclusion

The states in the Task Force study confront similar challenges. These include the likely prolonged delay before the national economy returns to anything close to the trend growth path which predated the financial crisis. Another stems from the budgetary pressures exerted by national demographic forces: the greying of the population and its implications for funding health care for all citizens and pensions for public employees. In addition, states are the cockpit in which the growing competitive pressures exerted by globalization are played out, requiring a nimble, modern economy. States need to nurture a skilled, flexible labor force, possess up-to-date infrastructure, and maintain fiscal competitiveness. These three elements are the vital qualities needed for attracting local and foreign investment and retaining or creating good jobs at good wages.

New York, like all states, will need to adapt to a reduction in the growth of federal spending and likely federal tax reform. It is particularly sensitive to cuts in health care spending, particularly those aimed at hospitals, which could cause major disruption at the state and local level. Federal tax and revenue changes, such as limitations on the deductibility for state and local taxes and the exemption for municipal bonds, could hit New Yorkers hard, with significant implications for both the state's and city's revenues, which are heavily dependent on Wall Street earnings.

The state has a long and proud history of future-looking development, as with the Erie Canal, protection of workers and consumers, progressive taxation, public activism, and strong unionization. But the Empire State is not the powerhouse it was generations ago. Today there are structural budget problems, political and policy rigidities, and continuing legacy costs.

New York's structural deficit, papered over with gimmicks, has existed for decades. The state budget is very procyclical: when the economy is booming, so is spending; when times are bad, revenues crash and spending remains. Spending is dominated by America's most expensive Medicaid program and the highest spending per K-12 pupil in the nation. Albany has increased dependence on a small group of very wealthy taxpayers to keep the state going, which worsens revenue volatility and budget instability and heightens the state's exposure to risks outside its control. The state does not use the limited reserves it has to help it through difficulties, nor has it successfully designed and built a reliable system of reserves. There is no assurance that the state's structural deficit is sustainable.

Two challenges loom large:

- A mammoth, aged, and often obsolete physical infrastructure – particularly transportation – which is expensive to maintain, restore, and replace.
- A growing number of illiquid, near-insolvent cities and counties with structural budget deficits. They are bending under the weight of unique spending burdens, such as the local share of Medicaid, legacy costs, and a new limit on property tax growth.

It is not clear how Albany can meet either of them.

There is public support for public spending (although not necessarily new GO debt) and progressive taxation is popular (and mitigated somewhat as federal deductibility eases the burden). Albany has made an effort to impose new fiscal discipline. Progress is evidenced in steps to control Medicaid and education aid, but it is too early to know how effective these changes will be and what their impact may be on services.

## Endnotes

- 1 All the data in this paragraph are from New York State Office of the State Comptroller (NYS OSC), *Census 2010: New York's Economic Reality*, November 2011.
- 2 In the last fifty years, Long Island gained almost 900,000 people, Hudson Valley almost 700,000, and New York City about 400,000.
- 3 Indeed, for years economists have noted that the city's economy in many ways is closer to that of Europe than many parts of the U.S. See Carol O'Cleireacain, "The Private Economy and the Public Budget of New York City," *The City and the World: New York City in the Global Context*, Margaret E. Crahan and Alberto Vourvoulias-Bush, eds. (New York: Council on Foreign Relations, 1997).
- 4 New York State Office of the State Comptroller, *Census 2010: New York's Economic Reality*, p. 6.
- 5 The Fiscal Policy Institute's analysis of the American Community Survey (ACS) 2010 estimates shows U.S. poverty rate of 15.3 percent; Buffalo at 30.2 percent, Rochester at 33.8 percent, and Syracuse at 34 percent. Fiscal Policy Institute, *New York State Economic and Fiscal Outlook 2012-2013* (Latham, NY: Fiscal Policy Institute, January 2012), p. 44, [http://www.fiscalpolicy.org/FPI\\_BudgetBriefingBook\\_2012.pdf](http://www.fiscalpolicy.org/FPI_BudgetBriefingBook_2012.pdf).
- 6 Almost 326,000 private sector jobs were lost from peak (March 2008) to trough (November 2009) and 20,000 government jobs from March 2008-September 2012.
- 7 New York State Office of the State Comptroller, *Economic Trends in New York State*, October 2010, [http://www.osc.state.ny.us/reports/economic/nys\\_economic\\_trends.pdf](http://www.osc.state.ny.us/reports/economic/nys_economic_trends.pdf).
- 8 See New York State Office of the State Comptroller, *Economic Trends in New York State*, May 2012, [http://www.osc.state.ny.us/reports/economic/economic\\_trends\\_in\\_nys\\_22013.pdf](http://www.osc.state.ny.us/reports/economic/economic_trends_in_nys_22013.pdf). Also, NYS Department of Labor, "New York's Economy Continues Growth, Adding 5,900 Private Sector Jobs in October," press release, <http://labor.ny.gov/stats/pressreleases/pruistat.shtm>. There is much professional discussion of the inadequacies of the unemployment survey. In the current weak recovery, New York's job growth has been the thirteenth highest among all the states, yet no state had a higher reported increase in unemployment over the past two years. Economists at the Fiscal Policy Institute believe the state's unemployment rate is overstated by as much as a full percentage point. Even so, the relatively high rate of initial unemployment claims indicates there is a serious problem. See "State of Working New York 2012: Data Show a Disappointingly Weak Recovery" (Latham, NY: Fiscal Policy Institute, September 2, 2012), <http://fiscalpolicy.org/state-of-working-new-york-2012-data-show-a-disappointingly-weak-recovery>.
- 9 There has been an exception of sorts. As a result of 1990 legislation, the state had nonbinding "spending targets" in place for fiscal years 1991-1992 and 1992-1993, along with a temporary, statutory limit on state expenditures for fiscal year 1993-1994. The limit, which applied to total state budgetary spending other than federal funds and debt service, was set at 10 percent of annual personal income statewide. The law expired in 1994.
- 10 The state constitution imposes no limits on the amount of state taxation or spending that the Legislature may approve, nor does it prohibit particular forms of taxation, such as income or sales taxes.
- 11 New York State Legislative Law, Sec. 54.2.a.
- 12 See, for example, Richard Ravitch, "A Five-Year Plan to Address the New York State Budget Deficit," March 20, 2010, [http://www.rockinst.org/pdf/budgetary\\_balance\\_ny/2010-03-10-LG\\_FYFP.pdf](http://www.rockinst.org/pdf/budgetary_balance_ny/2010-03-10-LG_FYFP.pdf).
- 13 *Pataki v. Assembly/Silver v. Pataki*, 4 NY 3rd 75 (2004), 824 NE 2d 898, 2004.
- 14 New York State Office of the State Comptroller, *Fiscal Update: Closeout Analysis of SFY 2009-10* April 2010, p. 3, <http://www.osc.state.ny.us/reports/budget/2010/yearend0410.pdf>.
- 15 *Ibid.*, p. 4, <http://www.osc.state.ny.us/reports/budget/2010/yearend0410.pdf>. New York Division of the Budget, 2010-2011 Financial Plan Mid-Year Update, November 1, 2010, p. 16, [http://www.budget.ny.gov/pubs/archive/fy1011archive/enacted1011/1011midyear/2010-11\\_MidYearUpdate.pdf](http://www.budget.ny.gov/pubs/archive/fy1011archive/enacted1011/1011midyear/2010-11_MidYearUpdate.pdf).
- 16 *Ibid.*, p. 5, and New York State Office of the State Comptroller, "New York's Cash Flow Crunch," November 2009, p. 1, <http://www.osc.state.ny.us/reports/budget/2009/cashflowcrunch.pdf>.

