New York and the Federal Fisc in the Aftermath of September 11th:

The State and Local Impacts of Federal Policy Options

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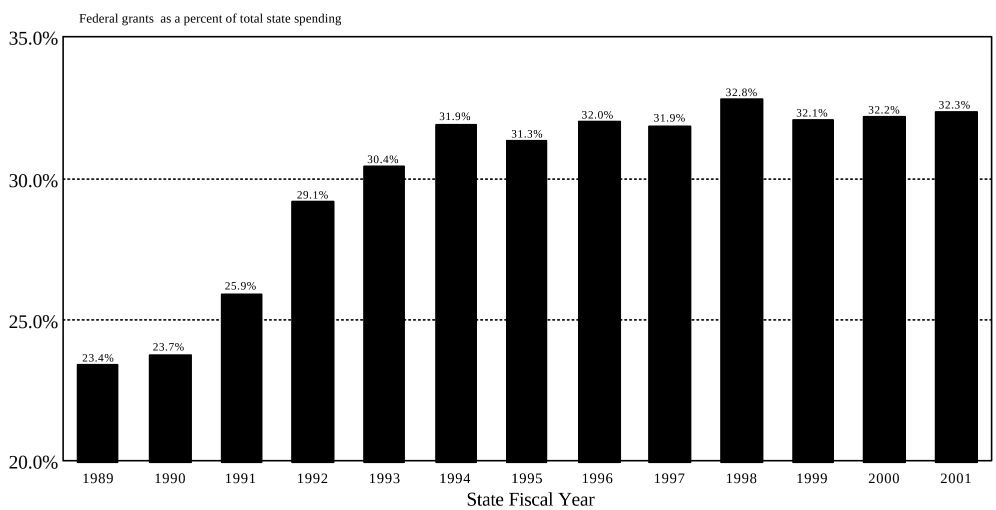
Federal, state and local policies always interact in the process of balancing the state's budget, but this year, perhaps more than any other year in recent history, the interdependence of the three levels of government is particularly acute. Both the national economic downturn and the unprecedented terrorist attacks of September 11 call for a strong, timely federal response. To date, the actions of the federal government on both fronts have been disappointing despite the efforts of the New York Congressional delegation. And, as the 107th Congress convenes for its second session, many of the proposals being advanced by the President and others include some elements that will help and others that would make it even more difficult for New York to balance its state budget.

I. The Importance of Federal Revenues to the State Budget

Federal grants are an important part of New York State's revenues and that importance has grown over the past decade. In 1991, federal grants represented only 25.9% of state spending. Last year, federal grants represented 32.3% of the state's total spending. Much of this growth can be attributed to the growth in federal revenues for the Medicaid program.

Federal grants consistently finance about one third of total state spending.



