

Balancing New York State's 2007-2008 Budget in an Economically Sensible Manner

February 2007

Fiscal Policy Institute

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

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

www.fiscalpolicy.org

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

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

February 2007

Table of Contents

I.	The Economic Context	2
	Jobs	3
	Wages.....	7
	Income Polarization	14
II.	The Fiscal Context	19
	Spending Trends	20
	Tax Cuts	22
	Pressure on Local Property and Sales Tax Bases	27
III.	Governor Spitzer’s Main Budget Proposals	41
	Savings	42
	Medicaid and Health Care	45
	Education	48
	Property Tax Relief.....	52

Balancing New York State's 2007-2008 Budget in an Economically Sensible Manner

I. The Economic Context. What are the social and economic challenges facing New York State as the Legislature considers Governor Eliot Spitzer's first Executive Budget?

II. The Fiscal Context. How do recent fiscal policy decisions affect the state, its local governments, and New York taxpayers?

III. Governor Spitzer's Major Budget Initiatives. What are the Governor's major budget initiatives and how do they address the social, economic and fiscal challenges facing New York State?

I. The Economic Context

New York State faces two major challenges.

Last November, FPI's new policy paper, *One New York: An Agenda for Shared Prosperity*, identified two major challenges facing New York State:

- Helping New York's regions grow together. The state economy as a whole is expanding, but growth has been highly uneven.
- Strengthening and expanding the middle class. New York's economy is increasingly polarized between rich and poor, with a shrinking middle class.

The *State of Working New York* and other FPI publications provide data to document these challenges. (See www.fiscalpolicy.org.)

The following slides cover the economic context for New York State's budget, and update trends in:

- Employment,
- Wages, and
- Resumption of income polarization.

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

Employment	(in thousands, seasonally adjusted)	U.S.	New York State	New York City
March 2001	(peak of business cycle)	132,504	8,671	3,742
November 2001	(end of national recession)	130,883	8,471	3,603
May 2003	(U.S. employment trough)	129,826	8,400	3,530
December 2006*	(latest month)	137,147	8,607	3,658
March 2001 - November 2001 (Recession)				
Change		-1,621	-200	-139
% change		-1.2%	-2.3%	-3.7%
November 2001 - May 2003 (Post-recession Downturn)				
Change		-1,057	-71	-73
% change		-0.8%	-0.8%	-2.0%
May 2003 - December 2006 (43 months of recovery)				
Change		7,321	207	128
% change		5.6%	2.5%	3.6%
March 2001 - December 2006 (from business cycle peak to latest)				
Change		4,643	-64	-84
% change		3.5%	-0.7%	-2.2%

Source: Bureau of Labor Statistics; New York State Department of Labor. NYS and NYC seasonal adjustment by FPI.

*December 2006 data subject to revision.

But employment trends have varied dramatically from region to region.

	Non-agricultural employment			Absolute and Percent Change					
	2000	2003	2006	2000 to 2003		2003 to 2006		2000 to 2006	
UNITED STATES	131,785,000	129,999,000	135,371,000	-1,786,000	-1.4%	5,372,000	4.1%	3,586,000	2.7%
NEW YORK STATE	8,635,200	8,407,000	8,601,600	-228,200	-2.6%	194,600	2.3%	-33,600	-0.4%
NEW YORK CITY	3,723,100	3,531,700	3,653,600	-191,400	-5.1%	121,900	3.5%	-69,500	-1.9%
EASTERN NEW YORK	2,623,500	2,644,400	2,705,700	20,900	0.8%	61,300	2.3%	82,200	3.1%
Nassau-Suffolk	1,218,000	1,222,800	1,246,400	4,800	0.4%	23,600	1.9%	28,400	2.3%
Putnam-Rockland-Westchester	550,900	555,100	571,100	4,200	0.8%	16,000	2.9%	20,200	3.7%
Albany-Schenectady-Troy	438,200	439,800	449,100	1,600	0.4%	9,300	2.1%	10,900	2.5%
Glens Falls MSA	51,400	52,200	54,400	800	1.6%	2,200	4.2%	3,000	5.8%
Kingston MSA	64,700	65,000	64,900	300	0.5%	-100	-0.2%	200	0.3%
Poughkeepsie-Newburgh-Middletown MSA	239,400	248,000	256,900	8,600	3.6%	8,900	3.6%	17,500	7.3%
Columbia County	21,700	21,000	21,300	-700	-3.2%	300	1.4%	-400	-1.8%
Greene County	13,700	14,500	14,700	800	5.8%	200	1.4%	1,000	7.3%
Sullivan County	25,500	26,000	26,900	500	2.0%	900	3.5%	1,400	5.5%
WESTERN AND NORTHERN NY	2,287,500	2,229,700	2,244,600	-57,800	-2.5%	14,900	0.7%	-42,900	-1.9%
<i>W&N NY Metropolitan Areas</i>	1,771,300	1,719,500	1,727,300	-51,800	-2.9%	7,800	0.5%	-44,000	-2.5%
Binghamton MSA	118,900	112,700	112,400	-6,200	-5.2%	-300	-0.3%	-6,500	-5.5%
Buffalo-Niagara Falls MSA	558,300	545,800	546,400	-12,500	-2.2%	600	0.1%	-11,900	-2.1%
Elmira MSA	43,600	40,900	40,500	-2,700	-6.2%	-400	-1.0%	-3,100	-7.1%
Ithaca MSA	58,600	60,700	62,100	2,100	3.6%	1,400	2.3%	3,500	6.0%
Rochester MSA	530,100	509,900	508,200	-20,200	-3.8%	-1,700	-0.3%	-21,900	-4.1%
Syracuse MSA	325,400	317,500	324,500	-7,900	-2.4%	7,000	2.2%	-900	-0.3%
Utica-Rome MSA	136,400	132,000	133,200	-4,400	-3.2%	1,200	0.9%	-3,200	-2.3%

	Non-agricultural employment			Absolute and Percent Change					
	<u>2000</u>	<u>2003</u>	<u>2006</u>	<u>2000 to 2003</u>		<u>2003 to 2006</u>		<u>2000 to 2006</u>	
<i>W&N NY Non-metropolitan areas</i>	516,200	510,200	517,300	-6,000	-1.2%	7,100	1.4%	1,100	0.2%
Allegany County	16,700	16,800	17,100	100	0.6%	300	1.8%	400	2.4%
Cattaraugus County	34,300	34,600	34,600	300	0.9%	0	0.0%	300	0.9%
Cayuga County	26,200	26,600	27,200	400	1.5%	600	2.3%	1,000	3.8%
Chautauqua County	59,500	56,600	56,900	-2,900	-4.9%	300	0.5%	-2,600	-4.4%
Chenango County	17,400	16,600	16,800	-800	-4.6%	200	1.2%	-600	-3.4%
Clinton County	35,500	36,000	35,500	500	1.4%	-500	-1.4%	0	0.0%
Cortland County	19,600	19,300	19,300	-300	-1.5%	0	0.0%	-300	-1.5%
Delaware County	17,400	17,900	18,300	500	2.9%	400	2.2%	900	5.2%
Essex County	15,800	15,200	15,400	-600	-3.8%	200	1.3%	-400	-2.5%
Franklin County	18,900	18,800	19,100	-100	-0.5%	300	1.6%	200	1.1%
Fulton County	18,800	18,500	18,700	-300	-1.6%	200	1.1%	-100	-0.5%
Genesee County	23,200	23,300	23,000	100	0.4%	-300	-1.3%	-200	-0.9%
Hamilton County	2,000	2,000	2,100	0	0.0%	100	5.0%	100	5.0%
Jefferson County	40,000	40,300	41,800	300	0.8%	1,500	3.7%	1,800	4.5%
Lewis County	6,700	6,500	6,700	-200	-3.0%	200	3.1%	0	0.0%
Montgomery County	19,300	19,100	19,900	-200	-1.0%	800	4.2%	600	3.1%
Otsego County	25,000	25,900	26,800	900	3.6%	900	3.5%	1,800	7.2%
St. Lawrence County	42,300	41,700	41,900	-600	-1.4%	200	0.5%	-400	-0.9%
Schuyler County	4,500	4,800	4,900	300	6.7%	100	2.1%	400	8.9%
Seneca County	10,500	11,000	11,400	500	4.8%	400	3.6%	900	8.6%
Steuben County	43,200	38,000	38,200	-5,200	-12.0%	200	0.5%	-5,000	-11.6%
Wyoming County	13,000	13,700	14,500	700	5.4%	800	5.8%	1,500	11.5%
Yates County	6,400	7,000	7,200	600	9.4%	200	2.9%	800	12.5%
NEW YORK STATE	8,635,200	8,407,000	8,601,600	-228,200	-2.6%	194,600	2.3%	-33,600	-0.4%
10-COUNTY DOWNSTATE AREA	5,492,000	5,309,600	5,471,100	-182,400	-3.3%	161,500	3.0%	-20,900	-0.4%
52-COUNTY UPSTATE AREA	3,142,100	3,096,200	3,132,800	-45,900	-1.5%	36,600	1.2%	-9,300	-0.3%

Totals may not agree due to rounding. Half-year figures are rounded averages of rounded monthly figures.

Sources: New York State Department of Labor; US Bureau of Labor Statistics. Not seasonally adjusted.

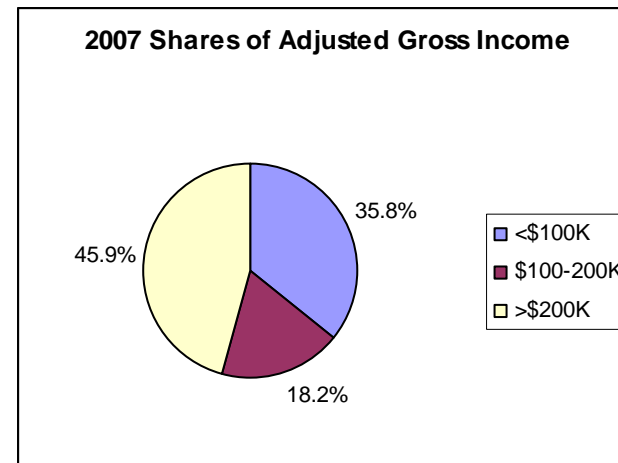
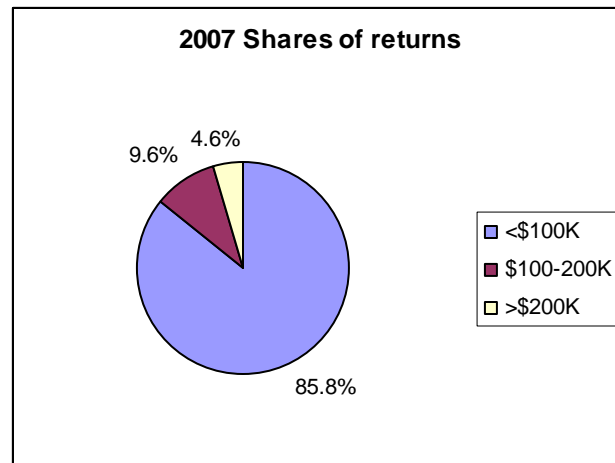
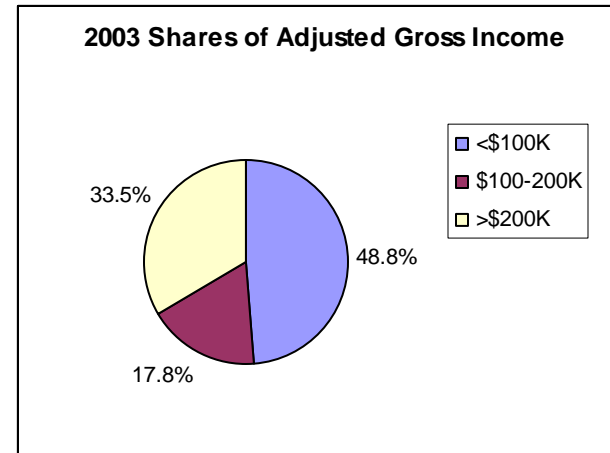
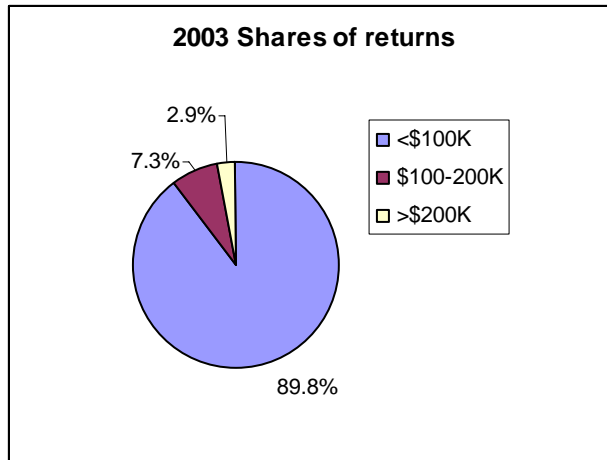
DOL data updated through Jan.18, 2007; 2006 figures are preliminary.

Five years after the nominal end of the recession, employment in most sectors has not recovered.

	Employment level (seasonally adjusted)		Employment change December to December					Percent change			
	December 2000	December 2006	2000-2003	2003-2004	2004-2005	2005-2006	2003-2006	2000-2003	2003-2004	2004-2005	2005-2006
Total Nonfarm	8,692,115	8,607,087	-280,756	91,417	41,770	62,541	195,728	-3.2%	1.1%	0.5%	0.7%
Construction	334,936	332,279	-17,908	8,581	-259	6,930	15,251	-5.3%	2.7%	-0.1%	2.1%
Manufacturing	739,663	558,711	-138,457	-7,992	-24,201	-10,302	-42,495	-18.7%	-1.3%	-4.1%	-1.8%
Wholesale Trade	379,059	348,019	-25,750	1,539	-952	-5,877	-5,290	-6.8%	0.4%	-0.3%	-1.7%
Retail Trade	887,106	883,721	-28,621	17,471	2,077	5,687	25,235	-3.2%	2.0%	0.2%	0.6%
Utilities	41,764	39,261	-1,551	-930	280	-303	-953	-3.7%	-2.3%	0.7%	-0.8%
Transportation and Warehousing	241,885	229,688	-18,959	5,169	562	1,030	6,762	-7.8%	2.3%	0.2%	0.5%
Information	330,135	269,321	-56,975	-6,388	3,988	-1,439	-3,840	-17.3%	-2.3%	1.5%	-0.5%
Finance and Insurance	563,523	538,840	-46,819	6,935	10,240	4,962	22,137	-8.3%	1.3%	2.0%	0.9%
Real Estate Rental and Leasing	185,183	186,216	-3,917	2,964	-1,023	3,009	4,950	-2.1%	1.6%	-0.6%	1.6%
Professional, Scientific, and Technical Services	564,838	551,994	-52,677	11,660	10,594	17,580	39,833	-9.3%	2.3%	2.0%	3.3%
Management of Companies and Enterprises	116,466	121,713	4,744	2,458	-1,829	-127	502	4.1%	2.0%	-1.5%	-0.1%
Admin. & Supp. and Waste Manage. & Remed. Servs.	454,269	426,661	-40,175	8,242	8,561	-4,237	12,567	-8.8%	2.0%	2.0%	-1.0%
Educational Services	299,262	359,628	38,620	7,610	5,703	8,432	21,745	12.9%	2.3%	1.7%	2.4%
Health Care and Social Assistance	1,102,147	1,220,747	64,690	19,617	14,372	19,920	53,909	5.9%	1.7%	1.2%	1.7%
Leisure and Hospitality	647,567	678,708	5,020	15,384	3,028	7,709	26,121	0.8%	2.4%	0.5%	1.1%
Other Services	343,138	362,477	6,358	6,290	1,987	4,704	12,981	1.9%	1.8%	0.6%	1.3%
Government	1,462,391	1,493,913	29,548	-8,711	6,999	3,685	1,973	2.0%	-0.6%	0.5%	0.2%

Source: NYSDOL, seasonal adjustment by Fiscal Policy Institute.