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- 17 New York State Finance Law Article 4, Section 53 governs Special Emergency Appropriations “necessary or essential to the proper and efficient functioning of the government of the state.”
- 18 See E.J. McMahon, “Ugly Budget – But a Pretty Precedent,” *New York Post*, June 30, 2010, [http://www.nypost.com/p/news/opinion/opedcolumnists/ugly\\_budget\\_but\\_pretty\\_precedent\\_Bu2aHMgWg6vJWFkk3gRcJO](http://www.nypost.com/p/news/opinion/opedcolumnists/ugly_budget_but_pretty_precedent_Bu2aHMgWg6vJWFkk3gRcJO); and E.J. McMahon, “Is New York Ungovernable? Certainly Not, and David Paterson Has Helped Show The Way,” *The Post-Standard*, Syracuse, NY, August 29, 2010, [http://blog.syracuse.com/opinion/2010/08/is\\_new\\_york\\_ungovernable\\_certa.html](http://blog.syracuse.com/opinion/2010/08/is_new_york_ungovernable_certa.html).
- 19 *County of Oneida, et al., v. Berle*, 49 N.Y.2d 515 (1980). For discussion of impoundment, see Robert Ward, “Gubernatorial Powers to Address Budget Gaps During the Fiscal Year” (Albany, NY: The Nelson A. Rockefeller Institute of Government, June 17, 2010), [http://www.rockinst.org/pdf/budgetary\\_balance\\_ny/2010-06-17-Gubernatorial\\_Powers.pdf](http://www.rockinst.org/pdf/budgetary_balance_ny/2010-06-17-Gubernatorial_Powers.pdf).
- 20 New York State Office of the State Comptroller, *Report on the State Fiscal Year 2011-12 Enacted Budget*, May 2011, p. 7, [http://www.osc.state.ny.us/reports/budget/2011/2011\\_enactedbudgetreport\\_0511.pdf](http://www.osc.state.ny.us/reports/budget/2011/2011_enactedbudgetreport_0511.pdf).
- 21 Tax receipts were lowered in the current and following years due to a weaker-than-forecasted economy, global economic uncertainty, and the likelihood of a weak bonus season on Wall Street.
- 22 A budget is not balanced when revenues and spending do not match; a deficit results when revenues are less than spending. A structural imbalance is when this is chronically the case because revenues grow more slowly than spending over the business cycle. In the case of New York, OSC reports going back years have pointed out a worsening structural imbalance – with annual spending growth exceeding revenue growth.
- 23 Ravitch, “A Five Year Plan to Address the New York State Budget Deficit.”
- 24 The Office of the State Comptroller documents the one-shot and temporary actions in each annual report on the state’s enacted budget. This number adds them for fiscal years 2002-2003 through 2009-2010.
- 25 New York State Office of the State Comptroller, *Report on Estimated Receipts and Disbursements State Fiscal Years 2010-11 through 2012-13*, November 5, 2010, p. 1, <http://www.osc.state.ny.us/press/releases/nov10/quickstart2010.pdf>.
- 26 New York State Office of the State Comptroller, *New York’s Deficit Shuffle*, April 2010, <http://www.osc.state.ny.us/reports/budget/2010/deficitshuffle.pdf>.
- 27 New York State Office of the State Comptroller, “DiNapoli: Stop Playing Games With State Deficit,” April 5, 2010, <http://www.osc.state.ny.us/press/releases/apr10/040510.htm>.
- 28 New York State Office of the State Comptroller *New York’s Deficit Shuffle*, op.cit., p.4.
- 29 Ibid, pp. 4 and 5.
- 30 Ibid, p. 8.
- 31 Ibid, Appendix B.
- 32 New York State Office of the State Comptroller, *Report on the State Fiscal Year 2012-13 Enacted Budget*, June 2012, [http://www.osc.state.ny.us/reports/budget/2012/2012-13\\_Enacted\\_Budget.pdf](http://www.osc.state.ny.us/reports/budget/2012/2012-13_Enacted_Budget.pdf).
- 33 Business and personal income taxpayers are prevented from claiming certain tax credits related to business activities above a specific dollar threshold to which they are otherwise entitled. (Although this cap affects the PIT, it affects only business-related credits and not personal expenses such as the child care credit.)
- 34 Prior to the projected amortizations over the next several years, the annual payment estimates for the period 2011-2012 through 2025-2026 ranged from a high of \$3.1 billion in 2014-2015 to a low of about \$960 million in 2025-2026. After the amortization, the range is from \$3.1 billion in 2018-2019 to a low of \$1.5 billion in 2011-2012. Cumulative costs over the fifteen years ahead are estimated to increase by some \$6 billion because of the plan, from \$29.3 billion to \$35.5 billion. Under current projections, savings will peak in 2013-2014, remain significant in 2014-2015, before declining and then transforming into net costs for at least ten years thereafter.