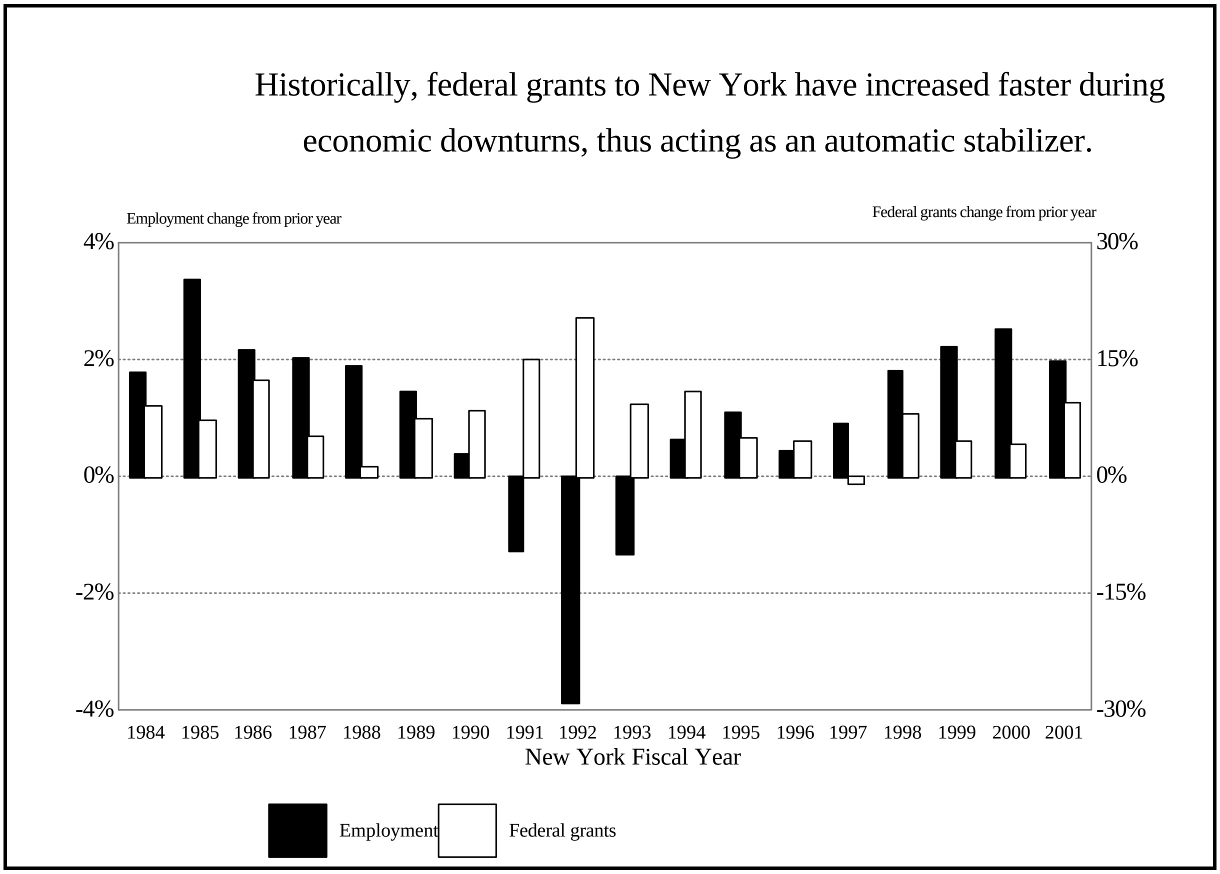
II. Addressing the Challenges to the "Macroeconomy"

Over the course of our nation's history, the federal government has assumed responsibility for the overall management of the macroeconomy. It is the federal government that is properly held accountable for maintaining economic stability and growth. The states can not coin money and they must run balanced budgets, so the exercise of both fiscal and monetary policy rests with the federal government. During the first nine months of 2001, the Bush Administration relied entirely on monetary policy and automatic stabilizers. But in the wake of the September 11th attacks, and in the face of the continuing deterioration of the economic situation despite 11 reductions in interest rates by the Federal Reserve during 2001, the administration recognized the need for a more aggressive fiscal policy response.