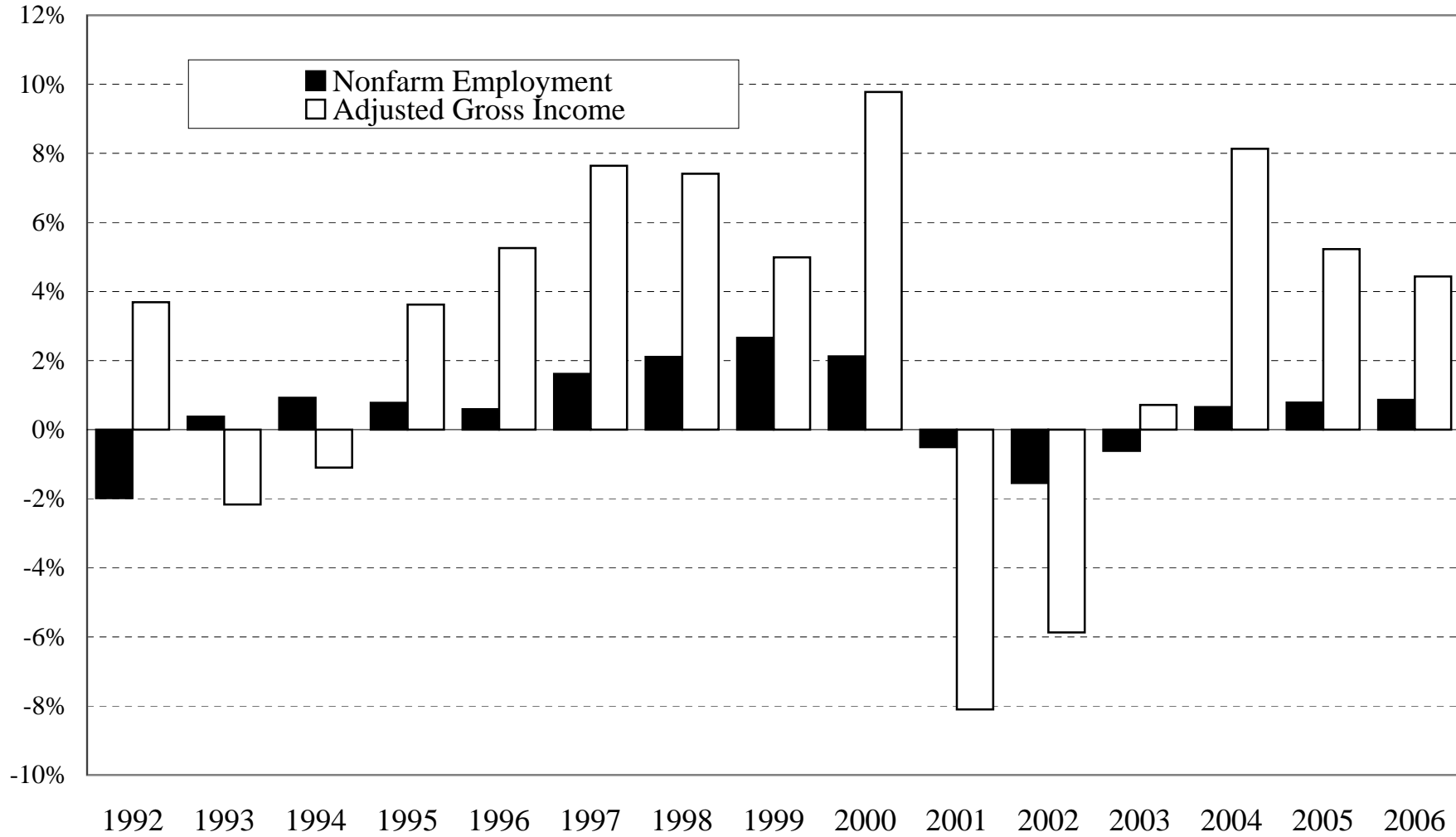
While income polarization moderated in the late 1990s, it has resumed growing since 2003.



Source: New York State Executive Budget: Economic and Revenue Outlook, 2007-08 (p. 260) and 2006-07 (p. 180).

New York's income growth often exceeds job growth. This recovery continues that trend.

Percent change in annual average nonfarm employment vs. percent change in adjusted gross income in constant (2006) dollars.



Capital gains and Wall Street wages account for a significant share of the growth in New York's personal income tax base.

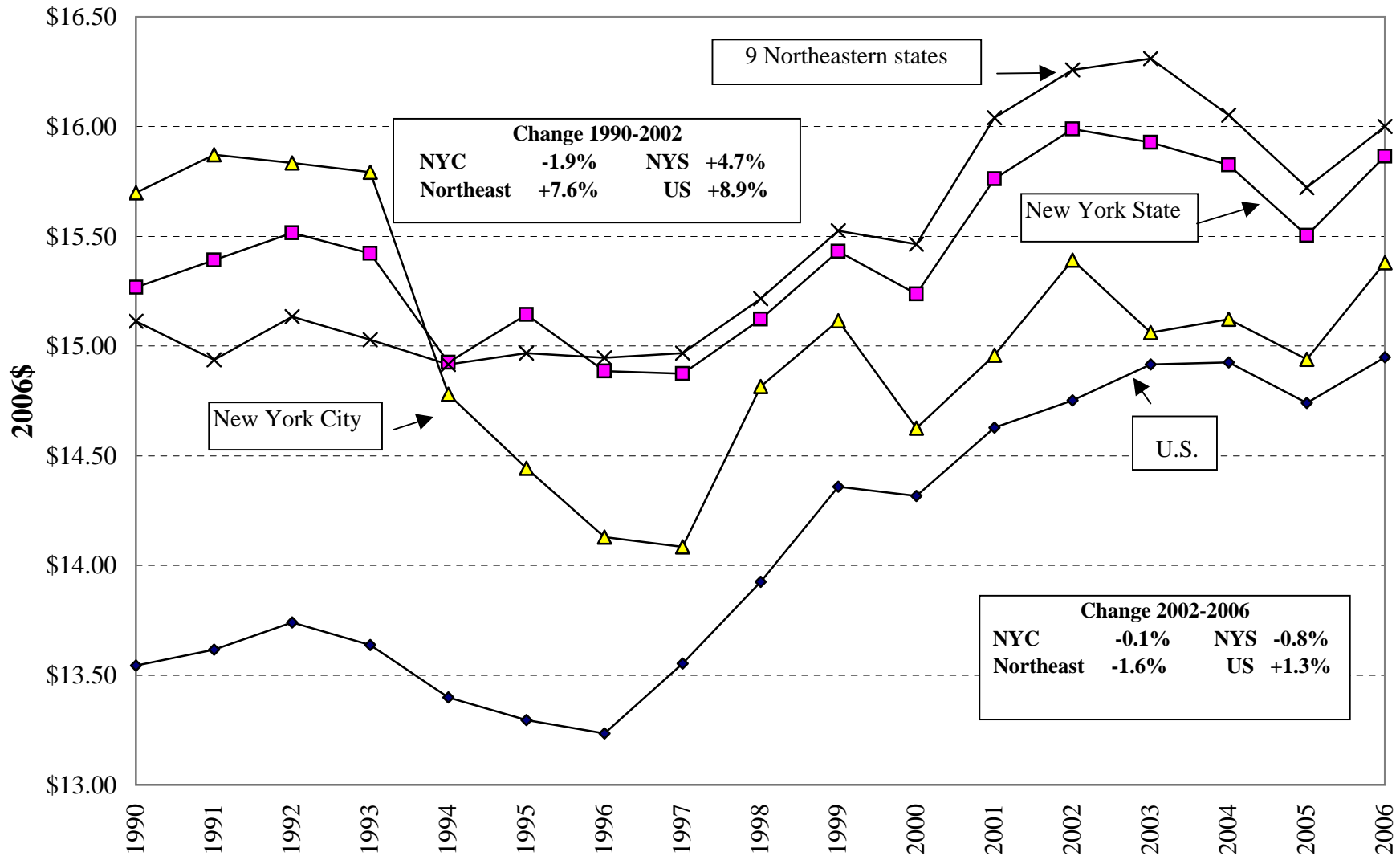
	New York State Adjusted Gross Income (NYSAGI) (\$ millions)	Net Capital Gains (\$ millions)	Total Wall Street Wages (\$ millions)	Change from prior year			Capital Gains and Wall Street Wages as share of	
				AGI (\$ millions)	Capital Gains (\$ millions)	Wall Street Wages (\$ millions)	AGI	AGI change from prior year
1991	270,686	8,735	12,321				7.8%	
1992	289,044	9,457	17,850	18,357	722	5,529	9.4%	34.1%
1993	291,420	13,365	18,572	2,376	3,908	722	11.0%	194.8%
1994	287,844	12,032	17,274	-3,576	-1,333	-1,298	10.2%	73.6%
1995	317,825	14,086	20,187	29,981	2,054	2,913	10.8%	16.6%
1996	344,569	22,441	24,534	26,744	8,355	4,347	13.6%	47.5%
1997	379,179	31,563	28,790	34,610	9,122	4,256	15.9%	38.7%
1998	413,128	38,929	33,602	33,949	7,366	4,812	17.6%	35.9%
1999	448,531	48,330	35,116	35,403	9,401	1,514	18.6%	30.8%
2000	508,934	62,302	48,777	60,403	13,972	13,661	21.8%	45.7%
2001	481,001	29,450	49,810	-27,933	-32,852	1,033	16.5%	113.9%
2002	459,919	20,398	40,278	-21,082	-9,052	-9,532	13.2%	88.2%
2003	473,778	28,455	38,008	13,859	8,057	-2,270	14.0%	41.8%
2004	525,964	51,196	46,161	52,186	22,741	8,153	18.5%	59.2%
2005	572,231	64,039	51,660	46,267	12,843	5,499	20.2%	39.6%
2006	616,875	70,895	64,471	44,644	6,856	12,811	21.9%	44.1%
2007	651,524	75,325	72,691	34,649	4,430	8,220	22.7%	36.5%
2008	687,076	79,664	77,823	35,552	4,339	5,132	22.9%	26.6%

Sources: NYSAGI and Capital Gains, New York State Division of the Budget; 2005-2008 are DOB projections.

Wall Street Wages from NYS DOL: 1991-1999 on SIC basis; 2000-2008 on NAICS basis.

2006-2008 Wall Street wages are FPI projections.

While the inflation-adjusted median hourly wage rose 2.3% in 2006 in New York State, it is still below its 2002 peak, and below the regional median.



Source: Economic Policy Institute and FPI analyses of Current Population Survey data. Universe: those employed, ages 18-64.

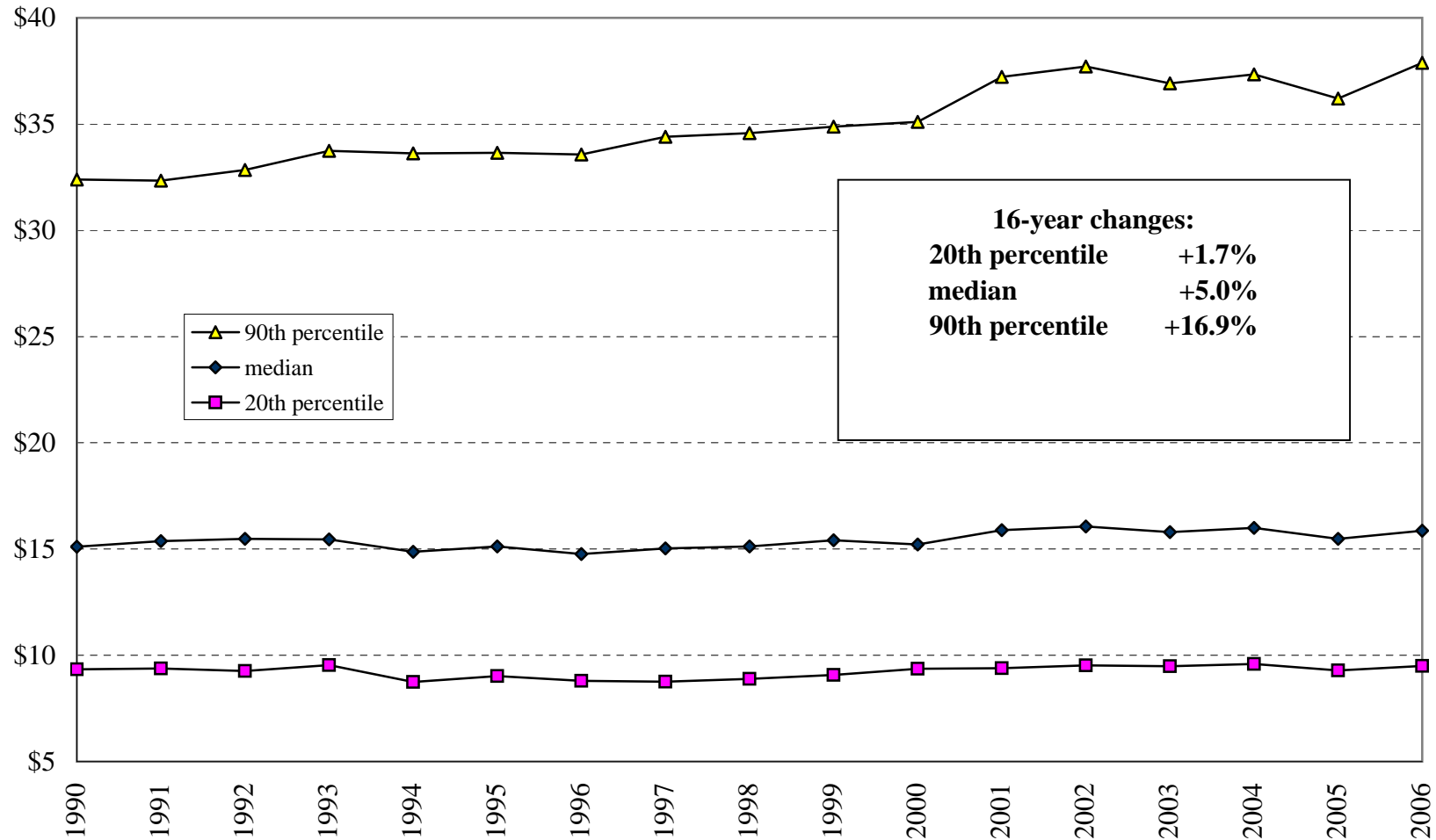
Real median wages have risen slowly.

	1999	2002	2006	Percent Change			Shares 2006
				1999- 2002	2002- 2006	1999- 2006	
Real median hourly wage*							
United States (all)	\$14.51	\$14.71	\$14.95	1.4%	1.6%	3.0%	
All NY State resident workers	\$15.42	\$16.06	\$15.87	4.2%	-1.2%	2.9%	100.0%
Males	\$17.39	\$17.93	\$17.00	3.1%	-5.2%	-2.2%	51.1%
Females	\$13.91	\$14.22	\$14.45	2.2%	1.6%	3.9%	48.9%
White, non-Hispanic	\$17.18	\$17.43	\$17.31	1.4%	-0.7%	0.7%	63.6%
Black, non-Hispanic	\$13.30	\$13.61	\$13.00	2.4%	-4.5%	-2.3%	13.8%
Hispanic	\$11.21	\$11.73	\$12.34	4.7%	5.2%	10.1%	15.0%
Less than high school	\$9.07	\$9.60	\$10.00	5.9%	4.1%	10.3%	9.6%
High school	\$13.11	\$13.45	\$13.00	2.6%	-3.3%	-0.8%	28.2%
Some college	\$14.51	\$14.57	\$14.00	0.4%	-3.9%	-3.5%	26.1%
Bachelors and higher	\$23.91	\$25.47	\$24.04	6.5%	-5.6%	0.5%	36.1%
Native born, including P.R.	\$16.17	\$16.81	\$16.39	4.0%	-2.5%	1.4%	73.1%
Foreign born	\$13.30	\$13.45	\$14.00	1.1%	4.1%	5.3%	26.9%

*2006 dollars; CPI-U-RS used to deflate nominal wages. People in workforce, ages 18-64.

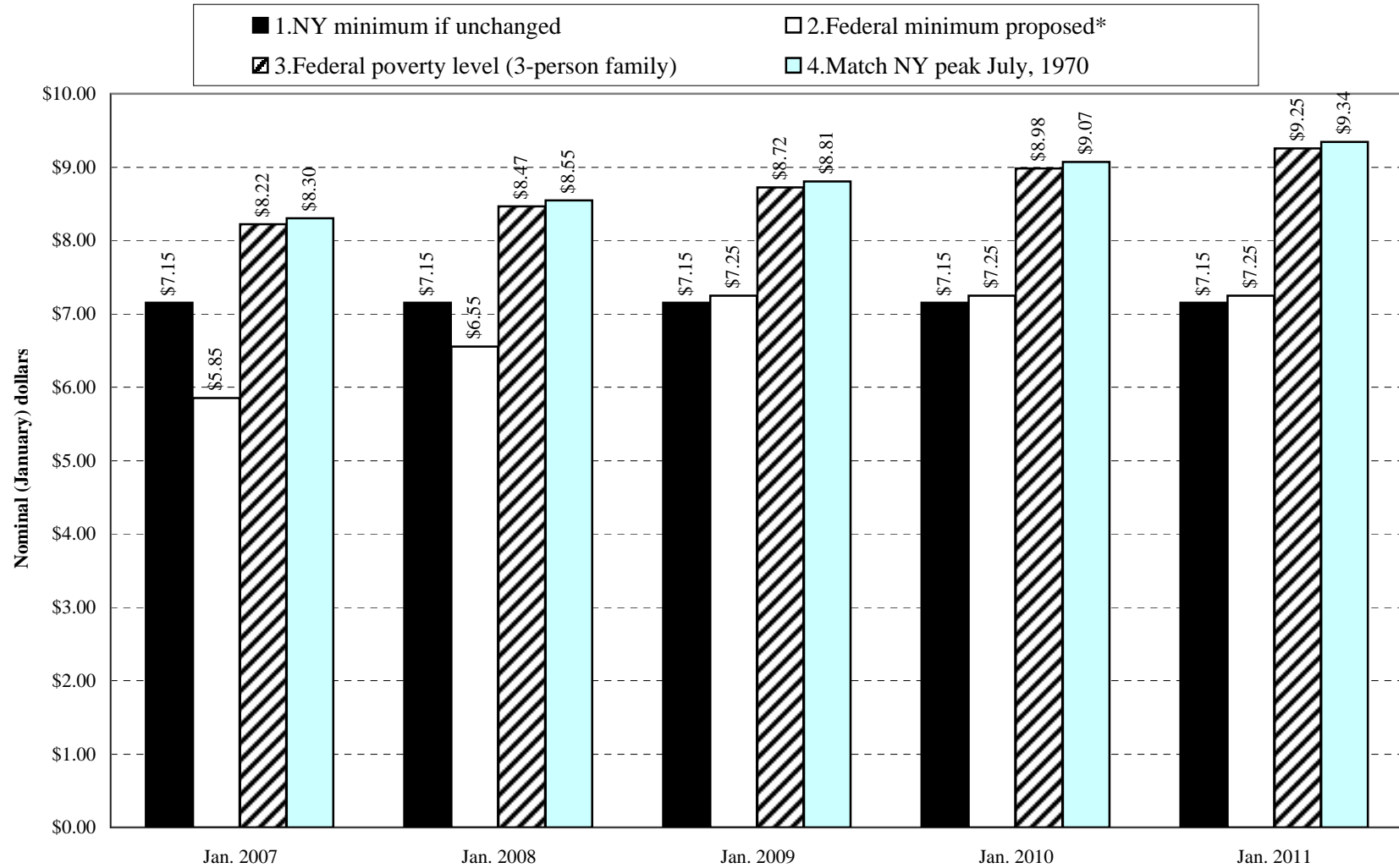
Source: Current Population Survey, analysis by Fiscal Policy Institute and Economic Policy Institute.