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- 35 Funds received as a result of these conversions would be deposited to the HCRA account, a special revenue health care fund with direct financial implications to the general fund. The documents state that if these funds are not received, the state would have to raise revenue or reduce health-related spending in HCRA.
- 36 There is a wide literature on RDFs. See our final RDF paper for a bibliography and examples. In particular, the Center for Budget and Policy Priorities has been following state RDFs during the past two recessions. Their studies are available at <http://www.cbpp.org>.
- 37 See Matthew Sollars and Tammy P. Gamberman. *The Broken Umbrella: How to Make New York State's Rainy Day Fund More Useful* (New York, NY: Citizens Budget Commission, 2011), [http://www.cbccny.org/sites/default/files/REPORT\\_BrokenUmbrella\\_06062011.pdf](http://www.cbccny.org/sites/default/files/REPORT_BrokenUmbrella_06062011.pdf).
- 38 In April 2011, Comptroller DiNapoli proposed that the cap should be increased to 5 percent and that for every year New York incurs a surplus, 50 percent of the surplus should be placed in the fund. The CBC (Ibid.) supported the comptroller's request for an increase to 5 percent of general fund spending as a "step in the right direction" (p. 10), but their work indicated that keeping at least 10 percent of annual tax receipts in the RDFs would have covered the most recent shortfall. They recommended developing a mandate for the prudent use of the funds, raising the caps, defining where the savings should come from, and basing both withdrawals and repayments on economic indicators. (p. 9).
- 39 Laws of New York, 2009, Chapter 506, <http://www.abo.ny.gov/abo/Chapter506of2009.pdf>.
- 40 New York State Office of the State Comptroller, *Report on the State Fiscal Year 2012-13 Enacted Budget*, p. 3.
- 41 See New York State Department of Health, MRT Waiver Amendment Information Page, [http://www.health.ny.gov/health\\_care/medicaid/redesign/mrt\\_waiver.htm](http://www.health.ny.gov/health_care/medicaid/redesign/mrt_waiver.htm).
- 42 "New York's Medicaid Reforms," *The New York Times*, Editorial, September 18, 2012, <http://www.nytimes.com/2012/09/18/opinion/new-yorks-medicaid-reforms.html>.
- 43 John Holohan and Irene Headen, Medicaid Coverage and Spending in Health Reform: National and State-by-State Results for Adults at or Below 133% FPL (New York: Kaiser Commission on Medicaid and the Uninsured, May 2010, <http://www.kff.org/healthreform/upload/medicaid-coverage-and-spending-in-health-reform-national-and-state-by-state-results-for-adults-at-or-below-133-fpl.pdf>).
- 44 The Lewin Group, "Patient Protection and Affordable Care Act (PPACA): Long Term Costs for Governments, Employers, Families and Providers," Staff Working Paper #11 (Falls Church, VA: The Lewin Group, June 2010), [http://www.lewin.com/~media/Lewin/Site\\_Sections/Publications/LewinGroupAnalysis-PatientProtectionandAffordableCareAct2010.pdf](http://www.lewin.com/~media/Lewin/Site_Sections/Publications/LewinGroupAnalysis-PatientProtectionandAffordableCareAct2010.pdf).
- 45 Ravitch, Richard, "Lieutenant Governor's Report on Controlling Increases in the Cost of New York Medicaid," State of New York Executive Chamber, September 20, 2010, [http://www.rockinst.org/pdf/budgetary\\_balance\\_ny/2010-09-20-LG\\_Medicaid.pdf](http://www.rockinst.org/pdf/budgetary_balance_ny/2010-09-20-LG_Medicaid.pdf).
- 46 Per capita aid to the District of Columbia was \$16,436.
- 47 The table is for federal fiscal year 2010, and thus includes grant spending under the stimulus program, which has since waned, but total grants nonetheless are greater now than in 2010.
- 48 U.S. Census Bureau, *State and Local Public Retirement Systems, 2010*.
- 49 The aggregate cost method does not calculate an accrued liability or amortize an unfunded accrued liability, so plans using this method report that they are fully funded. This is remedied, in part, by recent accounting standard changes that require retirement systems to report liabilities using the entry age normal cost method even if they use other methods to compute annual required contributions.
- 50 For example, the contribution rate for New York ERS jumped from 0.41 percent of payroll to 8 percent between 2001 and 2003, following the dot-com burst. Since then, it dropped to about 5 percent at the peak of the market (2007), jumped to 11 percent by 2010, and most likely will grow to about 15 percent over the next few years.
- 51 The normal cost within an aggregate cost plan is based on the difference between the actuarial assets and the total liability. That difference is then funded over the average work life of the plan. If there is no difference, there is no normal cost. With other actuarial accounting methods, each year additional benefits are accrued and the annual normal cost is the cost of those newly accrued benefits, regardless of the plan's current funding position.