A. Automatic stabilizers are important but do not provide sufficient economic stimulus.

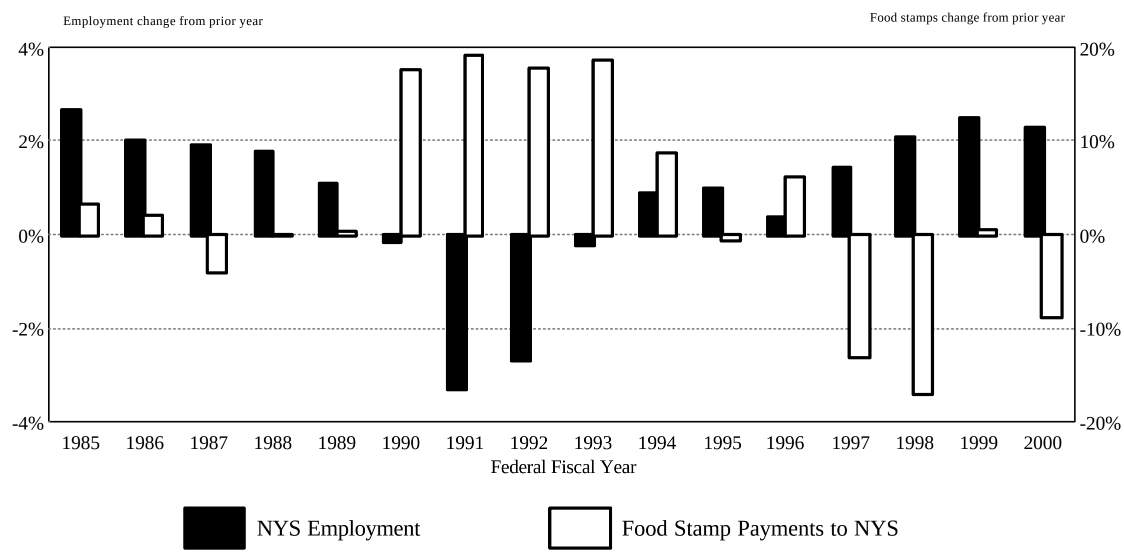
There are several federal programs that automatically increase expenditures when the economy slows down, thereby providing economic stimulus. As shown in the following chart, federal grants to the state of New York have grown faster when employment growth was slow and more slowly when employment growth accelerated. For example, the federal food stamp program is one of the most powerful automatic stabilizers. When job growth slows and unemployment goes up, more individuals apply for and receive food stamps which are funded entirely by the federal government, thereby increasing the flow of federal funds into the state. Likewise, as job growth accelerates and unemployment falls, the growth of food stamp expenditures has fallen. If food stamps had been converted from an entitlement program to a block grant, this important function of the program would have been lost. Fortunately, during the course of last year's reauthorization debate, no serious proposal for making such a conversion was on the table.

Medicaid, unemployment insurance, Supplemental Security Income(SSI) and Aid to Families



with Dependent Children (AFDC) have also historically served as automatic stabilizers. While both Medicaid and SSI expenditures have been growing steadily, they have grown faster in times of economic distress and experienced slightly lower growth rates when the economy was doing well.

The Food Stamp program has been one of the most responsive of the federal government's automatic stabilizers.



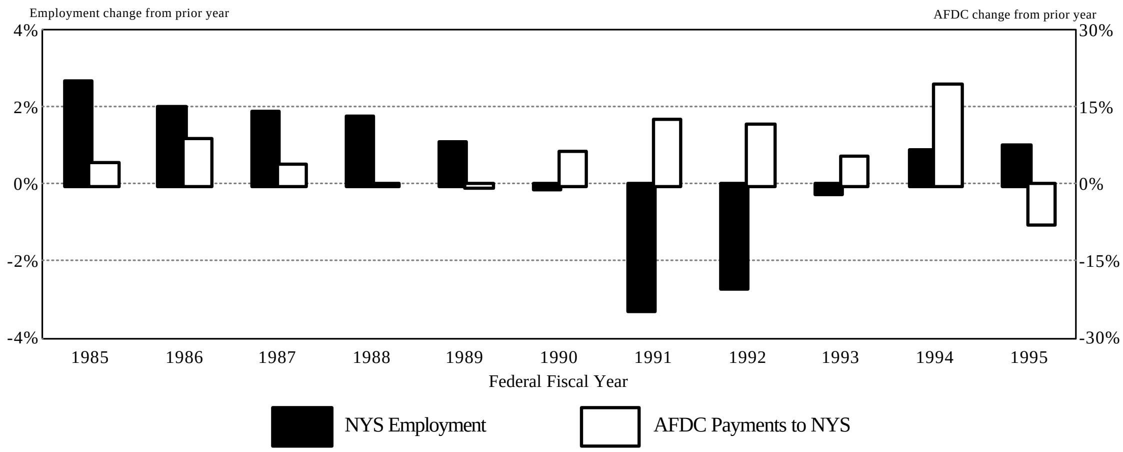
As an entitlement program, federal AFDC funds increased automatically when caseloads rose in a recession. As a block grant, its successor, Temporary Assistance for Needy Families (TANF) provides economic stimulus in a recession only if states have unspent balances in their block grant account which they are able to spend to stimulate the economy. The "automatic" nature of the AFDC stimulus has been lost in the transition to the block grant. While caseloads have fallen dramatically in every state since the implementation of TANF, many states do not have large reserves because they have initiated many new programs in services for low-income families in order to ease the transition from welfare to work. Most states are now spending nearly all of their annual grant amounts and in 2000, nearly a third of the states had increased spending levels so that they drew upon unspent funds from prior years to strengthen existing programs and launch new initiatives. In fiscal year 2001, before the onset of the recession, the states, for the first time, collectively spent more than the total annual block grant allocation.