Since 1990, only the New Yorkers with the highest wages have gotten substantial wage increases.



Source: FPI analysis of CPS (deflated by CPI U RS; ages 18-64).

To restore the minimum wage to its peak purchasing power, or to enable a minimum wage worker to support a family of three, New York would have to increase its minimum wage by a little over \$2 between now and 2011.



Year-to-year projections assume 3% annual increase in CPI. FPL for 2007 calculated by FPI following HHS methodology.

*House bill passed 1/07: Increases to take effect 60 days after enactment, and on 2 anniversaries of that date.

In many sectors in New York State, self-employment ("Non-employers") has been growing much faster than payroll employment.

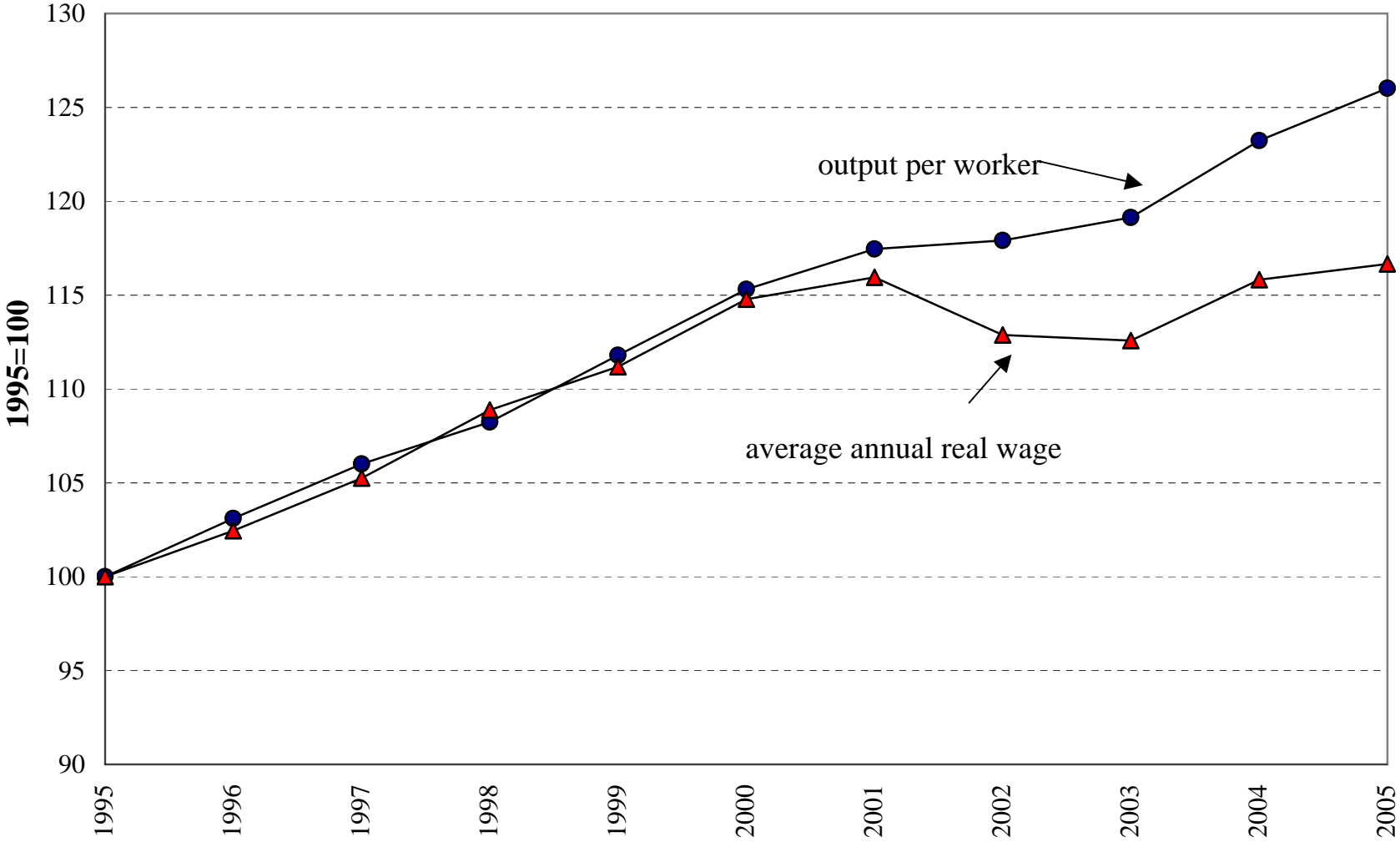
NAICS	Non-employers				Payroll employment			
	<u>2000</u>	<u>2004</u>	<u>change '00-'04</u>		<u>2000</u>	<u>2004</u>	<u>change '00-'04</u>	
0 Total private, non-agricultural*	1,196,278	1,403,669	207,391	17.3%	7,050,800	6,856,500	-194,300	-2.8%
21,22 Mining & utilities	1,765	1,939	174	9.9%	47,000	45,100	-1,900	-4.0%
23 Construction	103,623	116,974	13,351	12.9%	327,300	322,200	-5,100	-1.6%
3 Manufacturing	17,219	18,253	1,034	6.0%	750,800	597,000	-153,800	-20.5%
42 Wholesale trade	31,600	31,647	47	0.1%	380,300	354,200	-26,100	-6.9%
44-45 Retail trade	102,576	108,565	5,989	5.8%	882,000	868,000	-14,000	-1.6%
48-49 Transportation & Whsg.	75,597	82,106	6,509	8.6%	239,300	225,200	-14,100	-5.9%
51 Information	23,010	26,735	3,725	16.2%	319,100	269,100	-50,000	-15.7%
52 Finance and insurance	50,174	50,913	739	1.5%	563,600	519,700	-43,900	-7.8%
53 Real estate & rental & leasing	129,795	160,695	30,900	23.8%	183,300	182,200	-1,100	-0.6%
54 Prof'l, scientific, & tech. svcs.	196,071	215,997	19,926	10.2%	551,700	517,300	-34,400	-6.2%
56 Administrative & support	57,260	72,412	15,152	26.5%	450,000	420,100	-29,900	-6.6%
61 Educational services	25,259	37,403	12,144	48.1%	286,200	343,200	57,000	19.9%
62 Health care & social assist.	119,677	164,570	44,893	37.5%	1,093,800	1,176,800	83,000	7.6%
71,72 Leisure	106,276	126,379	20,103	18.9%	637,800	663,500	25,700	4.0%
81 Other services	156,376	189,081	32,705	20.9%	338,600	352,900	14,300	4.2%

Sources: Non-employer series: US Census, at <http://www.census.gov/epcd/nonemployer/>.

Payroll series: NYS DOL, Current Employment Survey.

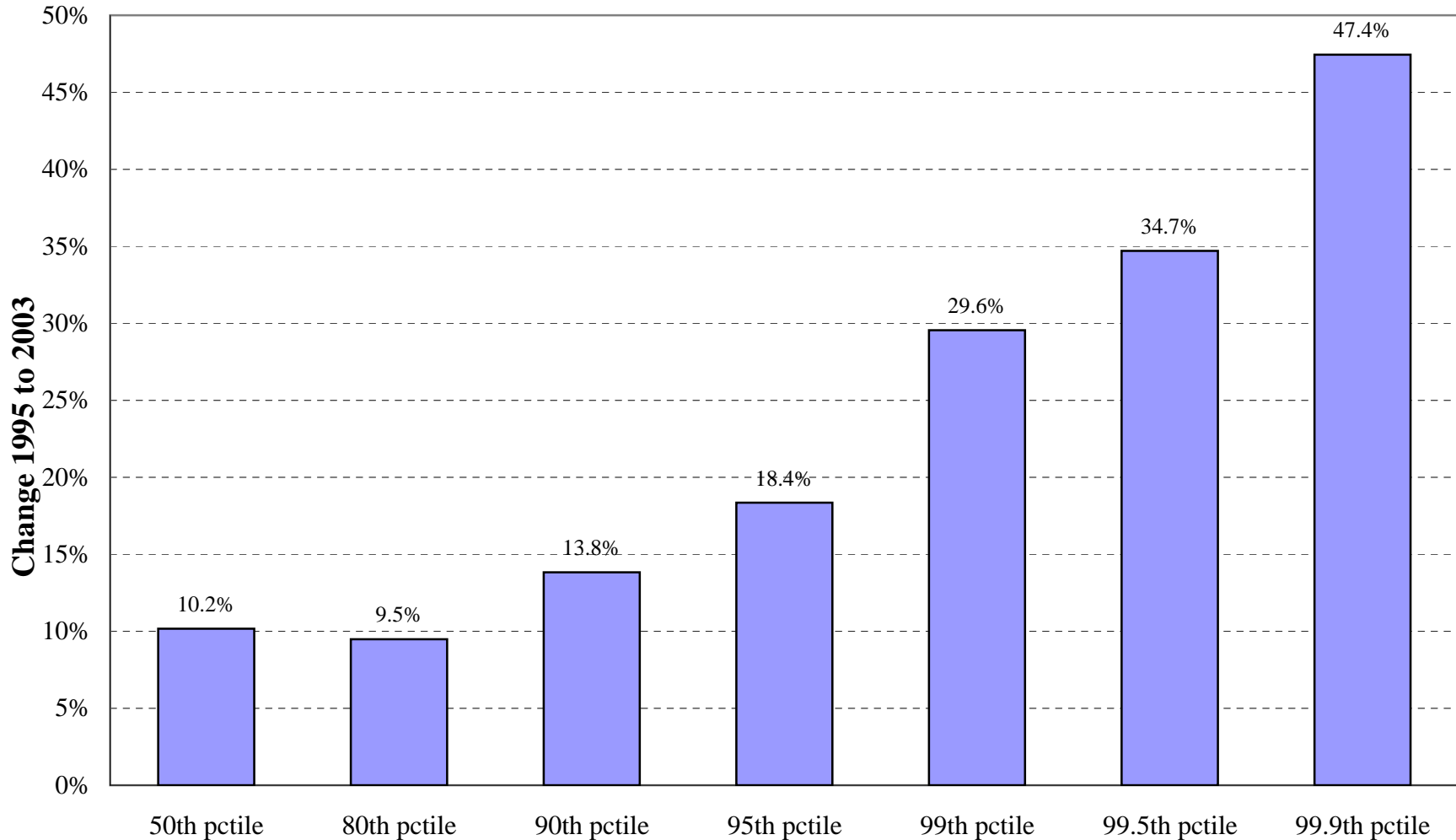
*Management of companies and enterprises (NAICS 55) not included in details or totals.

A wage-productivity gap has emerged since 2000, exacerbating the income gap.



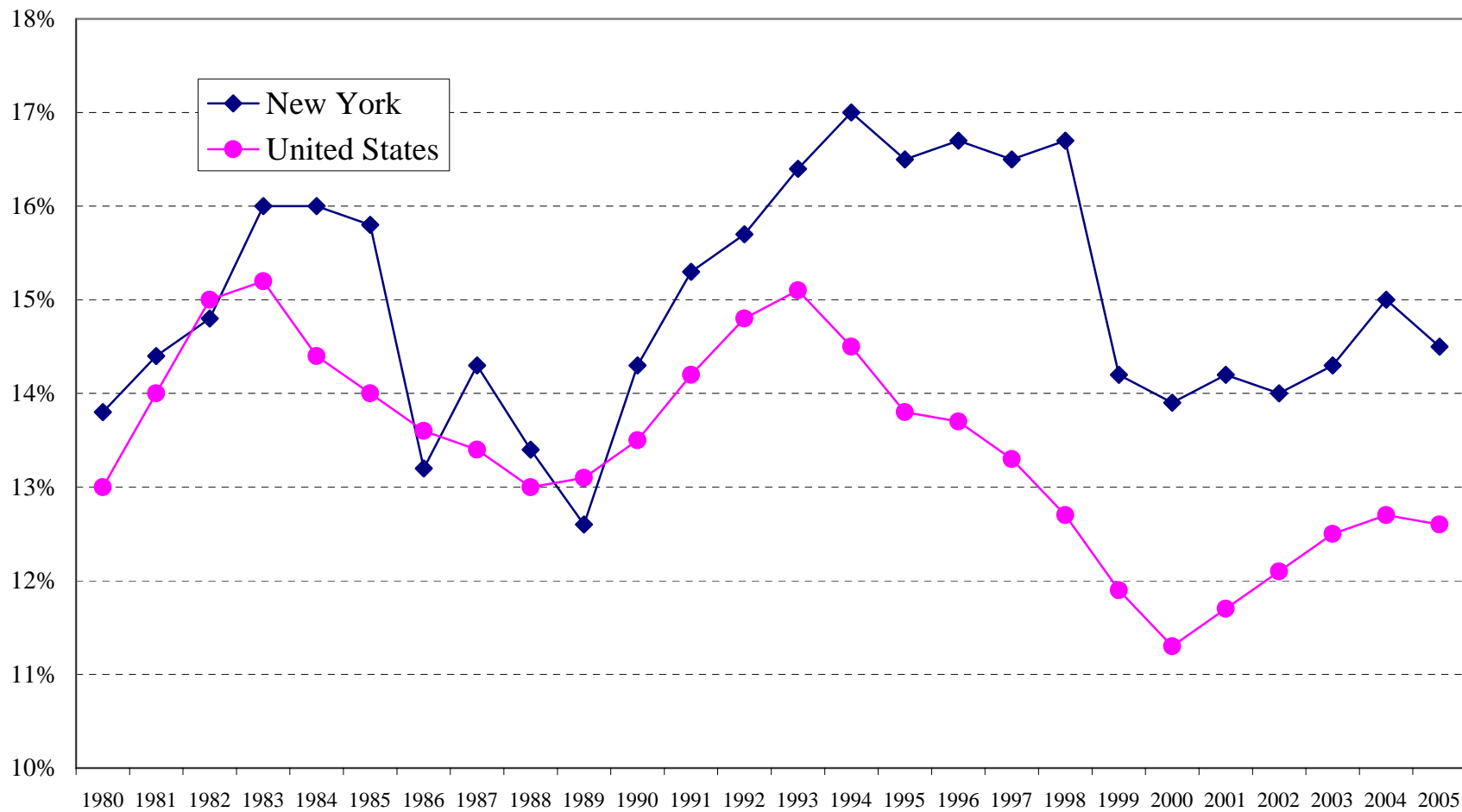
Source: FPI analysis of BEA data and QCEW data from BLS.

In the last decade, New York wage incomes have grown fastest for the highest-income New Yorkers.



Source: NYS Dept. of Taxation and Finance, real wage income for full-year resident returns, annual "Analysis of Personal Income Tax Returns" reports. Analysis by FPI.

Poverty Rate in NY Still Higher than US



Source: Current Population Survey.

FPI's economic analysis suggests several issues that deserve close monitoring:

- Whether income polarization continues to grow, impeding broadly shared prosperity.
- Beyond just having an upstate and a downstate ESDC, whether economic development policies and strategy translate into proper emphasis on:
 - Investing in workers,
 - Retaining and creating good jobs, and
 - Providing transparency and accountability.
- Whether the playing field among businesses is leveled by policies such as closing corporate loopholes, reforming health care and reforming workers' compensation.
- What the state does to create more effective labor markets:
 - Enforcing labor standards,
 - Raising the minimum wage, and
 - Improving the welfare-to-work transition.