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- 52 *McDermott v. Regan*, 82 N.Y.2d 354 (1993). In 1990 the state Legislature attempted to mandate that the state comptroller (sole trustee of the state's Common Retirement Fund) use an actuarial method known as projected unit credit (PUC) rather than the aggregate cost method then being used. The PUC method was less conservative and would result in near-term budgetary savings to the state. The state's highest court ruled that this would impair the benefits of the pension fund.
- 53 Although the decision did not pertain to the Teachers Retirement System, in the case of school districts, the state withholds the districts' contributions from the state aid otherwise payable to the districts; so, as a practical matter these contributions also are made by local governments as determined by the state comptroller.
- 54 In 2003, in response to criticism that employer contributions had been allowed to drop to unrealistically low levels, the Legislature enacted a new requirement that employers contribute at least 4.5 percent of payroll every year. While some increase from such low (perhaps artificially low) rates was to be expected on an actuarial basis, employer costs of more than 10 percent of salary, starting in 2005, led many local government leaders and other critics to argue that pensions were becoming unaffordable. New York State Office of the State Comptroller, *New York State and Local Retirement System Comprehensive Annual Financial Report for Fiscal Year Ended March 31, 2004*, p. 26, [http://www.osc.state.ny.us/retire/word\\_and\\_pdf\\_documents/publications/cafr/cafr\\_04.pdf](http://www.osc.state.ny.us/retire/word_and_pdf_documents/publications/cafr/cafr_04.pdf).
- 55 State Budget Crisis Task Force, *Full Report*, July 2012, <http://www.statebudgetcrisis.org/wpcms/wp-content/images/Report-of-the-State-Budget-Crisis-Task-Force-Full.pdf>.
- 56 This section based largely on Robert Ward, "Pensions and OPEB in New York, Prepared for the Task Force on the State Budget Crisis" (Albany, NY: The Nelson A. Rockefeller Institute of Government, March 2012).
- 57 Article V, Section 7 of the state constitution provides: "After July first, nineteen hundred forty, membership in any pension or retirement system of the state or of a civil division thereof shall be a contractual relationship, the benefits of which shall not be diminished or impaired." Such benefits are also not subject to taxation; see Article XVI, Section 5.
- 58 New York State's Tier I applies to employees hired before January 1, 1973. Before statutory changes creating Tier V were enacted in December 2009, other changes occurred in Tier II (covering employees hired from July 1, 1973, through July 26, 1976); Tier III (July 27, 1976, through August 31, 1983); and Tier IV (September 1, 1983, through December 31, 2009).
- 59 Assets held by the Common Retirement Fund jumped by 70 percent from 1996 to 2000. Employer contributions were reduced from 3.7 percent of payroll in 1997 to 0.9 percent in 2000 and 2001 for the ERS. Employer contribution reductions for the Police and Fire Retirement System (PFRS) were even more dramatic, from 13.0 percent of payroll in 1996 to 1.4 percent in 2003. Further, the state itself was flush; personal income tax revenues in fiscal 2001 were 30 percent higher than those just two years earlier. Over the preceding five years, the legislature had adopted significant reductions in the personal income tax and in certain business taxes while creating a major new state-funded offset to school property taxes paid by homeowners. Unions had significant recent evidence to support their arguments for pension improvements on the basis of affordability and equity.
- 60 E.J. McMahon, "Blame Albany: Why union aims high," *New York Post*, December 22, 2005, [http://www.manhattan-institute.org/html/nypost\\_blame\\_albany.htm](http://www.manhattan-institute.org/html/nypost_blame_albany.htm).
- 61 Benefit changes resulting from Tier V are outlined at <http://www.osc.state.ny.us/retire/employers/tier-5/comparison.php>.
- 62 Changes include increasing the normal retirement age for most workers from sixty-two to sixty-three; reducing the pension "multiplier" for each year of service; increasing employee contribution rates so that employees earning more than \$45,000 pay more (rates rising from 3 percent in steps as the salary increases to 6 percent for those with salaries greater than \$100,000); and requiring the final average salary to be calculated over five years rather than three.
- 63 The state's first use of the practice came during the Depression. Senate Committee on Budget and Tax Reform (Senator Liz Krueger, chair), *Pension Amortization: Smoothing The Way or Stretching the Limits?*, December 2010, <http://www.empirecenter.org/files/Pension%20Amortization%20Report.pdf>.
- 64 State of New York, *Annual Information Statement Update*, February 8, 2012, p. 25, <http://www.budget.ny.gov/pubs/archive/fy1112archive/enacted1112/AIS/AISUpdateFebruary2012.pdf>.

- 65 The first modern use of amortization came in 1989, when the state’s pension funds were determined to be underfunded and “catch-up” payments by employers were required. The Legislature allowed employers to make such payments over a seventeen-year period with interest of 8 or 8.25 percent. Additional amortizations, typically for five years, were authorized by the legislature in association with several early retirement incentives from 1995 to 2002.
- 66 For example, if a retirement system with \$150 billion in assets, assumed to be earning 7.5 percent, segregated \$3 billion of those assets in an account earning 3.75 percent, the remaining assets would have to earn 7.58 percent for the system to hit the overall 7.5 percent target. This is just an illustration, but these numbers are not far from the current situation with New York’s Common Retirement Fund.
- 67 See p. D-4 of *New York State Statement of Updated Annual Information Pursuant to Continuing Disclosure Agreements: FY 2012 (Ending March 31, 2012), Annual Information Statement, Continuing Disclosure (New York State, July 26, 2012)*. Employer counts are based on data provided separately by the Office of the State Comptroller.
- 68 Roger L. Davis, *An Introduction to Pension Obligation Bonds and other Post-Employment Benefits, Third Edition* (Various Locations: Orrick, Harrington & Sutcliffe LLP, 2006), p. 46.
- 69 *Ibid.*, page 43.
- 70 This section is based primarily on Robert Ward, “Pensions and OPEB in New York.”
- 71 New York State Division of the Budget figures. The Empire Center for New York State Policy estimates that annual taxpayer-funded costs for retiree health coverage for all state and local government workers in New York total around \$5 billion. E. J. McMahon and Empire Center for New York State Policy, *Iceberg Ahead: The Hidden Cost of Public-Sector Retiree Health Benefits in New York* (Albany, NY: Empire Center for New York State Policy, 2010), Endnote 1, <http://www.empirecenter.org/Documents/PDF/Iceberg21.pdf>.
- 72 New York State Division of the Budget, *2012-13 Executive Budget Briefing Book*, p. 68.
- 73 For employees, they were increased by 2 percent, rising to 12 percent for individual policies and 27 percent for family coverage.
- 74 New York State Office of the State Comptroller, *State of New York Basic Financial Statements and Other Supplementary Information for Fiscal Year Ended March 31, 2012*, pp. 107, 109, 110.
- 75 New York State Financial Control Board (FCB), *Review of FYs 2013-2016 Financial Plan. July 19, 2012*, p. 1, [http://www.fcb.state.ny.us/pdf/FY2013\\_2016\\_Review.pdf](http://www.fcb.state.ny.us/pdf/FY2013_2016_Review.pdf).
- 76 McMahon and Empire Center, *Iceberg Ahead*.
- 77 At its peak (early-mid 1990s), the GCT accounted for as much as 16 percent of taxes and almost 1 percent of state GDP. See Fiscal Policy Institute, *New York State Economic and Fiscal Outlook 2012-2013, Jan. 2012*, pp. 52-53, [http://www.fiscalpolicy.org/FPI\\_BudgetBriefingBook\\_2012.pdf](http://www.fiscalpolicy.org/FPI_BudgetBriefingBook_2012.pdf).
- 78 The state budget offers extensive comparisons between the New York State tax structure and those of other states. These comparisons are difficult and generally assume that the entity sending in the tax payment is where the tax liability ultimately rests, which is often not the case. See New York State Department of the Budget, *NYS Budget Documents: Economic & Budget Outlook, Comparison of NY State Tax Structure with Other States*.
- 79 Fiscal Policy Institute, “Reforming the New York Tax Code” (Latham, NY: Fiscal Policy Institute, December 5, 2011) includes several proposals to broaden the base of the corporate tax, potentially generating more than \$200 million annually.
- 80 This element of the state’s tax policy has drawn criticism from a wide variety of observers – for example, from E.J. McMahon of the Manhattan Institute’s Empire Center as well as from groups that traditionally argue in favor of expanding the revenue base.
- 81 Office of the State Comptroller annual reports on enacted budgets.
- 82 John Mikesell “The Disappearing American Retail Sales Tax,” (Washington, DC: The Tax Association, November 2011).
- 83 *Ibid.* Such shrinkage was typical, although most other states started and ended with broader sales tax bases than New York. Nationwide, the median sales tax coverage for states was 47 percent of personal income during 1970-2010, ending at 34 percent in 2010.
- 84 For example, the tax rates in effect for 2009 through 2011 included a top rate of 8.97 for individuals at \$250,000 and above, or couples reporting \$500,000 in taxable income. A 7.85 percent rate extended on down the income scale, further expanding the number of taxpayers above the