At the end of the last federal fiscal year (September 30, 2001), New York reported $865 million in unobligated TANF funds. These funds could be used this year to stimulate the state's economy, but spending from the TANF block grant will not increase automatically unless caseloads rise precipitously over the next few months. Increased spending on TANF programs other than cash assistance would require legislative approval and probably could not be implemented in a timely fashion.

The 1996 welfare law established a TANF block grant structure that envisioned states taking primary responsibility for absorbing increased costs that could occur for a variety of reasons, but established a contingency fund mechanism so that the federal government would share in the increased costs that could arise from a serious economic downturn. Unfortunately, the contingency fund established in the 1996 law was deeply flawed (it also expired at the end of FY 2001). There is broad consensus that had need risen substantially due to a recession prior to its expiration, it would not have provided needed help to states.

TANF is scheduled for reauthorization this fall. The reauthorization legislation should include a contingency fund that provides additional federal funds to states in which an increased number of

During the last economic downturn, Aid to Families with Dependent Children (AFDC) was an important automatic stabilizer. The Personal Resposibility and Work Act of 1996 replaced the AFDC program with a fixed block grant for Temporary Assistance to Needy Families (TANF).



families need assistance due to an economic downturn The trigger mechanisms should be redesigned to ensure that states facing economic difficulties are eligible. The Center on Budget and Policy Priorities suggests allowing states to qualify based on a significant increase in unemployment (such as a 50 percent or 1.5 percentage point increase in their total unemployment rates, or a 1.0 percentage point increase in their insured unemployment rates), as well as on criteria indicating that additional families need assistance, such as a significant increase in the number of families receiving TANF cash benefits or participating in subsidized jobs programs.

The unemployment insurance system also works as an automatic stabilizer, providing extended benefits which are partially funded by the federal government when unemployment goes up. New York's extended benefit program, financed half by state UI funds and half by the federal government, is activated automatically if the Insurance Unemployment Rate (IUR) exceeds 5% for 13 weeks and is at least 20% above the average state IUR of the corresponding 13-week period in either of the two previous years. In the current downturn, New York's unemployment rate has not yet gone high enough to meet the requirements of the trigger mechanism for this program.   New York's IUR for the last week of 2001 was 3.03%, almost two percentage points below the level required by federal law to activate or trigger the program. In fact, despite the national recession, no state had an IUR in excess of 5% at the end of December.

However, two states, Washington and Oregon, have already activated their extended benefits programs. Their programs automatically began providing extended benefits to workers because, like six other states including New York's neighbors Vermont and Connecticut, Washington and Oregon exercised their option under a 1992 law which allows them to use an alternative activation trigger based on their Total Unemployment Rate (TUR). While New York's TUR for the end of 2001 was 5.1%, still

1.4 percentage points below the 6.5% required to automatically activate the program under the alternative trigger provision,[1] New York is more likely to meet the TUR trigger in the next few months than the IUR trigger. It is easier for a state to meet the TUR trigger in a recession than the IUR trigger because the IUR measures unemployment only among the "insured" who tend to experience unemployment rates that are significantly lower and significantly less volatile than the overall unemployment rate.[2]

By not adopting the TUR trigger, and thereby dragging out the initiation of an extended benefits program, New York tries to minimize money spent from the state's UI fund while putting pressure on Congress to enact an Emergency Benefits program, funded entirely by the federal UI trust fund. This gamble may leave thousands of unemployed New Yorkers without benefits and leave the state's economy without the important economic stimulus provided by these supplemental benefits.