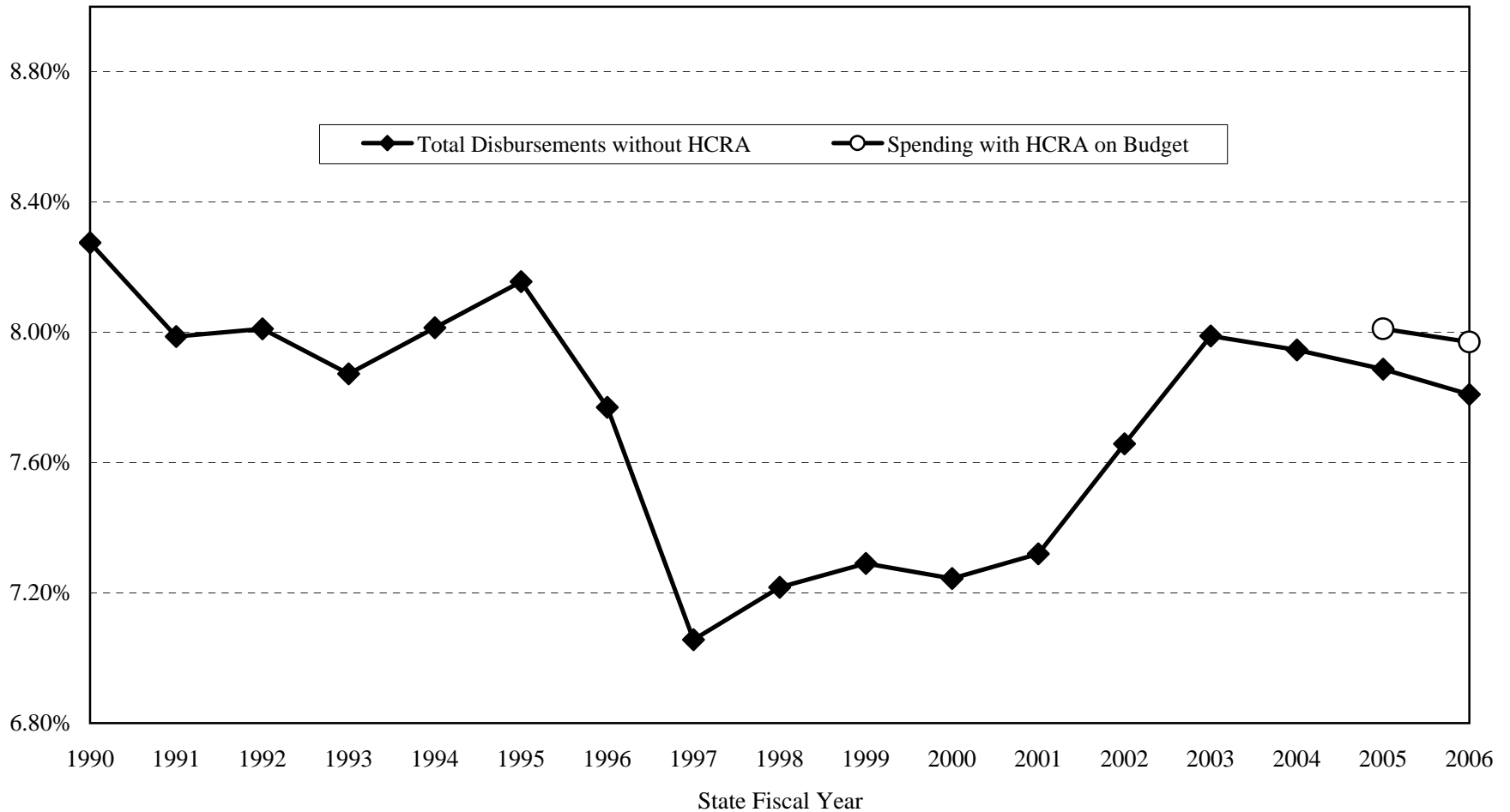
In sum, do the state's economic policies help New York's regions grow together, and strengthen and expand the middle class?

II. The Fiscal Context

- In the last several years, current services spending relative to the size of the economy returned to traditional levels after a decline in the mid- to late 1990s.
- The large multi-year tax cuts enacted in the 1990s have a continuing impact on the balancing of the state budget.
- The reductions in the state's top Personal Income Tax rates have shifted the burden of that tax.
- Corporate income tax revenues have fallen substantially relative to the size of the economy. As some tax loopholes have been closed, new ones are being invented.
- State fiscal policy choices of the last 25 years have placed great pressure on local property and sales tax bases.

Current services spending relative to the size of the economy returned to traditional levels after a decline in the mid to late 1990s.

Spending from all state funds for current services, as a percent of personal income.



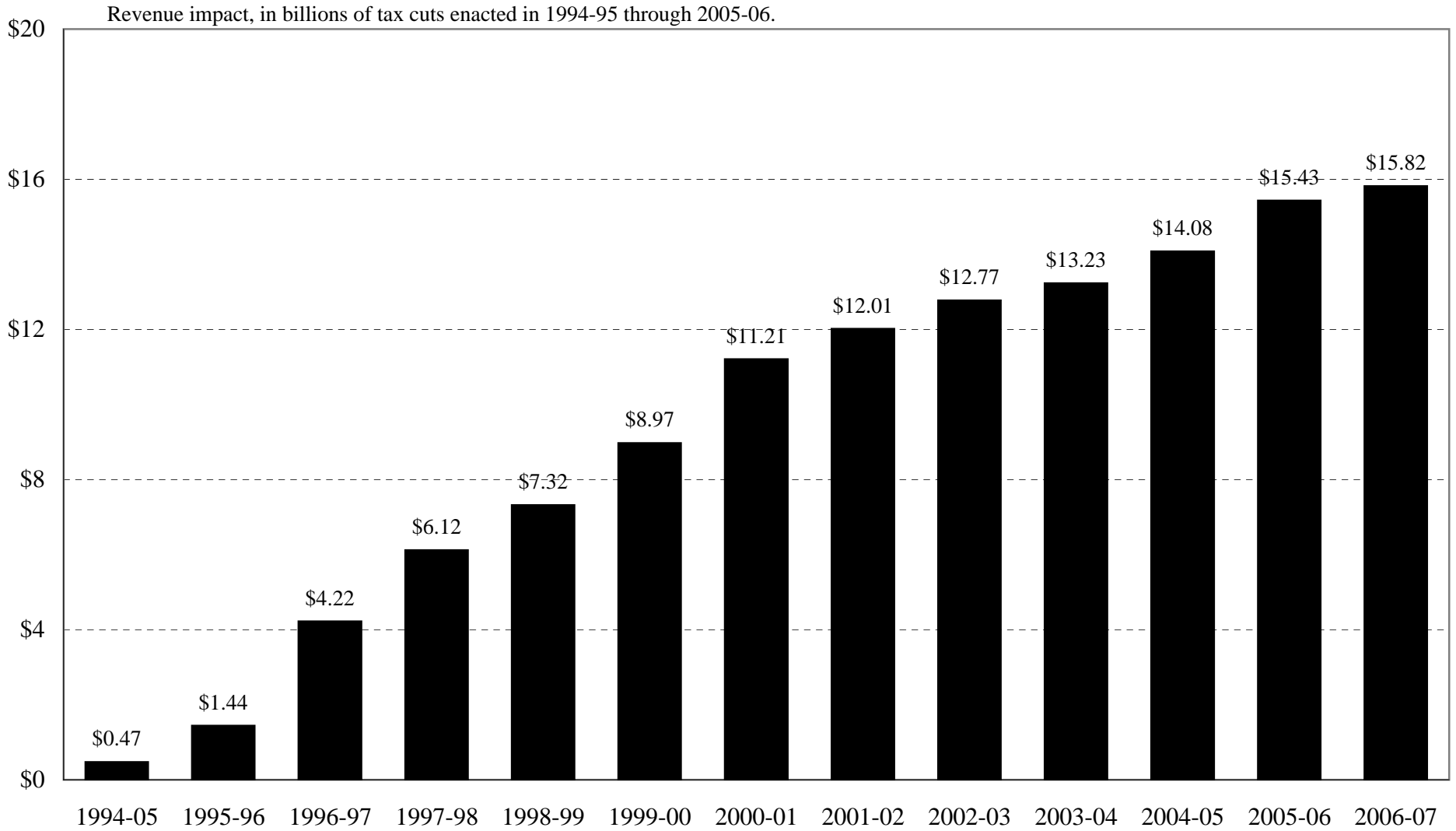
Note: 2002-03 and 2003-04 disbursements have been adjusted to account for the payment in 2003-04 of \$1.9 billion of obligations incurred in 2002-03

Since 1990, New York State's expenditures for employee wages and salaries have declined in real terms by over \$1 billion, almost 10 percent.

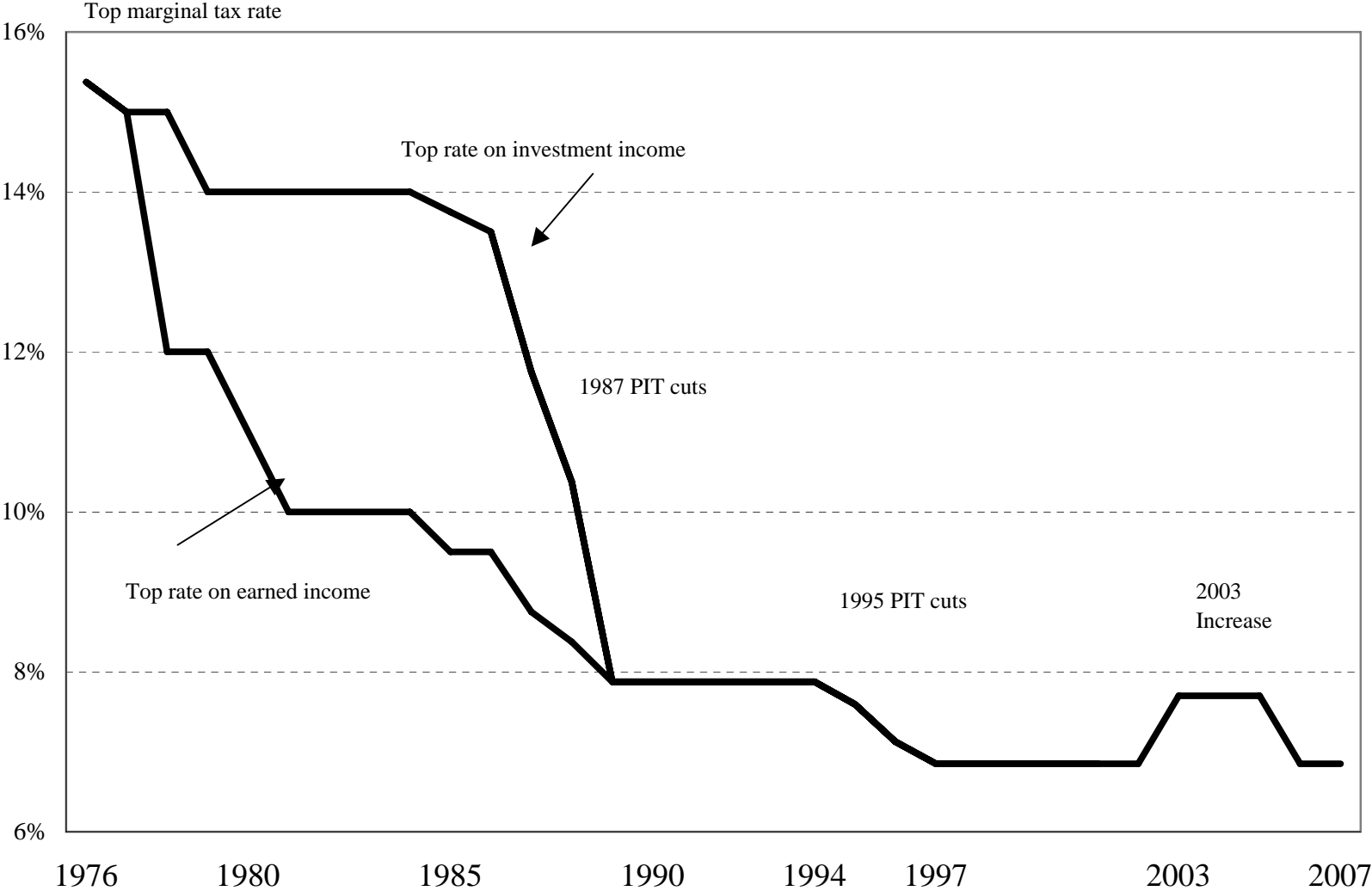
Personal Service expenditures in millions of SFY 2006 dollars

	<u>General Fund</u>	<u>Special Revenue Funds</u>	<u>Total</u>
State FY 1989-90	\$7,513.4	\$4,295.6	\$11,809.0
State FY 1994-95	\$6,029.3	\$5,032.9	\$11,062.1
State FY 2005-06	\$5,705.3	\$4,946.3	\$10,651.7
<u>Average Annual Change</u>			
1989-90 to 1994-95	-\$296.8	\$147.5	-\$149.4
1994-95 to 2005-06	-\$36.0	-\$9.6	-\$45.6
<u>Average Annual Percent Change</u>			
1989-90 to 1994-95	-4.31%	3.22%	-1.30%
1994-95 to 2005-06	-0.61%	-0.19%	-0.42%
<u>Total 16 -Year Change</u>			
Amount	-\$1,808.1	\$650.7	-\$1,157.4
Percent	-24.06%	15.15%	-9.80%

The tax cuts enacted since 1994 are reducing state revenues by approximately \$16 billion during the current 2006-2007 fiscal year.



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

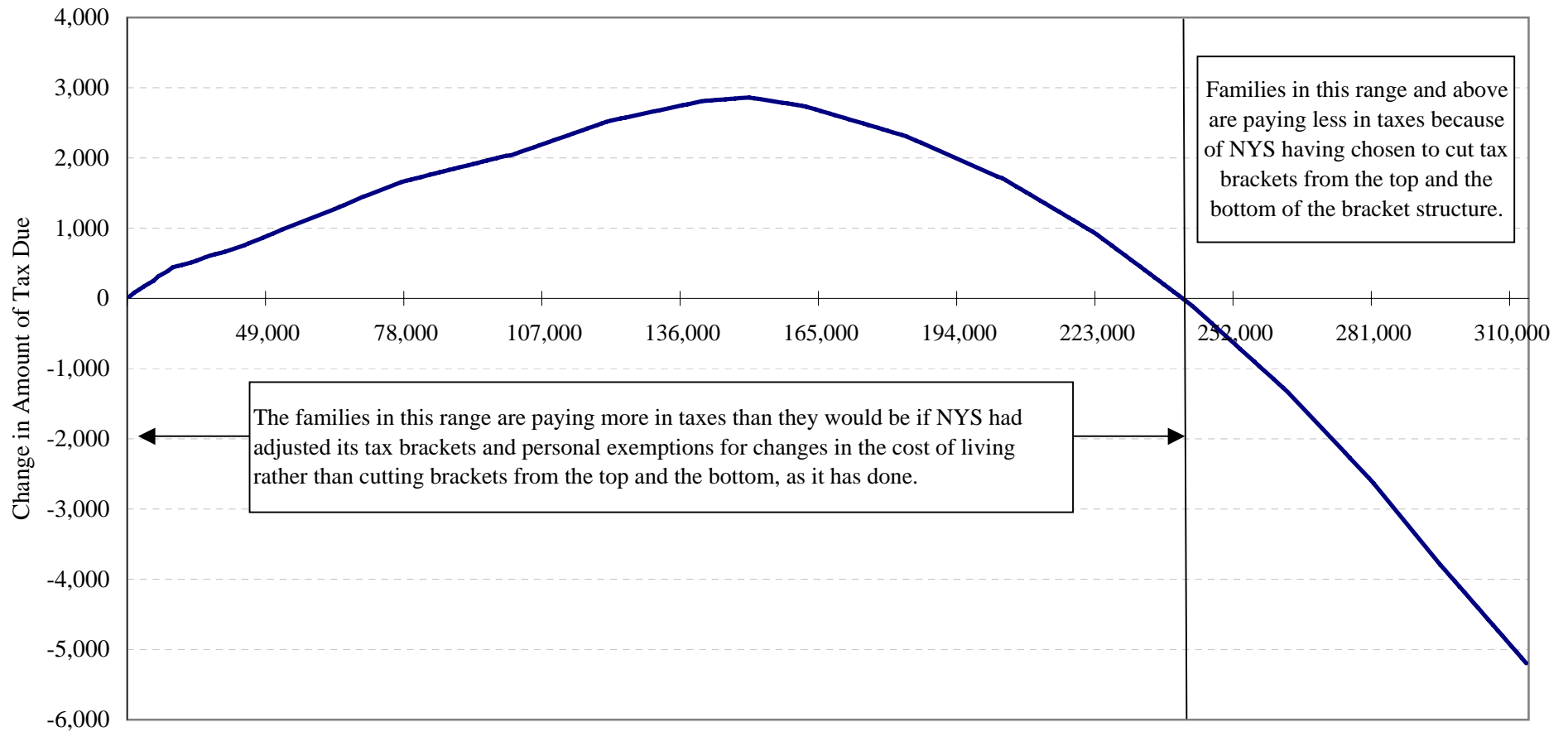


New York's top state personal income tax rate is at an historical low relative to New Jersey and Connecticut.