permanent law top rate of 6.85 percent. When the Legislature imposed a similar “surcharge” on high income taxpayers from 2003 to 2005, the top rate was lower than that just enacted at 7.7 percent and applied to more taxpayers than the new law (the 2003 tax increase applied to all those with incomes of \$500,000 or above). Before 2003, the top rates were imposed starting at relatively modest levels of income (in the range of \$20,000 to \$30,000 from 1961 through 1987, and rising to \$40,000 for married couples from 1997 through 2002). While these rates limited the progressivity, they also limited volatility to some extent. From 1919 to 1933, only taxpayers with income above \$50,000 paid the state income tax. In 2011, such an amount would represent roughly \$871,000 in 1933 dollars. However, in 1934 the threshold was reduced to \$9,000, the equivalent of \$152,000 today. Until 2003, the top rate consistently applied to middle income taxpayers. Historical data are from the Department of Taxation and Finance’s *New York State Tax Sourcebook*, [http://www.tax.ny.gov/research/stats/statistics/policy-special/tax\\_sourcebook/new\\_york\\_state\\_tax\\_sourcebook\\_electronic\\_toc.htm](http://www.tax.ny.gov/research/stats/statistics/policy-special/tax_sourcebook/new_york_state_tax_sourcebook_electronic_toc.htm).

- 85 Email from Morris Peters to Robert Ward, December 12, 2011.
- 86 The new legislation also narrows the base of the metropolitan commuter transportation mobility tax (the “MTA payroll tax”) by exempting several hundred thousand taxpayers. This may increase volatility of the mobility tax modestly, but it is much less important in the state’s revenue system — representing an estimated \$1.4 billion this fiscal year, compared to \$38 billion for the PIT.
- 87 “Moody’s Assigns Aa2 Rating and Stable Outlook to State of New York’s General Obligation Bonds, Series 2011E & 2011F,” [http://www.moodys.com/research/MOODYS-ASSIGNS-Aa2-RATING-AND-STABLE-OUTLOOK-TO-STATE-OF-PR\\_232581](http://www.moodys.com/research/MOODYS-ASSIGNS-Aa2-RATING-AND-STABLE-OUTLOOK-TO-STATE-OF-PR_232581), December 2, 2011.
- 88 See Donald J. Boyd and Lucy Dadayan, “Revenue Declines Less Severe, But States’ Fiscal Crisis is Far from Over,” *State Revenue Report*, (Albany, NY: The Nelson A. Rockefeller Institute, April 2010), [http://www.rockinst.org/pdf/government\\_finance/state\\_revenue\\_report/2010-04-16-SRR\\_79.pdf](http://www.rockinst.org/pdf/government_finance/state_revenue_report/2010-04-16-SRR_79.pdf), where Table 11 provides a measure of relative dependence by US states on capital gains in their income tax receipts.
- 89 According to the Department of Taxation and Finance, during years when New York’s top PIT rate was 6.85 percent, the average effective New York tax rate on taxable gains was more than 6 percent. (More than 92 percent of capital gains are reported by taxpayers with adjusted gross income of \$200,000+; the average effective PIT rate for taxpayers with AGI above \$144,427 was 6.0 percent in 2008.)
- 90 The city’s high earning residents pay a combined state and local PIT rate of 12.7 percent, the highest in America.
- 91 The city does not have a nonresident PIT, although a city unincorporated business tax does hit a significant group of high income partners in law, accounting, advertising, architecture, and other partnerships who live outside the city. The real property tax provides considerable revenue stability. And the city has an effective four-year financial plan and modified accrual accounting, which brings greater transparency and forces forward-looking action.
- 92 “If the high volatility of New York’s revenue system persists into the next decade, long-range fiscal planning and maintaining a fiscal cushion through strong rainy day fund and fund reserve policies will become all the more important.... New York does not have a strong track record with either of these practices.” Robert Bifulco and William D. Duncombe, “Budget Deficits in the States: New York,” *Public Budgeting & Finance* 30, 1 (Spring 2010): 58-79.
- 93 Prior federal attempts since the 1980s have been fought off successfully. However, many anticipate that a future “grand bargain” on deficit reduction would be of a different nature. Significant limitation or elimination of the deduction would raise the effective “price” of taxes and could provide an incentive to states and localities to limit spending. See, for example, Gilbert E. Metcalf, “Assessing the Federal Deduction for State and Local Tax Payments,” *National Tax Journal*(64, 2, Part 2, June 2011): 565, [http://ntj.tax.org/wwtax/ntjrec.nsf/009a9a91c225e83d852567ed006212d8/ad1766b28983f8bb852578ab004e909c/\\$FILE/PSI05-Metcalf.pdf](http://ntj.tax.org/wwtax/ntjrec.nsf/009a9a91c225e83d852567ed006212d8/ad1766b28983f8bb852578ab004e909c/$FILE/PSI05-Metcalf.pdf).
- 94 Congressional Budget Office, *The Deductibility of State and Local Taxes* (Washington, DC: Congressional Budget Office, February 2008), [http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/88xx/doc8843/02-20-state\\_local\\_tax.pdf](http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/88xx/doc8843/02-20-state_local_tax.pdf). The impact on local governments in New York would be only slightly higher than the national average; federally deductible taxes represented 42.7 percent of local government own-source revenues in the state, compared to 39.9 percent nationally, although that masks large variations — particularly the special case of New York City.
- 95 Debt service and pension costs, for example.
- 96 Carol O’Cleireacain, “Health Insurance Cost Sharing: New York State’s Model for Localities” (Albany, NY: The Nelson A. Rockefeller Institute of Government, November 2010), [http://www.rockinst.org/pdf/budgetary\\_balance\\_ny/2010-11-08-Health\\_Insurance\\_Cost.pdf](http://www.rockinst.org/pdf/budgetary_balance_ny/2010-11-08-Health_Insurance_Cost.pdf).