	<u>1976</u>	<u>1985</u>	<u>2003</u>	<u>2004</u>	<u>2006</u>
New York	15.375%	9.5%	7.7%	7.7%	6.85%
New Jersey	2.5%	3.5%	6.37%	8.97%	8.97%
Connecticut	0	0	5.0%	5.0%	5.0%

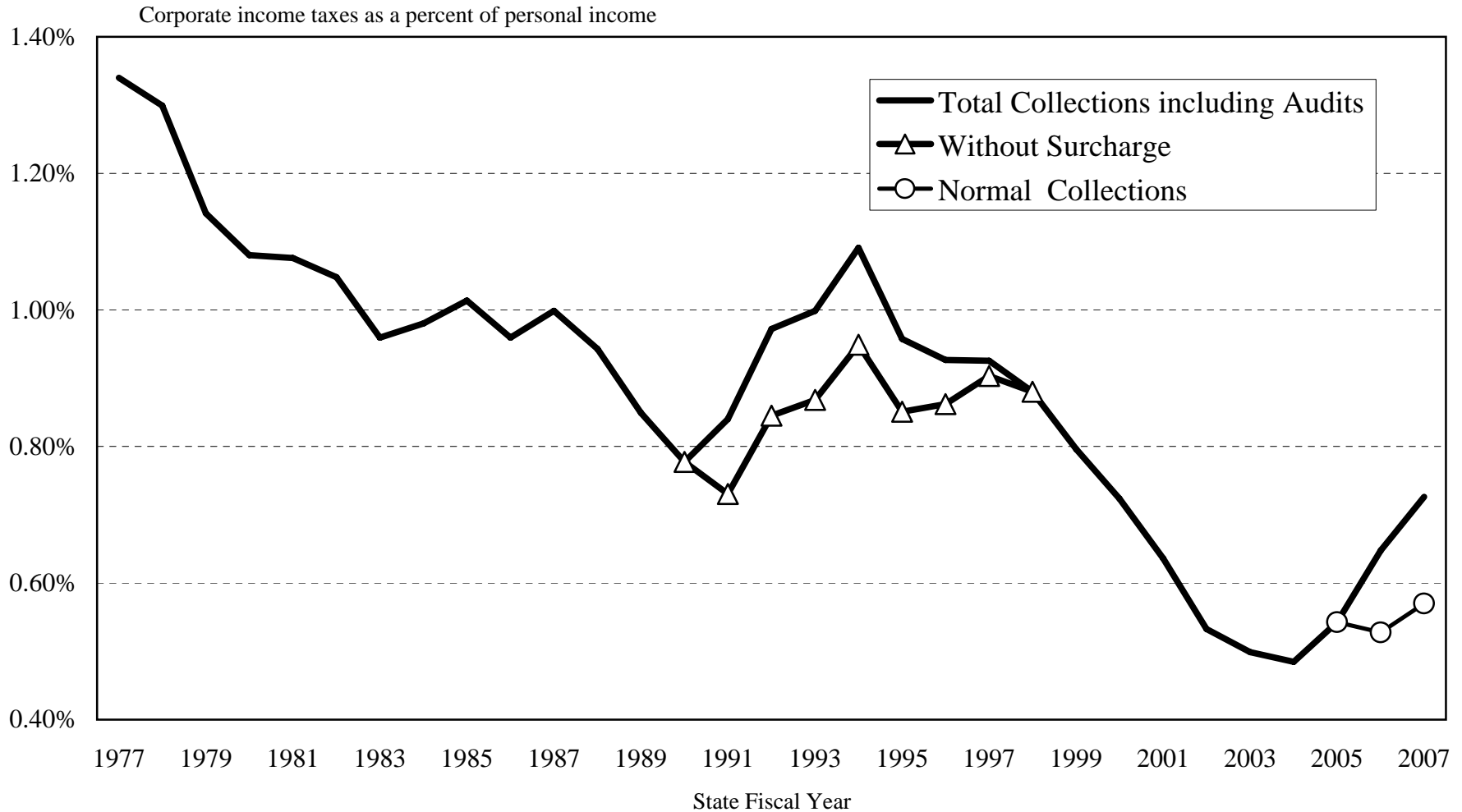
Note: The tax rates shown above are for wages, salaries and business income. Prior to 1991, Connecticut taxed the interest, dividends and capital gains of high income residents but it did not tax business income, wages, salaries and other income. From 1978 through 1988, New York employed a dual rate system in which it applied a higher top rate to investment income than to wages, salaries and business income. For 1985, the top rate applicable to investment income was 13.5%.

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



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

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

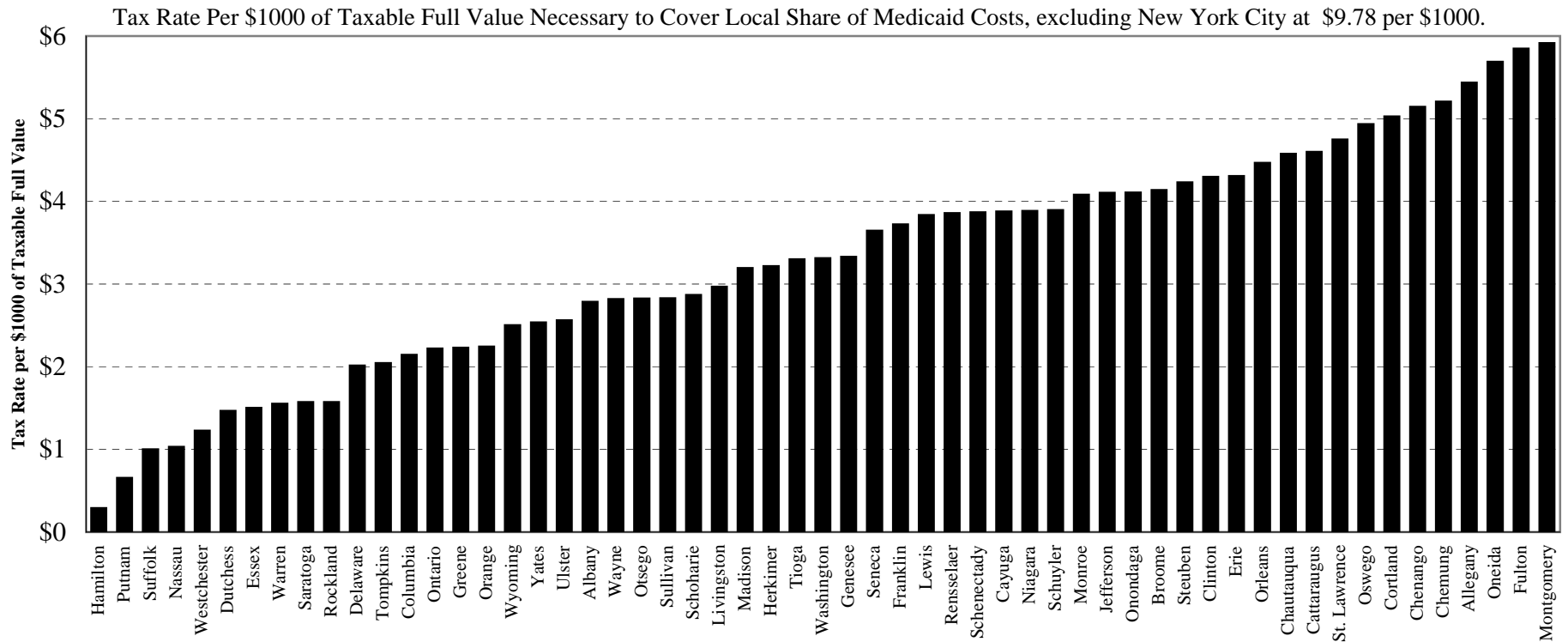


Note: Includes the state's main income tax on general corporations (the Corporate Franchise Tax, Article 9-A & 13), as well as the Corporation and Utilities Tax (Article 9), the Insurance Tax (Article 33) and the Bank Tax (Article 32).

State policy choices have placed great pressure on local property and sales tax bases.

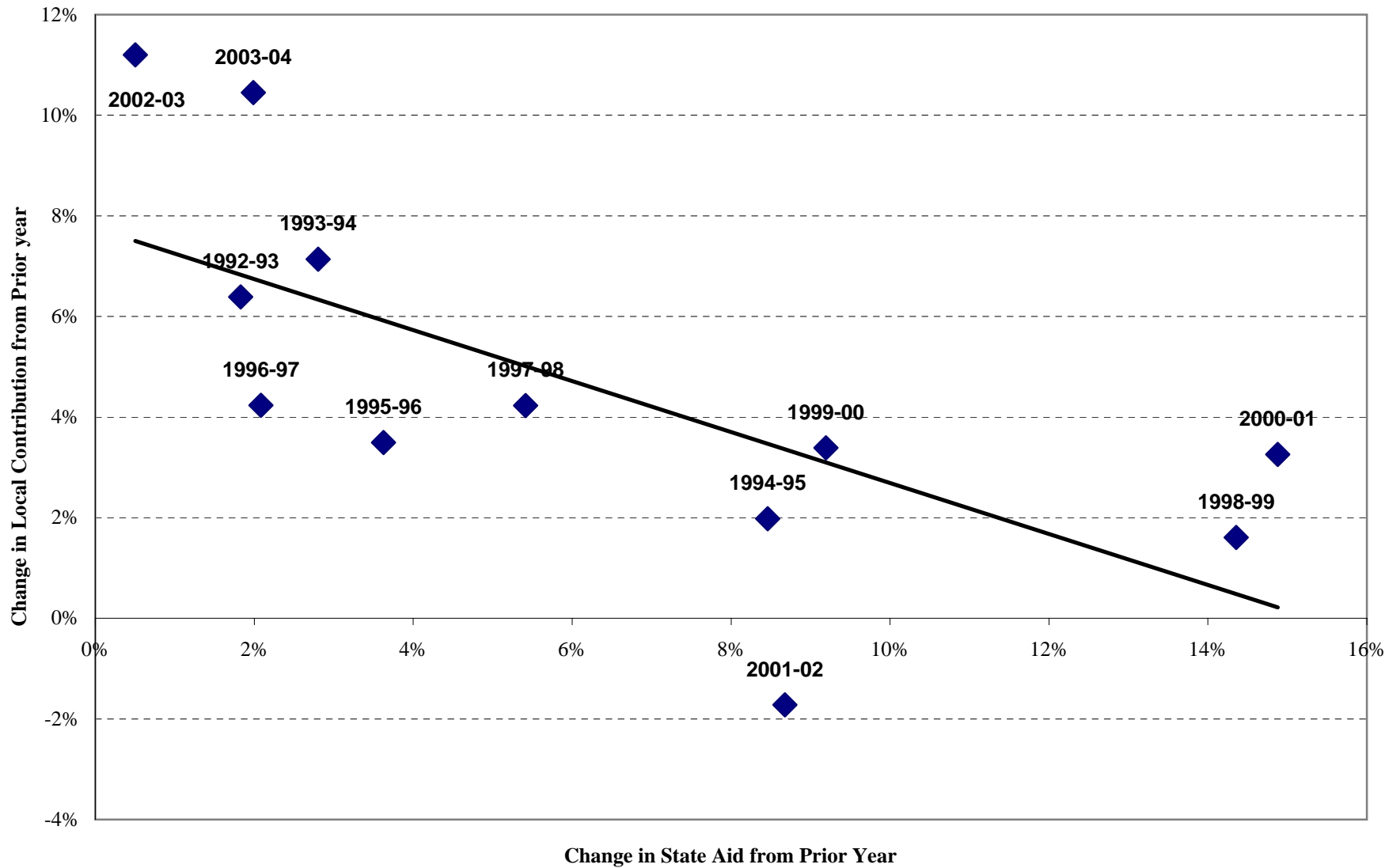
- The state's failure to honor its commitment to revenue sharing has particularly hurt upstate cities.
- New York State's approach to sharing Medicaid costs places the greatest pressure on those localities that have relatively weak tax bases compared to their needs.
- State aid to education has declined as a share of local school budgets.
- New York's property tax relief programs, including the STAR program, are poorly targeted.

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

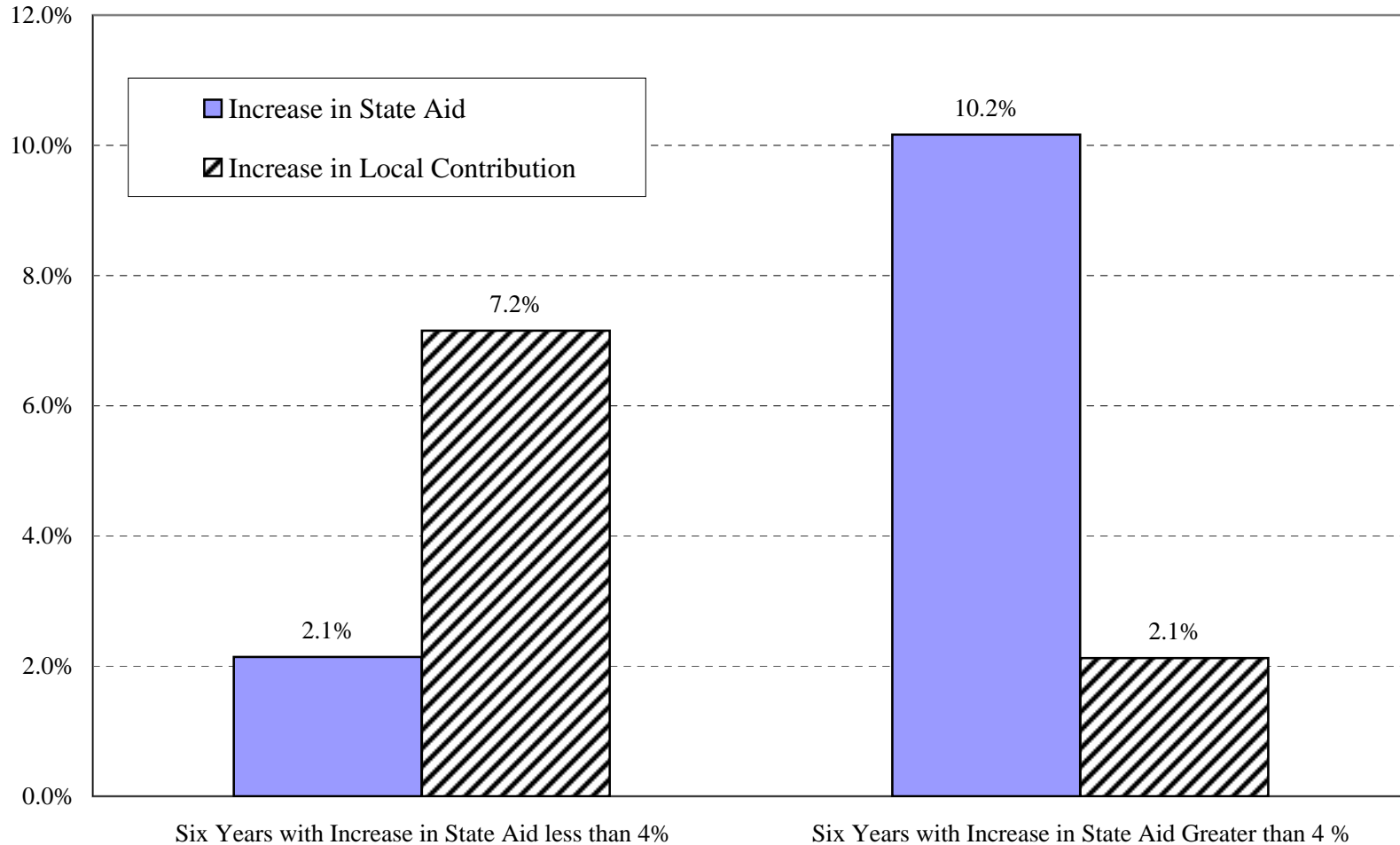


Sources: Medicaid Expenditures from NYS Department of Health. Full value from Office of State Comptroller.

There is a strong inverse relationship between changes in property tax levies and changes in state aid.

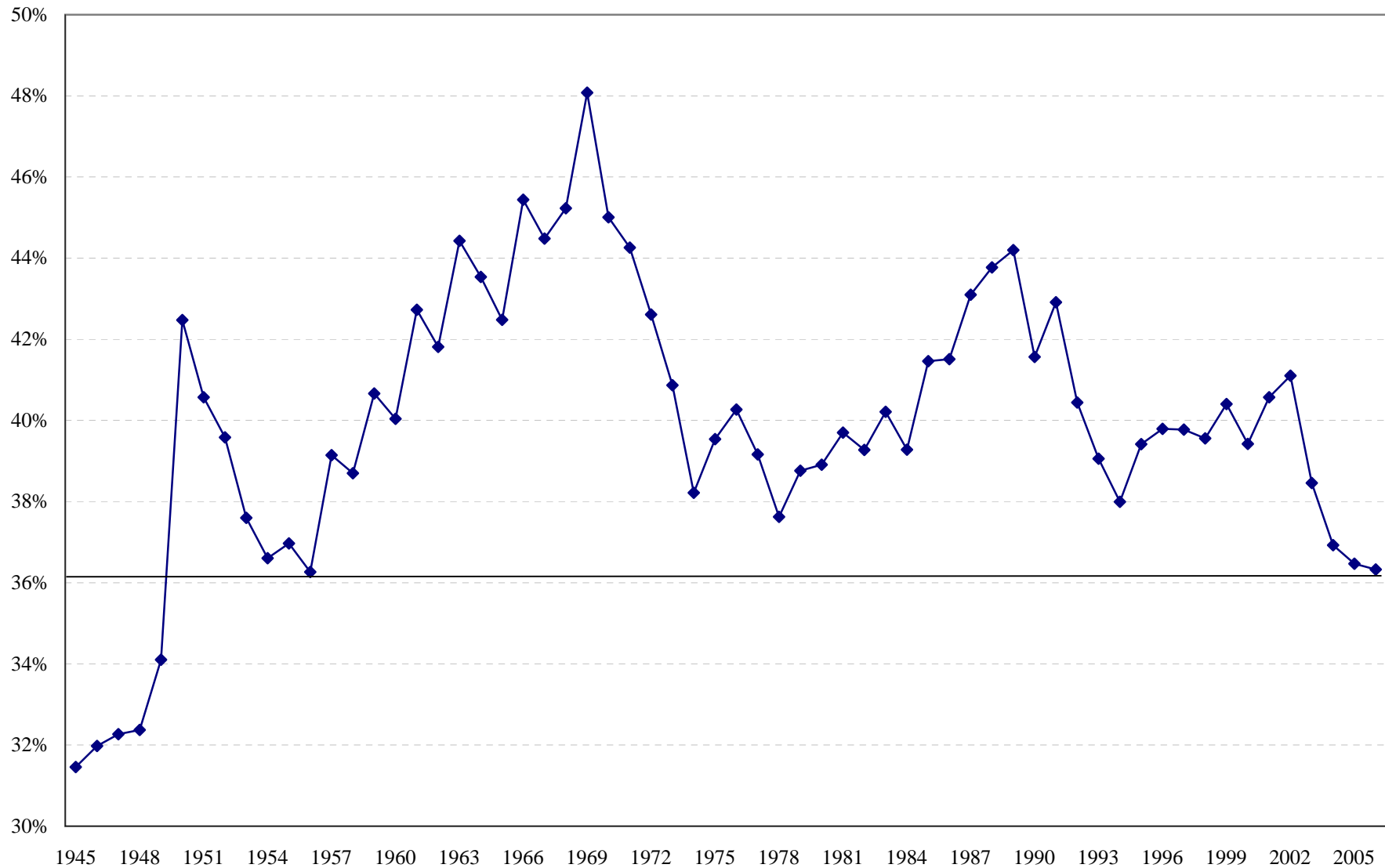


The growth in school property taxes is low in years when state aid increases are higher. Property tax increases accelerate when state aid increases are lower.



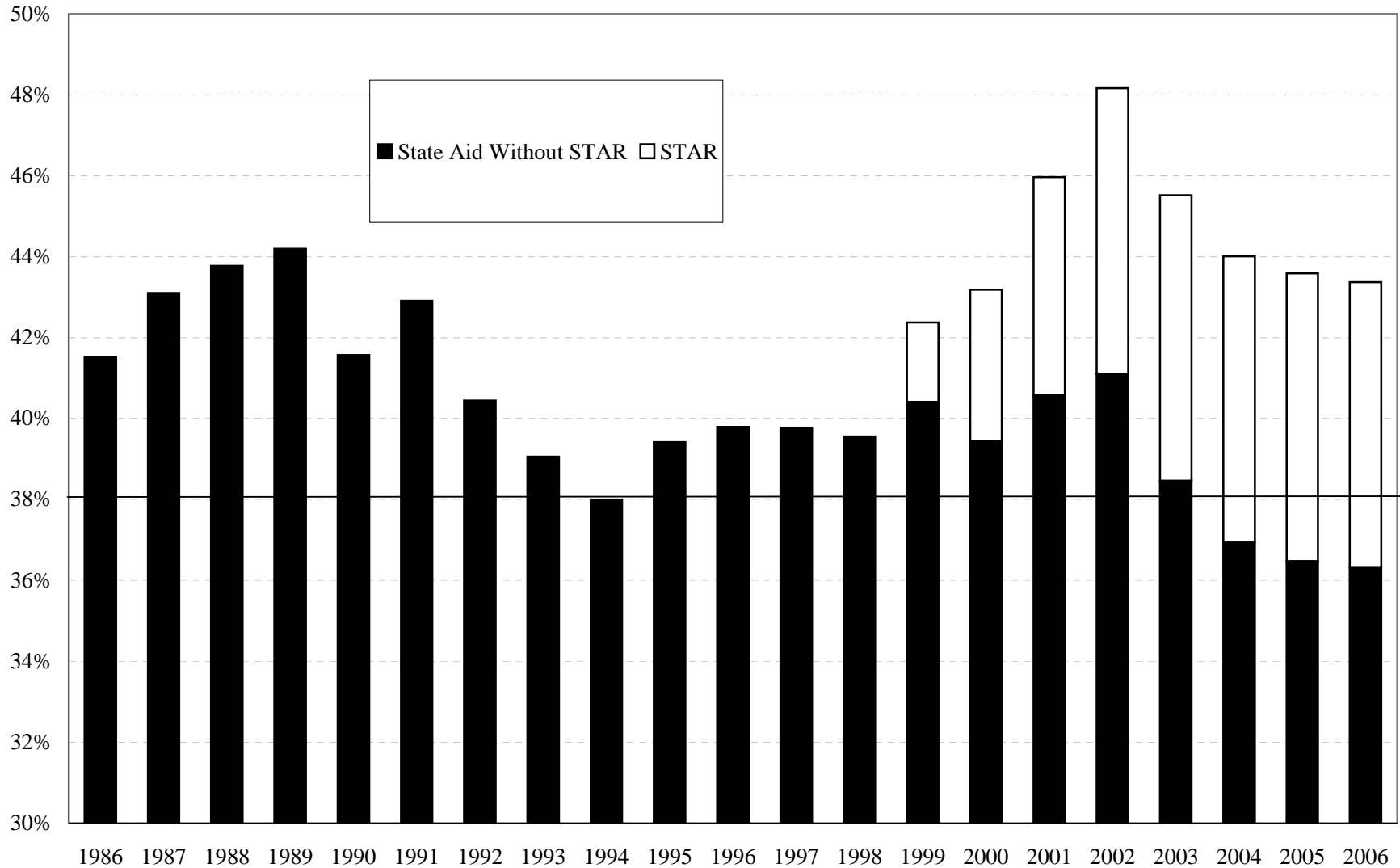
Data state aid and local revenues for 1991-1992 to 2003-2004 used to calculate changes from prior year from State Education Department, Analysis of School District Finances, January 2006.

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



Source: State Education Department, Analysis of School District Finances in NYS School Districts, January 2007.

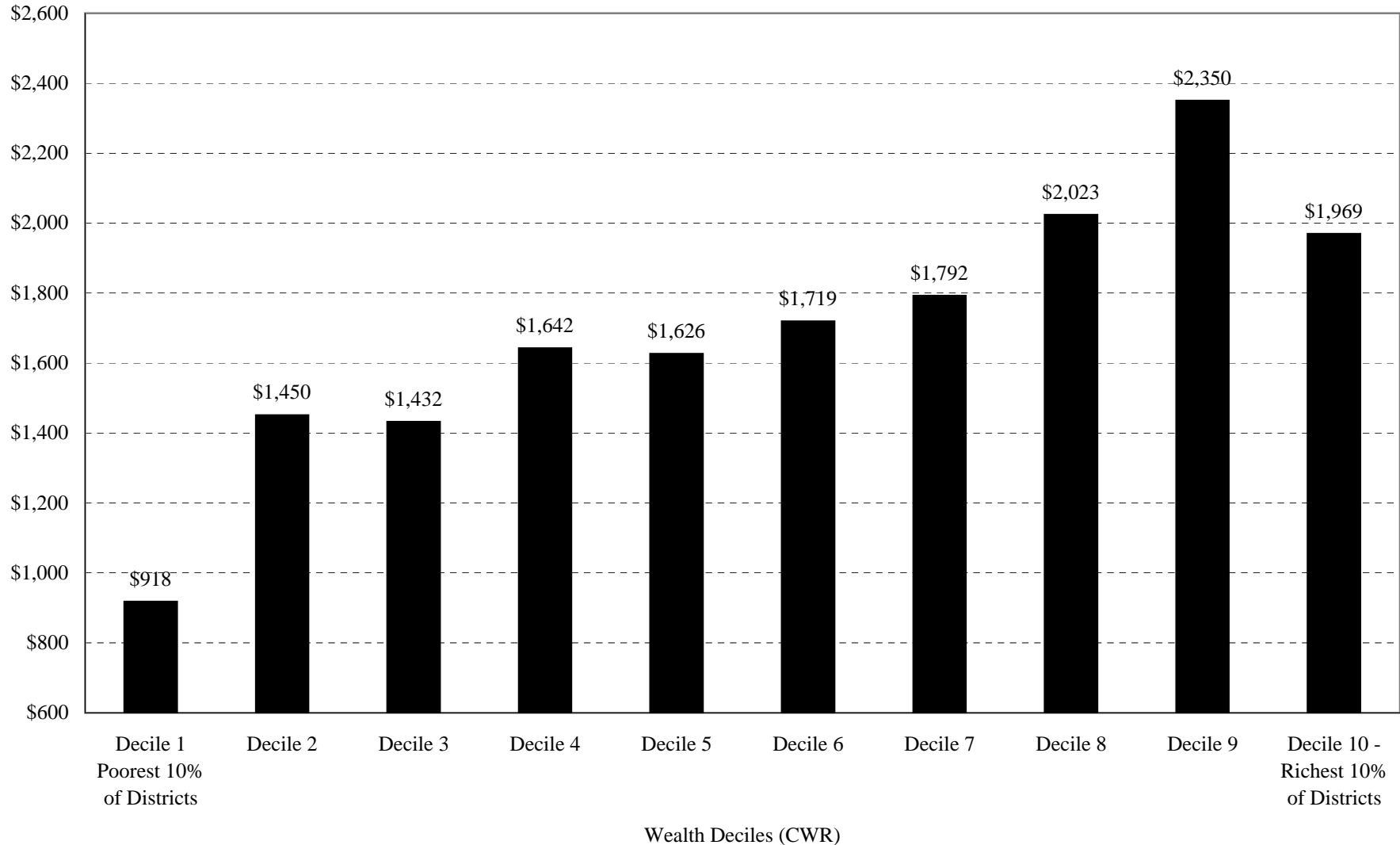
When STAR is taken into consideration, the State covers a larger share of public school budgets.



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

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

2006-2007 STAR per pupil by Combined Wealth Ratio decile excluding New York City.



STAR provides much more state revenue per pupil to schools in the New York City suburbs than it provides to schools in New York City and other needy, urban school districts.

	2005-2006 STAR Revenue	2005-2006 Enrollment	STAR per Pupil
5 NYC-Area Suburban Counties	\$1,137,983,549	681,378	\$1,670
State Total/State Average	\$3,163,973,078	2,827,978	\$1,119
Rest of State	\$1,216,628,878	1,111,611	\$1,094
Binghamton	\$6,451,229	6,374	\$1,012
Albany	\$10,225,351	10,424	\$981
Utica	\$9,091,957	9,308	\$977
Newburgh	\$11,823,684	12,459	\$949
New York City - with PIT Supplement	\$809,360,651	1,034,989	\$782
Poughkeepsie	\$2,979,298	4,887	\$610
Syracuse	\$11,709,790	22,584	\$518
Buffalo	\$17,668,614	41,388	\$427
Rochester	\$14,259,434	36,710	\$388
New York City - without PIT Supplement	\$165,360,651	1,034,989	\$160

STAR: New York's Flawed Property Tax Relief Mechanism

- Under STAR, all owner-occupied residential dwellings in the state are eligible for a state-funded homestead exemption of at least \$30,000. In counties in which the median home value is greater than the statewide median home value, the value of this exemption is prorated upward by the ratio of the county median home value to the statewide median home value. In Westchester County, the county with the highest median home value, the current “sales price differential factor” is 2.961, making the value of the exemption about \$88,830.
- Homeowners aged 65 and over, with incomes below \$60,000 adjusted upward for changes in the cost of living since 2003 (for the 2007-08 school year this income threshold is \$67,850) are eligible for an “enhanced” STAR exemption of \$50,000. This exemption is also prorated up in counties with median home values above the statewide median. Last year, the governor and the legislature increased the enhanced exemption from \$50,000 to \$56,800 to reflect increases in the cost of living since 2001.
- In the 2001-2002 school year, the first year in which STAR was fully phased in, the NYS Office of Real Property Services reported that there were nearly 640,000 “enhanced” STAR exemptions and more than 2.2 million “basic” STAR exemptions representing \$118.9 billion in exempt value. In the Office’s latest report on property tax exemptions (for the 2005-06 school year) there were about 622,000 “enhanced” STAR exemptions and 2.68 million “basic” STAR exemptions.

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

- Because STAR provides reimbursements to school districts only for the property taxes on owner-occupied dwellings, it substantially disadvantages those communities (primarily cities) with large numbers of renters. Likewise, STAR provides no relief to small business.
- New York City receives a less-than-proportionate share of STAR. State reimbursements to school districts, during 2006-07, for STAR property tax exemptions are estimated to be about \$2.62 billion with about \$163 million (or 6.2 percent) of that total going to New York City. New York City's low share of the property tax reimbursements is attributable to two factors—its relatively high percentage of renter-occupied dwellings and the special calculations of STAR benefits established for the Big 5 cities. In recognition of the limited benefits that would accrue to New York City under the STAR property tax exemption, the initial STAR legislation established a special New York City STAR Supplement, which provides for a state-funded reduction in the NYC resident income tax.
- Other city school districts with large percentages of renters are treated even worse than New York City, since they do not benefit from anything like the NYC STAR Supplement. Because STAR represents 40 percent of the increases in state revenue to school districts since its creation, it has come to undercut the effectiveness of the state aid system in addressing fiscal disparities among school districts. Under STAR, state aid is provided to districts without regard to enrollment or student need.

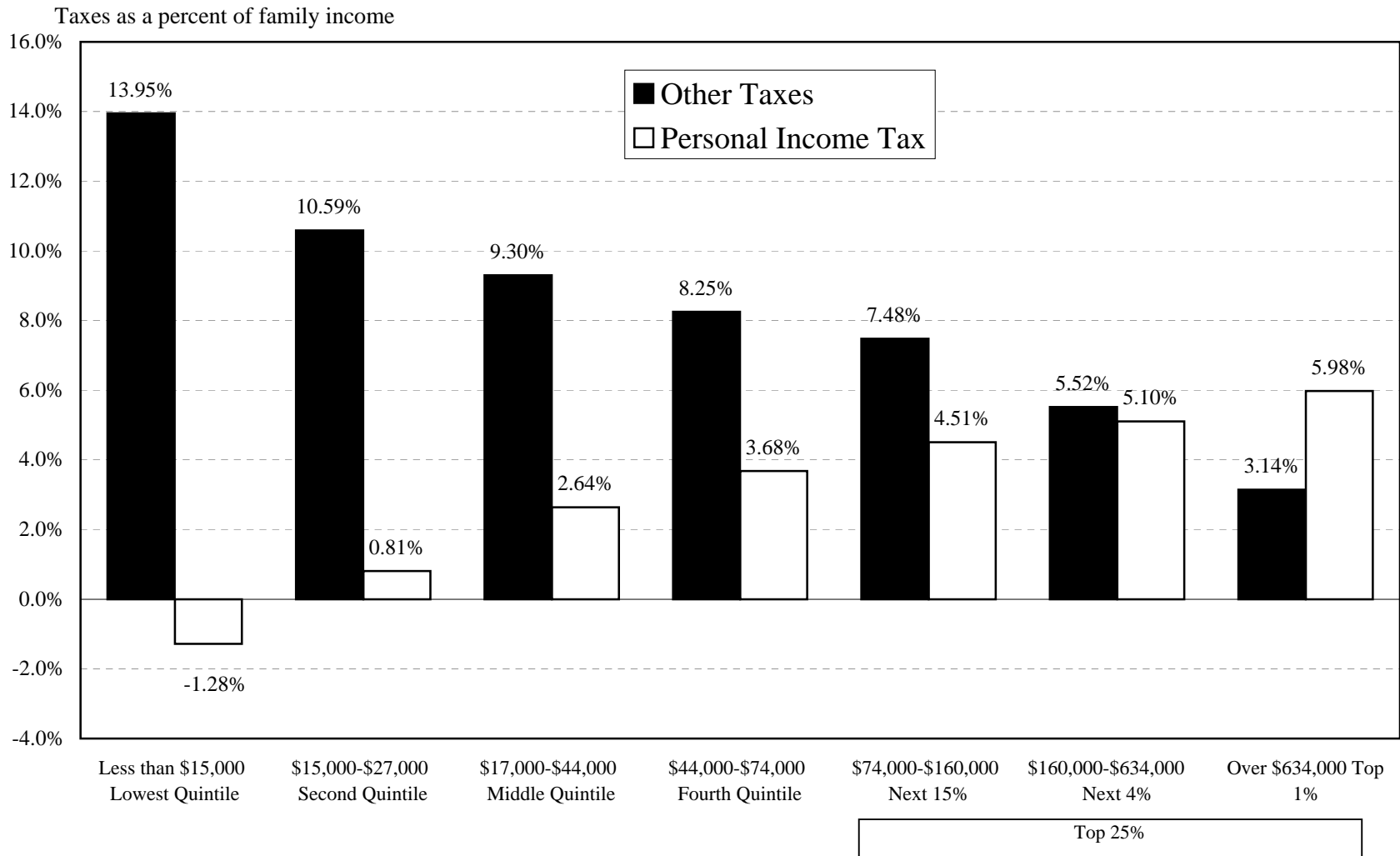
The STAR program, as currently structured, is not effectively targeted—thus costing much more than it needs to for the amount of relief that it gives to taxpayers overburdened by high property taxes.