- 97 The Office of the State Comptroller reports that of 798 local units audited, 22 percent enacted local laws allowing them to adopt a budget with a tax levy that exceeded the cap, although it is not clear the extent to which property tax levies actually utilized the authorization to exceed the cap. Five percent, or 43, of the audited governments adopted a levy that inappropriately exceeded the cap. The Office of the State Comptroller continues to educate, monitor, and audit on this issue. See, for example, <http://osc.state.ny.us/localgov/pubs/newsletter/summer2012.pdf>.
- 98 Office of the State Comptroller, Division of Local Government and School Accountability, *New Fiscal Realities Challenge Local Governments.*, August 2012, p. 3, <http://www.osc.state.ny.us/localgov/pubs/fiscalrealities2012.pdf>.
- 99 Ibid., p. 1.
- 100 “DiNapoli Proposes Early Warning System To Identify Local Governments In Fiscal Stress,” September 24, 2012, <http://www.osc.state.ny.us/press/releases/sept12/092412.htm>.
- 101 Office of the State Comptroller, Division of Local Government and School Accountability, *New York Cities: An Economic and Fiscal Analysis 1980-2010*, September 2012, p. 2, <http://www.osc.state.ny.us/localgov/pubs/fiscalmonitoring/pdf/nycreport2012.pdf>.
- 102 Other jurisdictions receiving such authorization during the period included the cities of Glen Cove, Newburgh, and Olean; Erie and Nassau counties; the towns of Deerpark (Orange County), Sidney (Delaware County), and Stony Point (Rockland County); the school districts of Beacon, Campbell-Savona, Chenango Valley, East Moriches, Fabius-Pompey, Patchogue-Medford, and South Country; and the village of Hempstead. Todd Miles, “Deficit Financing in New York,” *Municipal Lawyer*, New York State Bar Association, 18, 1, Winter 2004, p. 8.
- 103 These are the village of Lynbrook, the town of Oyster Bay, the city of Glen Cove, and the city of Long Beach. In the case of Glen Cove, the retirement of six police officers generated separation costs of \$1.8 million, 4 percent of the annual budget. Long Beach is required to repay in five years; the other three are given ten years. See Citizens Budget Commission, “How Sick Leave Can be Bad for a Locality’s Fiscal Health and Health Insurance May Be Even Worse,” July 2, 2012, <http://www.cbcny.org/cbc-blogs/blogs/how-sick-leave-can-be-bad-localitys-fiscal-health-and-health-insurance-may-be-even-w>.
- 104 See Todd Miles, “Deficit Financing in New York” for an interesting discussion of this issue.
- 105 New York State Office of the State Comptroller, *Report on the State Fiscal Year 2012-13 Enacted Budget. June 2012*, p. 4, [http://www.osc.state.ny.us/reports/budget/2012/2012-13\\_Enacted\\_Budget.pdf](http://www.osc.state.ny.us/reports/budget/2012/2012-13_Enacted_Budget.pdf).
- 106 New York City’s CAFR for FY 2012 is expected at the end of October 2012 and will mark the thirty-second year of GAAP balance.
- 107 “AA” by Standard & Poors, “Aa2” by Moody’s, and “AA” by Fitch for General Obligation bonds are “their highest ratings in at least 70 years.” Carol Kostik, NYC Deputy Comptroller for Public Finance, <http://www.comptroller.nyc.gov/bureaus/pf/bond-archive.shtm>.
- 108 New York City Office of Management and Budget, “The City of New York Executive Budget 2013: Budget Summary,” [http://www.nyc.gov/html/omb/downloads/pdf/sum5\\_12.pdf](http://www.nyc.gov/html/omb/downloads/pdf/sum5_12.pdf).
- 109 Per analyses of the state oversight agencies (Fiscal Control Board and New York State Office of the State Comptroller), Ibid., and New York State Office of the State Comptroller, *Review of the Financial Plan of the City of New York, July 2012, Report 4-2013*.
- 110 One action was to release \$500 million from a pension reserve, which had been set aside for expected cost increases resulting from actuarial changes in funding assumptions, as a result of the interaction of a number of changes in pension funding assumptions. The city actuary’s recommendations made revisions to the mortality rates and a decrease in the interest earning assumption to 7 percent from 8 percent, which increased costs. He also recommended a change in the method to calculate contributions, which is consistent with new changes by Governmental Accounting Standards Board, and created an unfunded liability to be amortized over twenty-two years. See New York State Financial Control Board (FCB), *Review of FYs 2013-2016 Financial Plan. July 19, 2012*, p.1.
- 111 Ibid., p.1.
- 112 See [http://www.nyc.gov/html/omb/html/publications/finplan11\\_12.shtml](http://www.nyc.gov/html/omb/html/publications/finplan11_12.shtml) for the updated plan and David W. Chen, “A Shortfall Looms, Bloomberg Plans Cuts,” *The New York Times*, November 12, 2012, <http://www.nytimes.com/2012/11/12/nyregion/bloomberg-proposes-cuts-to-libraries-and-higher-fees-on-school-lunches.html>, for the gist of it.
- 113 Mayor Thomas S. Richards, *Testimony, City of Rochester, NY, 2012*.

- 114 This section relies heavily on William Duncombe and Robert F. Pecorella, "State Education Aid in New York in the Wake of the Campaign for Fiscal Equity Decision," a draft of the chapter of the same name in *Governing New York State, Sixth Edition*, eds. Robert F. Pecorella and Jeffrey M. Stonecash (Albany, NY: SUNY Press, December 2012).
- 115 Robert D. Stone, "Education" in *The New York State Constitution: A Briefing Book*, ed. Gerald Benjamin (Albany, NY: The Rockefeller Institute Press, 1994), pp. 179-80.
- 116 This is forty fewer than in 1980, due to consolidation. See <http://www.p12.nysed.gov/irs/statistics/public/2012/TABLE2.pdf>.
- 117 National Education Association "Rankings and Estimates: Rankings of the States 2011 and Estimates of School Statistics 2012," Research Paper, December 2011, [http://www.nea.org/assets/docs/NEA\\_Rankings\\_And\\_Estimates\\_FINAL\\_20120209.pdf](http://www.nea.org/assets/docs/NEA_Rankings_And_Estimates_FINAL_20120209.pdf).
- 118 "Elementary and Secondary Public and Nonpublic School Enrollment," Table 1, <http://www.p12.nysed.gov/irs/statistics/public/2012/TABLE1.pdf>.
- 119 U.S. Census, *Public Education Finances*. June 2012, Table 8, <http://www2.census.gov/govs/school/10f33pub.pdf>.
- 120 These funds are mandated by statute; should they fall short, the balance is recouped from the General Fund.
- 121 In some cases, additional revenues are generated by a mix of further payments and nonproperty taxes levied by the municipality or school district: [https://stateaid.nysed.gov/publications/handbooks/handbook\\_2011.pdf](https://stateaid.nysed.gov/publications/handbooks/handbook_2011.pdf).
- 122 Sources include the Office of the State Comptroller's annual report on actual cash-basis disbursements and an annual Financial Condition Report, which presents expenditure and revenue figures on a GAAP basis. The two Office of the State Comptroller's data sets show similar rates of growth in state aid from fiscal years 2003-2004 to 2010-2011: total increases of 40.5 percent according to the cash report, and 42 percent based on the Financial Condition Report. The State Education Department (NYSED) figures for state aid to local schools show a slightly lower rate of increase, just under 37 percent and districts' total revenues (including local funds) rising by 43.3 percent over the period.
- 123 Academic researchers have noted the retirement of a sizable number of teaching and other employees (hired from the late 1970s into the 1980s) has freed up costs, since younger employees replacing them are much less expensive. The New York State Council of School Superintendents has estimated such changes may reduce per-employee costs by as much 50 percent. The number of retirements is likely to decline in coming years; in 2000, 25 percent of active members in the Teachers Retirement System were approaching normal retirement status within the decade; in 2011, only 16 percent of active Teachers Retirement System members were at that stage of their careers. *New York State Teachers Retirement System, Comprehensive Annual Financial Reports, 2011 and 2001*.
- 124 Robert Lowry, Council of School Superintendents, *2012-13 State Budget and the Schools*. Presentation at the 2012 Winter Institute, March 5, 2012, p. 30.
- 125 The regents called for the Legislature "to appropriate all funds available to education within legal limits." See New York State Board of Regents, *Proposal on State Aid to School Districts For School Year 2012-13*, at <http://www.p12.nysed.gov/stateaidworkgroup/2012-13RSAP/RSAP1213final.pdf>.
- 126 New York State Department of Education, Office of Higher Education, "Statewide Plan for Higher Education 2004-2012, Appendix B," <http://www.highered.nysed.gov/swp/page10.htm>.
- 127 State University of New York, "The Power of SUNY: Strategic Plan 2010 & Beyond," <http://issuu.com/generationsuny/docs/powerofsuny?mode=embed&layout=http%3A%2F%2Fskin.issuu.com> and SUNY Fast Facts 2011, [http://www.suny.edu/about\\_suny/fastfacts/](http://www.suny.edu/about_suny/fastfacts/).
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- 129 Ibid., <http://www.highered.nysed.gov/swp/page5.htm#funding>.
- 130 Ibid., <http://www.highered.nysed.gov/ocue/he/structureofhe.html>.
- 131 Over the past five years, operating support to SUNY was: \$1.331B in 2006-2007; \$1.507B in 2007-2008; \$1.458B in 2008-2009; \$1.267B in 2009-2010; and \$1.186B in 2010-2011.

- 132 As of 2011-2012, tuition rates for the New York resident undergraduate students at SUNY had been increased only three times since 1995-1996. Tuition was \$3,400 from 1995-1996 through 2002-2003; \$4,350 from 2003-2004 through Fall 2008-2009; \$4,970 from Spring 2008-2009 through 2010-2011; and \$5,270 as of 2011-2012.
- 134 The plans may include public-private partnerships, plans for campus expansions, tuition increases, and coordination with local governments.
- 134 \$113.2 million in additional spending authority for SUNY and \$66.6 million for CUNY.
- 135 *Comprehensive Annual Financial Report of the State of New York For Fiscal Year Ended March 31, 2011*. Data reported Capital Assets at Year-End, Net of depreciation, Total Primary Government, p. 25, <http://www.osc.state.ny.us/finance/finreports/cafr11.pdf>.
- 136 *Comprehensive Annual Financial Report City of New York for Fiscal Year Ended June 30, 2011*. Data reported Capital Assets at Year-End, Net of depreciation, p. 274.
- 137 New York State Department of Transportation, *Multimodal Investment Needs & Goals For the Future*, <https://www.dot.ny.gov/programs/repository/multimodal%20investment%20needs.pdf> and New York State Department of Environmental Conservation *Wastewater Infrastructure Needs of New York State*, March 2008, [http://www.dec.ny.gov/docs/water\\_pdf/infrastructure\\_rpt.pdf](http://www.dec.ny.gov/docs/water_pdf/infrastructure_rpt.pdf). New York State Department of Health, *Drinking Water Infrastructure Needs of New York State*, November 2008, [http://www.health.ny.gov/environmental/water/drinking/docs/infrastructure\\_needs.pdf](http://www.health.ny.gov/environmental/water/drinking/docs/infrastructure_needs.pdf).
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- 144 [http://www.eastaurorabee.com/news/2011-12-15/Legal\\_Notices/Thruway\\_board\\_adopts\\_2012\\_capital\\_program.html](http://www.eastaurorabee.com/news/2011-12-15/Legal_Notices/Thruway_board_adopts_2012_capital_program.html).
- 145 Metropolitan Transportation Authority, *Twenty Year Capital Needs Assessment 2010-2019*, Draft - August 2009, <http://www.mta.info/mta/capital/pdf/TYN2010-2029.pdf>.
- 146 The 2012-2013 budget did establish the NY Works Task Force, which will oversee and coordinate capital plans across forty-five agencies and authorities. NY Works allocated \$102 million dollars for flood and dam repair.
- 147 New York State Division of the Budget, "FY 2013 Capital Program and Financing Plan," <http://publications.budget.ny.gov/eBudget1213/capitalPlan/CapPlan.pdf>.
- 148 Debt service as a percent of tax revenue is 13.4 percent in fiscal year 2012 and expected to rise to 15.2 percent by 2016 in the Mayor's Executive Budget and Financial Plan for fiscal years 2013-2016.
- 149 The city of New York Office of Management and Budget, "May 2012 Executive Budget, Fiscal Year 2013," [http://www.nyc.gov/html/omb/html/publications/finplan05\\_12.shtml](http://www.nyc.gov/html/omb/html/publications/finplan05_12.shtml).
- 150 The bridge needs major rehabilitation, which would cost \$3.4 billion on top of the \$750 million maintaining it over the past decade.