- One of the basic flaws of the STAR program is that, with the exception of the “enhanced” STAR available to seniors with income below the \$60,000 cutoff (adjusted for inflation to \$67,850 for 2007-08), it provides the same benefit to all homeowners in a particular school district (or in a municipal segment of a school district that is located in more than one municipality) regardless of the relationship between their income levels and their property tax bills. This creates two significant problems.
 - First, it prevents the program from delivering on its rhetorical promise—that it is designed to protect New Yorkers from being “forced from their homes because of escalating school property taxes.”
 - Second, it provides a significant amount of relief to a significant number of homeowners for whom property taxes represent only a relatively small percentage of their income.
- The combined result of these two shortcomings is that STAR, as currently structured, costs much more than it needs to for the amount of relief that it actually provides to homeowners who are truly overburdened by their property taxes. Similarly, a reformed STAR program could provide much more relief to those who need it at a greatly reduced cost.

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

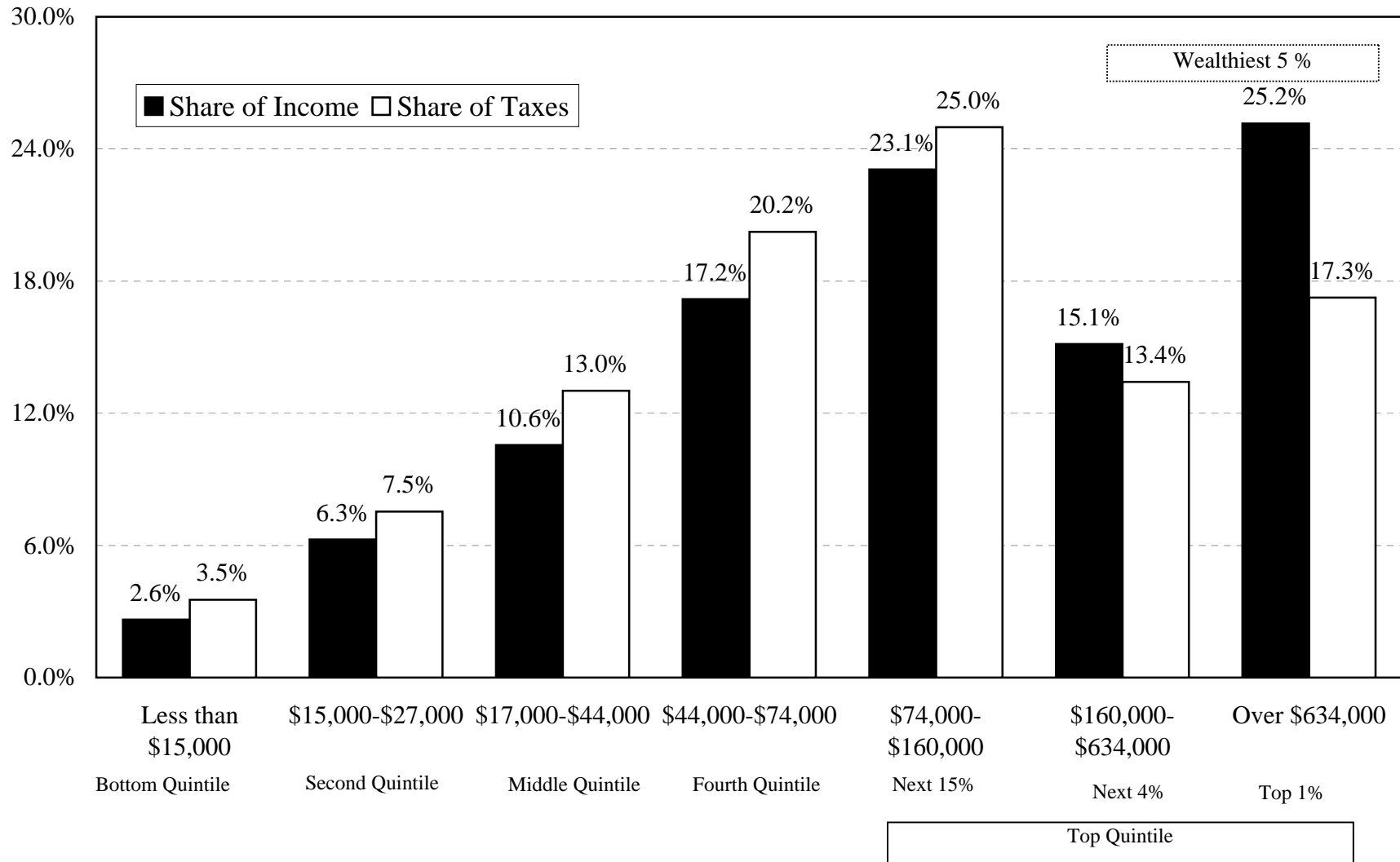
- A second basic flaw of the current program is that similarly situated taxpayers are treated very differently depending on where they live. Two taxpayers with the same incomes and the same property tax bills will get very different amounts of relief through STAR if one of those taxpayers lives in one of the seven counties with median home values that are 30 percent or more above the state median, and the other does not.
- While, on average, residents of some communities may have higher incomes and higher property tax bills than people in some other communities, these averages should not serve as the basis for treating two similarly situated New York taxpayers differently.
- While a higher percentage of the residents of one community may be in a particular income/property category than the residents of another community, all of the taxpayers with that income/property tax mix should be treated the same.

Property and sales taxes fall more heavily on low and moderate income families while the income tax is more clearly based on the ability to pay.



Source: Institute for Taxation & Economic Policy, 2003. Table shows 2002 tax law at 2000 income levels for nonelderly

The overall impact of New York's tax policy choices is that middle income and low income New Yorkers carry a disproportionate share of the tax burden.

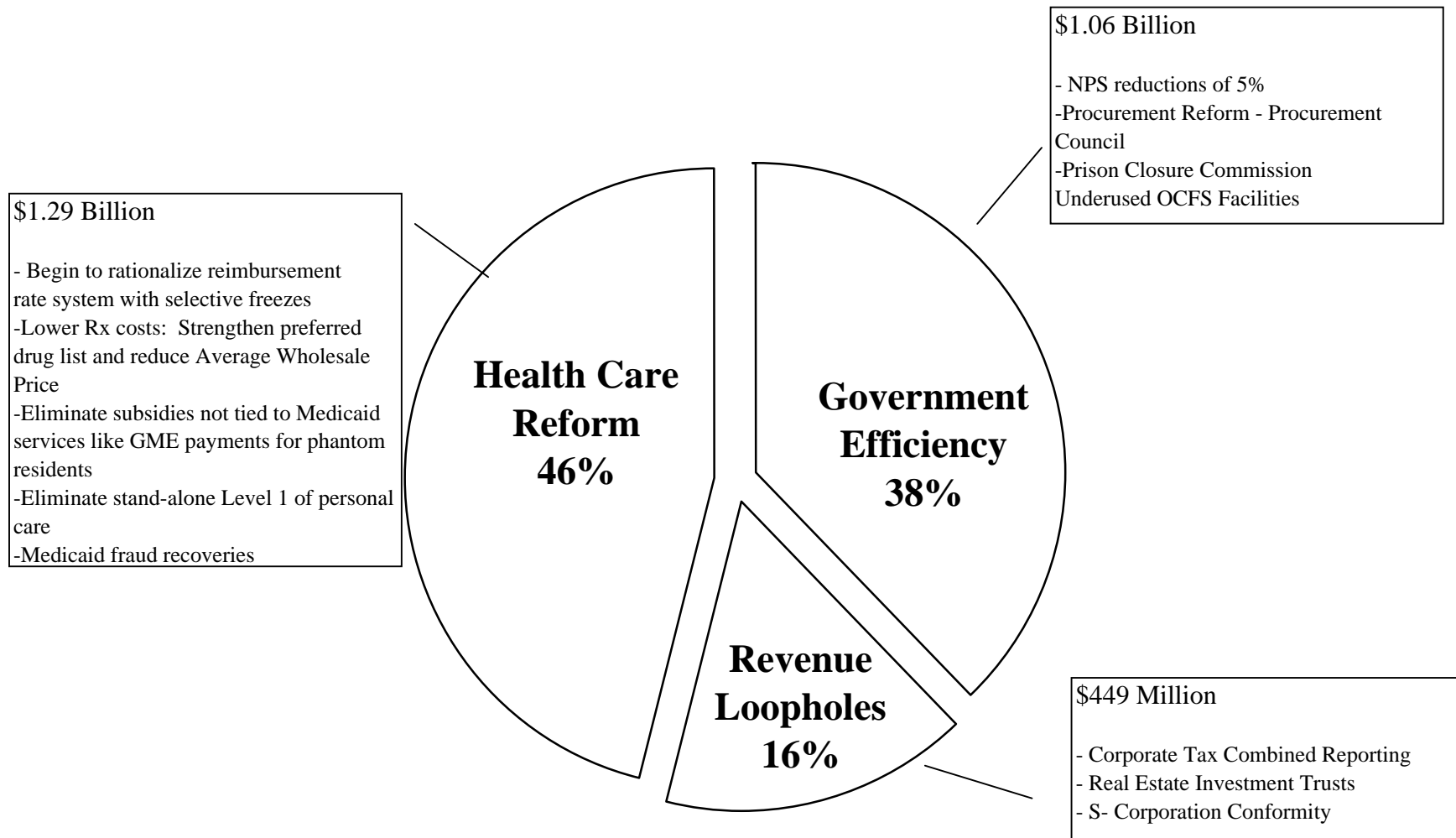


Source: Institute for Taxation & Economic Policy, 2003. Table shows 2002 tax law at 2000 income levels for nonelderly taxpayers, after federal offset. The percentages for the seven income groups add to 100%.

III. Governor Spitzer's Main Budget Initiatives

- Generate General Fund savings in order to balance the budget and fund new initiatives.
- Reduce Medicaid costs while expanding health insurance coverage.
- Fully fund education with aid ties to reform and accountability.
- Target property tax relief to those who really need it.

Governor Spitzer proposes \$2.8 billion in General Fund savings to close a projected \$1.6 billion budget gap and to fund new initiatives.



Governor Spitzer proposes to close a number of specific corporate tax loopholes. In addition, he proposes a systematic reform, combined reporting, that will level the playing field and make it harder for tax planners to invent new ways for multi-state corporations to avoid paying state taxes.

- Closing corporate tax loopholes protects corporations that play by the rules.
- New York would join 17 states including California, Colorado, Illinois, New Hampshire and Texas in requiring multi-state and multi-national corporations to file a combined return for their entire “corporate family” rather than being able to use inter-subsidary transactions to move income to countries or states where that income is not taxable. Under combined reporting, a corporate family files a single tax return covering the income of all of its subsidiaries, with that income apportioned among the states based on the locations of all its property, payroll and sales.
- Rather than closing corporate tax loopholes one at a time, combined reporting provides a systematic approach to stop income-shifting schemes.
- Combined reporting has the advantage of protecting the state from new methods of transferring profits among subsidiaries that invariably arise once a single loophole is closed.
- Income shifting can only be pursued by multi-state corporations which gives these businesses an unfair advantage over smaller companies operating only in New York. Combined reporting will level the playing field.

Public Procurement Reform

- **The New York government should reduce wasteful “contracting out.”** Up to \$500 million a year is wasted by NYS each year by contracting out work that could be done by State employees at a significantly lower cost.* There are numerous State contracts under which NYS pays contractors up to four times the salary of a State employee (including a 35 percent fringe benefit factor) to do the same work done by State employees. A more rational approach to contracting out would protect state taxpayers by requiring a cost/benefit analysis before a contract for personal services is executed to determine whether those services could be performed at a lower cost by State employees. Maine and Massachusetts have already adopted legislation restricting wasteful contracting out.
- **For the first time, the 2007-08 Executive Budget provides detailed reporting on the State’s use of outside consulting services.** State agencies employed an estimated 7,546 employees under consultant contracts in SFY 2006-07 at an estimated cost of \$910.9 million or an average cost of \$120,718 per consultant contract employee. It is estimated that the number of employees employed under consultant contracts will decrease to 7,278 employees in SFY 2007-08, a decrease of 268 contract employees (a 3.5 percent decrease). Interestingly consultant contract employees will be paid \$924 million in SFY 2007-08 or an average cost of \$126,966 per consultant contract employee, a 5 percent increase over the average cost in SFY 2006-07.
- In addition, the Governor proposes to reduce the reliance on contract staff at the Department of Transportation by hiring 108 new engineers. This implements the approach recommended by former Comptroller Edward Regan more than 15 years ago.

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

Many of the proposed Medicaid cost savings make sense, but freezing reimbursement rates across-the-board will jeopardize the health of many hospitals.

- The Berger Commission in its final report identified several weaknesses in the state's health care system that will be exacerbated by an across-the-board freeze in trend factors. Like the governor, the commission calls attention to the problems of excess capacity, but it also notes that for the past eight years, the state's hospitals as a group have lost money and a majority of the state's nursing homes, even some that are fully occupied, operate at a loss.*
- If reimbursement rates do not keep pace with costs, more providers will fail. This see-who-makes-it approach contrasts sharply with the orderly closing plan proposed by the Berger Commission, which observes that:

Turbulence afflicts our health care providers; facility closures and declarations of bankruptcy are too common. Since 1983, 70 hospitals and over 63 nursing homes have closed in New York State. Some of our oldest and proudest names in health care struggle under the unintended consequences of bankruptcy proceedings. Patient access to stable health care services is at risk.
- An across-the-board freeze in trend factor is a blunt instrument that will result in disorderly closure of facilities. There are more precise ways to control Medicaid expenditures. One highlighted by the Berger Commission is redesigning the state's reimbursement mechanisms, which currently "distort patterns of service delivery and induce facilities to pursue high margin services, sometimes at the expense of more essential community needs." This re-design could meet several goals simultaneously, increasing primary and preventive care and bringing down costs, in a manner consistent with rather than conflicting with an orderly rightsizing of the industry.

* Commission on Health Care Facilities in the 21st Century, A Plan to Stabilize and Strengthen New York's Health Care System, December 2006.

Almost one fourth of the growth in Medicaid expenditures in NYS since 1997 can be attributed to increased expenditures on prescription drugs and supplies.

	NYS Spending on Prescription Drugs and Supplies (billions)*	All Other NYS Medicaid Spending (billions)**	Total NYS Medicaid Spending (billions)**
1997	\$1.40	\$18.97	\$20.37
1998	\$1.70	\$20.20	\$21.90
1999	\$2.15	\$20.72	\$22.87
2000	\$2.58	\$21.09	\$23.67
2001	\$3.10	\$22.95	\$26.05
2002	\$3.77	\$25.44	\$29.21
2003	\$4.29	\$28.47	\$32.76
2004	\$4.94	\$30.00	\$34.94
Growth	\$3.54	\$11.04	\$14.57
Percent Change	252.4%	58.2%	252.4%
Share of 1997 Base	6.9%	93.1%	100.0%
Share of 1997 to 2004 Growth	24.3%	75.7%	100.0%

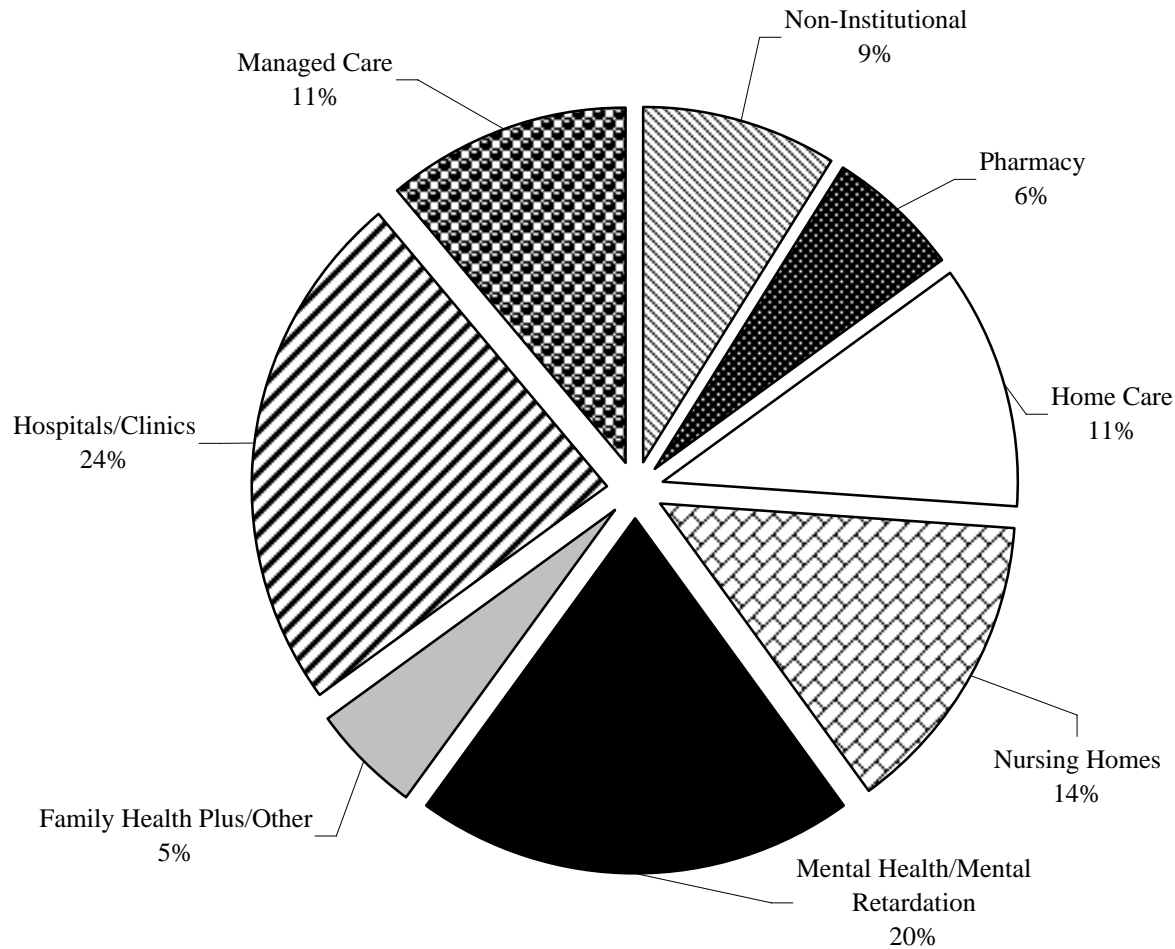
* Does not include the portion of prepaid care expenditures (e.g. HMOs) that is attributable to prescription drugs and supplies.