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- 151 These thruway bonds would require no state budget action and would not be subject to the state debt cap. The governor has said construction will be paid for mostly by toll-backed bonds; although he has requested the Thruway Authority to find other funding sources in an effort to prevent tolls from almost tripling to \$14 from \$5, it is not clear what those sources might be.
- 152 New York State Office of the State Comptroller, *Assessment of the Thruway Authority's Finances and Proposed Toll Increase*, August 2012, [http://www.osc.state.ny.us/reports/thruway\\_policy\\_08142012.pdf](http://www.osc.state.ny.us/reports/thruway_policy_08142012.pdf).
- 153 The act, Moving Ahead for Progress in the 21st Century (Map-21), increased funding to generate roughly \$7.5 billion of lending capacity in fiscal years 2013 and \$10 billion in 2014. It also requires the Department of Transportation to review letters of interest for TIFIA loans on a rolling basis, which may explain New York's desire to get in before competitors. Stephanie Cohen, "State Raises Loan Request for Tappan Zee; Sees More Frequent Toll Hikes Without Loan," Bloomberg BNA Infrastructure Investment & Policy Report, September 11, 2012.
- 154 The request could drop to \$2.4 billion, depending on the construction costs, which may become clearer with the selection of a winning construction bid scheduled for October 2012. Note that in February 2012, New York sent the US Department of Transportation a letter of interest requesting a \$2 billion loan for the TZB project, which the Department did not act on in their first round on funding in April 2012. See Kate Hinds, "No Federal Loan for Tappan Zee Bridge — At Least Right Now," Transportation Nation Web Site, April 26, 2012, <http://transportationnation.org/2012/04/26/no-federal-loan-for-tappan-zee-bridge-at-least-right-now/>.
- 155 The authority has announced scheduled toll increases. Formal state approval is not required for toll increases; however, in past years, thruway toll hikes have been blocked by political pressure from elected officials.
- 156 Since the first modern capital program began in 1982, there has been about \$90 billion invested in the system. See New York State Office of the State Comptroller, *Financial Outlook for the Metropolitan Transportation Authority*, October 2012, <http://www.osc.state.ny.us/osdc/rpt8-2013.pdf>, according to the state comptroller.
- 157 Ibid.
- 158 In 2003, although transit ridership declined in the face of a poor economy, revenue increased following increases in fare and toll rates.
- 159 Five of the Metropolitan Transportation Authority's largest sources are closely associated with general business conditions: the corporate franchise tax surcharge; Metropolitan Transportation Authority district sales tax; petroleum business taxes; mortgage recording tax; and the urban taxes.
- 160 The ruling was based on the argument that the affected counties did not approve a home rule message requesting the state to impose the tax. Four similar Supreme Court cases have been dismissed and the Metropolitan Transportation Authority expects the case to be overturned on appeal. However, the tax remains very unpopular on Long Island, the home of the leader of the state Senate. As a result of the ruling, Moody's issued a "credit negative" for the Metropolitan Transportation Authority.
- 161 New York State Office of the State Comptroller, *Financial Outlook for the Metropolitan Transportation Authority*, p. 6.
- 162 Even with the biennial fare and toll increases of 7 percent, the burden could reach 19.8 percent by 2018. Ibid.
- 163 Coverage is the ratio of pledged revenues available to pay annual debt service. Ibid, p. 7.
- 164 Permanent Citizens Advisory Committee to the MTA. *The Road Back: A Historic Review of the MTA Capital Program*, May 2012, p. 31, <http://www.pcac.org/wp-content/uploads/2009/06/the-road-back.pdf>.
- 165 See Bruce Schaller, "New York City's Congestion Pricing Experience and Implications for Road Pricing Acceptance in the United States," *Transport Policy* 17, 4 (August 2010), 266-73.
- 166 Citizens Budget Commission. *A Better Way to Pay for the MTA*. October 10, 2012, <http://www.cbcny.org/content/better-way-pay-mta>.
- 167 Authority lease purchase debt was secured by a lease arrangement with the state. Prime examples of this are bonds issued by the Urban Development Corporation for state prison facilities and by the Dormitory Authority for state university academic facilities. In addition, New York authorities issued service contract debt in which the state entered into a contract with an authority to issue debt and provide a related service to the state.
- 168 These bonds were issued regularly several decades ago to enable public authorities to finance housing, higher education, and health care. In these cases, the state acknowledged that if the amount of revenue available to the authorities for debt service (from rents, tuition, and fees) fell short of

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required amounts, it was obligated to replenish the accounts from annual state budget appropriations. Issuing moral obligation debt ended with the near collapse of various state authorities in the mid-1970s.

169 New York State Division of the Budget, "Update to Annual Information Statement (AIS) State of New York, August 10, 2012, <http://www.budget.ny.gov/investor/ais/AISUpdateAug2012Final.pdf>.

170 Following New York's definition, a revenue bond is described as one that utilizes state revenues such as the sales tax or the personal income tax as an explicit security for a specific group of bonds.

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