** Includes prepaid care expenditures (e.g. HMOs).

Source: New York State Department of Health, Medicaid Expenditure Reports by Type of Service.

In New York, Medicaid pays for more than just hospitals and nursing homes. The state offices of Mental Health and Mental Retardation account for one out every five Medicaid dollars or an estimated \$9.5 billion in 2007-08.

Spending by Category: 2007-08 Medicaid - \$47.6 Billion (All Sources)



Governor Spitzer is proposing a solution to the Campaign for Fiscal Equity lawsuit that addresses the Court of Appeals' orders.

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

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

Foundation Aid Explained

Local Cost of Education

-

Expected Local Contribution

=

Foundation Aid

Avg. Cost of Successful Schools

X

Regional Cost Index

X

Pupils Adjusted for Needs
(student = 1.0 + ...)

Special Education = 1.41
 Census-Based Poverty = 0.65
 Free/Reduced Price Lunch Eligibility = 0.65
 Limited English Proficiency = 0.5

Adjusted Statewide Avg. School Tax Rate

X

Relative Income

X

Full Value Property Base

*** All districts will receive a minimum annual Foundation Aid increase of 3%, on top of building, transportation, high-cost special education and BOCES aid**

FOUNDATION FORMULA SAMPLE CALCULATIONS

	New York City	Albany	Brentwood
(A) Establishing the cost of an adequate education			
(1) Per Pupil Amount from Successful Schools Study <i>\$5,258 for 2007-08 adjusted for inflation to \$5,662 for 2010-11 - assumes 2.5% inflation per year</i>	\$5,662	\$5,662	\$5,662
(2) Regional Cost Index <i>Ranges from 1.0 in North Country to 1.425 in NYC/LI</i>	1.425	1.124	1.425
(3) Student Need Adjustment Factor <i>Ranges from 1.0 to 2.0 depending on poverty, frpl, lep, sparsity</i>	1.801	1.678	1.779
(4) Per Pupil Foundation Amount - 2010-2011	\$14,528.69	\$10,678.53	\$14,353.17
(B) Establishing the expected local contribution			
(5) Full value per pupil	\$458,839	\$372,348	\$275,034
(6) Income adjustment <i>Income per Pupil Compared to State Average (.65 to 2.0)</i>	1.127	0.820	0.650
(7) Adjusted Tax Rate <i>\$16 per \$1000 times Income Adjustment</i>	18.03	13.12	10.40
(8) Expected local contribution per pupil	\$8,273	\$4,885	\$2,860
Foundation Aid per Pupil: A MINUS B	\$6,256	\$5,793	\$11,493

(C) CALCULATION OF FOUNDATION AID FOR 2007-2008	New York City	Albany	Brentwood
(9) Enrollment	1,184,742	12,479	19,041
(10) Foundation Aid for 2010-2011 <i>Foundation Aid per Pupil times Enrollment</i>	7,411,544,545	72,294,965	218,834,785
(11) Base Year State Aid	5,063,400,651	42,568,007	139,615,051
(12) Difference between Foundation Aid and Base Year Aid	2,348,143,894	29,726,958	79,219,734
(13) Multiply Line (12) times 20%	469,628,779	5,945,392	15,843,947
Proposed 2007-2008 Foundation Aid	5,533,029,430	48,513,399	155,458,998
<i>Add Line 13 to Line 11</i>			
Fully Implemented Increase in Foundation Aid	46%	70%	57%
2007-2008 Foundation Aid Increase	9%	14%	11%

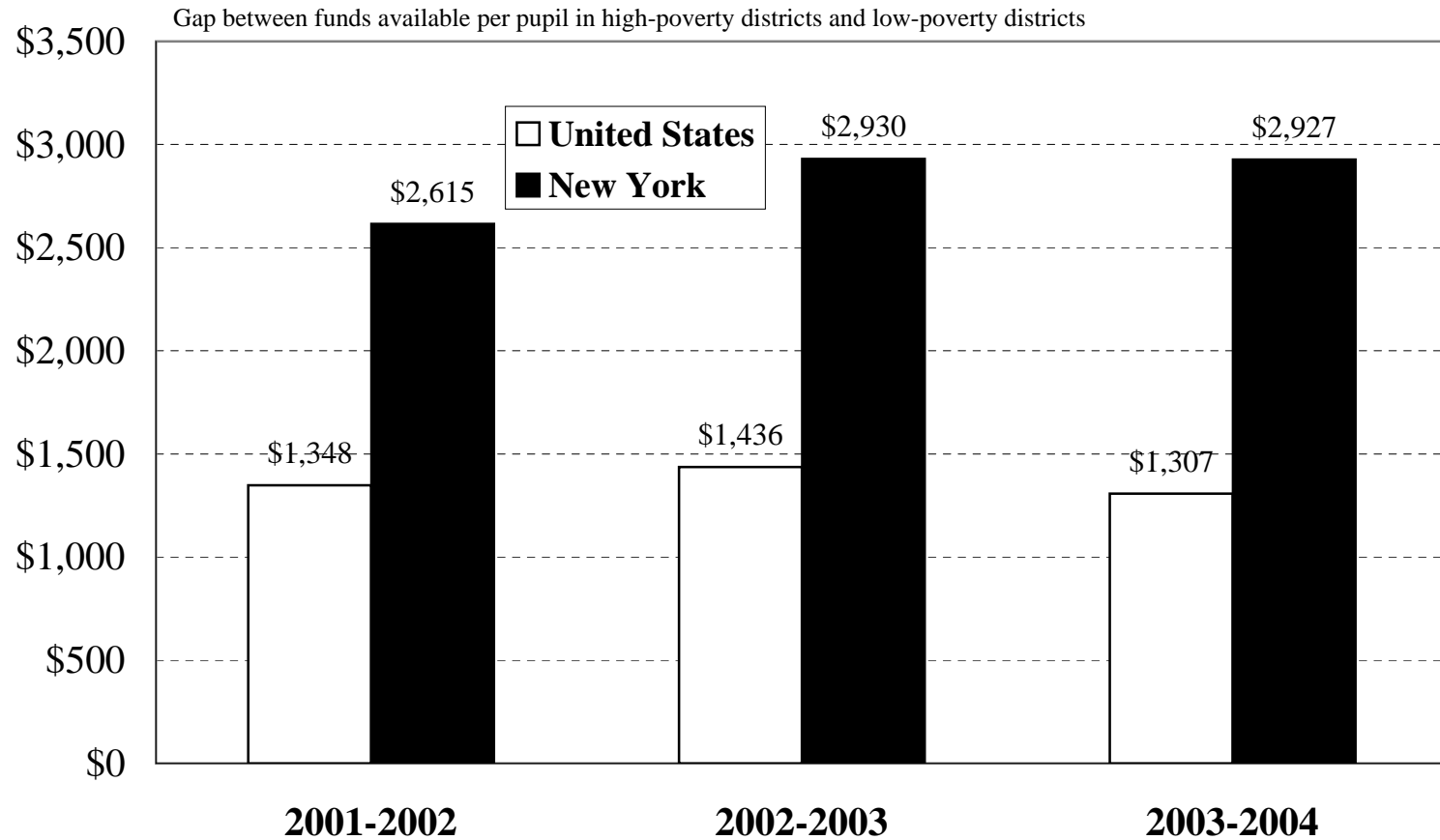
Governor Spitzer's proposed reform of STAR is a step in the right direction but it does not go far enough.

- The governor's proposal would vary STAR benefits by income, so that a millionaire would get less than a middle-income family.
- But it does not vary the benefit based on the relationship between a family's income and its property tax bill. Two families living in the same school district would get the same benefit if they both made \$50,000—even if one has a property tax bill of \$3,000 a year and the other a bill of \$6,000 a year.
- In addition, the governor's proposal does not address the problem of two families with the exact same income and the exact same property tax bill getting substantially different benefits if they happen to live in different part of the state.

A school spending cap would be fundamentally inconsistent with a statewide solution to the Court of Appeals decision in the CFE case.

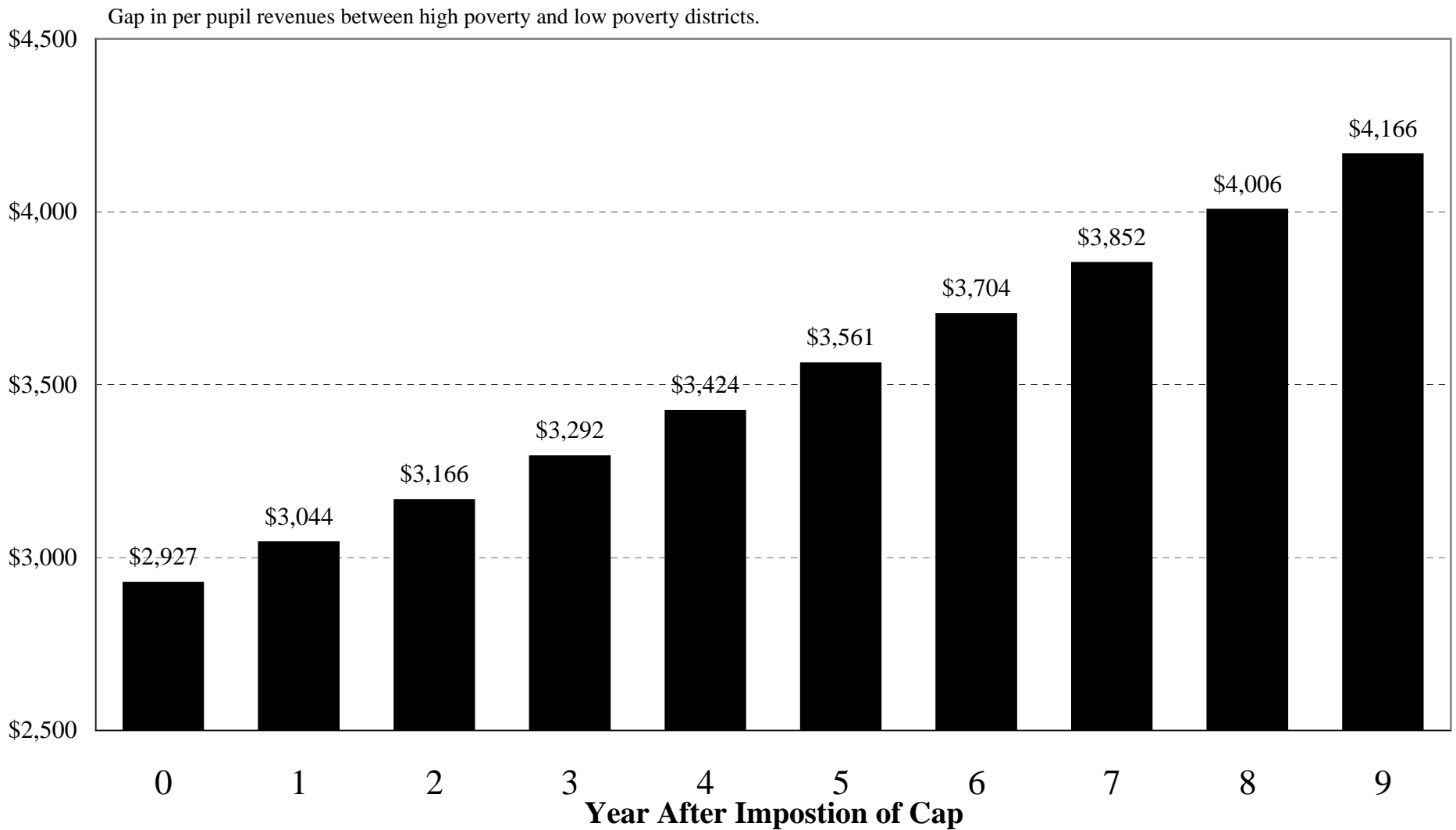
- Because STAR provides reimbursements to school districts only for the property taxes on owner-occupied dwellings, it substantially disadvantages those communities (primarily cities) with large numbers of renters.
- Even under the proposal advanced by the governor in the proceeding before the Special Masters in the CFE case and in the subsequent appeals, 177 of the 639 districts analyzed needed to increase spending for purposes of providing a Sound Basic Education over and above the levels needed to meet ordinary annual changes in the cost of educational inputs. Modifying this model to make the corrections recommended by the Referees in the CFE case, 477 districts would require additional spending over and above inflationary increases.
- A percentage-based spending cap of this type would institutionalize and exacerbate the inequities inherent in the current system. Moreover, caps set at 4 percent or at the level of the Consumer Price Index are inconsistent with the costs increases school districts currently face.

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



Source: The Education Trust, "The Funding Gap 2006: How the Federal Government Makes Rich States Richer," December 20, 2006

A cap on local school budgets would make this gap grow wider each year.



Source: \$2,927 gap from Education Trust calculations based on U.S. Department of Education school district revenue data for the 2003-2004 school year.

Impact of a Cap on Increases in School Spending on Two Neighboring Westchester County School Districts

Base Year Data from the Successful Schools Model developed by Standard & Poor's for the the New York State Commission on Education Reform (the Zarb Commission)*		
	Harrison	Port Chester
Enrollment	3,336	3,564
Percentage of Students Economically Disadvantaged	5%	42%
Estimated Actual Spending Per Pupil*	16,681	12,048
Needed Resources Per Pupil Under Pataki Proposal to the Courts During the CFE Appeal	11,452	13,039
Amount by which actual spending per pupil is over/(under) needed resources per pupil	5,229	(991)

Four Years Later Assuming that (a) Costs Per Pupil Increase 4% Per Year, (b) enrollment remains constant; and (c) a Spending Cap Limits the Growth in Actual Spending Per Pupil to 4% Per Year		
	Harrison	Port Chester
Enrollment	3,336	3,564
Percentage of Students Economically Disadvantaged	5%	42%
Estimated Actual Spending Per Pupil*	19,515	14,095
Needed Resources Per Pupil Under Pataki Proposal to the Courts During the CFE Appeal	13,397	15,254
Amount by which actual spending per pupil is over/(under) needed resources per pupil	6,117	(1,159)

*Expenditure estimates are for the 2002-03 school year, in January 2004 dollars, not including debt service and transportation

New York State can lower property taxes and reduce the fiscal disparities it has imposed on local governments.

As we have seen, New York State divides responsibility for the financing of important public services between itself and local governments in ways that place great pressure on local property and sales taxes. This is especially problematic for those localities that have relatively weak tax bases compared to their needs. It also increases the regressivity of the overall state-local tax system while exacerbating the impact of the property tax's shortcomings.

The governor and the legislature can simultaneously address these fiscal disparities and reduce the pressure that has been placed on the local property tax base by:

1. Implementing a legitimate statewide solution to the court decisions in the Campaign for Fiscal Equity lawsuit.
2. Gradually increasing the state share of Medicaid costs and basing each county's share of Medicaid costs on objective measures of its relative "ability to pay."

3. Restoring the state's commitment to "revenue sharing" with its local governments through a transparent needs-based formula that is honored over time.
4. Eliminating the fiscal disparities in the School Tax Relief (STAR) program, which disadvantage city school districts with high percentages of needy children.
 - The governor and the legislature should undertake a comprehensive reevaluation of all of the state's real property tax relief programs and work toward an integrated circuit-breaker variation of STAR that is consistent with the principles of horizontal and vertical equity.
 - In addition, since STAR is both a property tax relief mechanism and a way to deliver state revenue to school districts, it should also be integrated with a legitimate statewide solution to the CFE decision to ensure that it is fair to the upstate cities.



The Fiscal Policy Institute is a nonpartisan research and education organization that focuses on tax, budget, and economic issues that affect the quality of life and the economic well being of New York State residents.

www.fiscalpolicy.org

**One Lear Jet Lane
Latham, NY 12110
518-786-3156**

**11 Park Place, Suite 701
New York, NY 10007
212-414-9001**