B. Getting the stimulus package right

The resources that the existing federal government automatic stabilizers generate during an economic downturn are too small relative to the overall size of the economy to bring the economy out of anything but the very mildest recession. Therefore, the federal government often needs to adopt other stimulus measures. Thus, during most recessions the federal government concludes that it needs to adopt additional stimulus measures.

The President's original economic stimulus plan, the Economic Security and Recovery Act of 2001 passed the House of Representatives on October 24th of last year. The Senate Finance Committee has approved a Democratic stimulus bill, the Economic Recovery and Homeland Defense Act of 2001, which has been brought to the Senate floor twice, receiving 51 votes both times, but falling short of the 60 votes necessary for passage. The House of Representatives passed another stimulus bill on December 20, 2001, the Economic Security and Worker Assistance Act of 2001. These are important efforts, but the President and the Congress have to do more than just get the name right. They must adopt legislation that gets money into circulation and doesn't just fatten the bottom lines of some favored corporations. They must also ensure that both the tax cuts and the spending programs that they adopt in the name of "economic stimulus" help the economy now, not when the recession is over, and the damage to American families has been done. They must also consider the impact of their stimulus packages on state finances.

The basic idea is that when the economy is slowing down, the federal government can stimulate the economy by reducing taxes or increasing spending. But, not all tax cuts and not all spending increases are effective in accomplishing this end. To really stimulate the economy, a tax cut or a spending increases must take effect immediately. They must get money into the economy now, not months or years from now. One criticism of some past efforts at economic stimulus is that by the time the Congress acted and by the time the stimulus programs were implemented the recession was over. This doesn't mean that the federal government should sit back, do nothing, and let people suffer. Instead, it means that we have to make sure that we avoid doing things in the names of "economic stimulus" that

[1]The TUR trigger also requires that the TUR be 10 percent above the three-month average TUR in either of the two preceding years. New York's TUR is already 13% above last year's TUR.

[2]During the recession of the 1990s, the IUR trigger activated the EB program in 10 states for an average of 6.2 months. If the TUR trigger had been in effect, the EB program would have been activated in 43 states for an average of 18.4 months and would have provided $10.9 billion more in benefits.

will feathered the nests of some favored constituencies but which will have very little to do with the problem at hand.

C. The Need for State Fiscal Relief

Since the states are required to balance their budgets, they will have to increase taxes or cut spending, thus making the recession even worse. One way the federal government can help to prevent this situation and move money into the economy quickly is by providing support to state budgets. Several competing proposals are being considered to immediately and temporarily increase the portion of state Medicaid costs that are picked up by the federal government. For each state, the federal government pays a percentage of all Medicaid costs, ranging from 50 percent to 80 percent. Increasing the Medicaid matching rate would provide simple, immediate fiscal relief to the states. The process of reimbursing states for Medicaid costs is already well-established. Changing matching rates would create no federal bureaucratic complications, and would create no restrictions on states in terms of how they use the funds freed up by greater federal Medicaid reimbursements.

There are three major proposals being discussed to provide fiscal relief to the states through the Medicaid program. The first, sponsored by New York's Congressman King, State Budget Relief Act of 2001, HR 3414 would provide $1.6 billion in fiscal relief for New York. It would increase the federal Medicaid match rate or FMAP by 2 percentage points for all states and by an additional 2.5 percentage points for states with higher than average unemployment. As written, the Senate Finance Committee stimulus bill, HR 3090 would provide $536 million in fiscal relief to New York through a 1.5 percentage point increase in the FMAP. The Senate Finance Committee bill provides for an additional 1.5 percentage point increase in high unemployment states. If the method used to measure high unemployment in the Senate Finance Bill is changed to match the provisions in the King bill, as has been discussed, or unemployment in New York rises above the national average, New York would be eligible for over $1 billion.[3] The House stimulus package takes a different approach, providing one-time grants to states to assist paying for state Medicaid and SCHIP costs. New York's grant would be set at $574 million for 2002.

All of these proposal call for merely a one-time temporary increase in the FMAP. As seen by the extensive debate on these proposals to date, it takes a considerable amount of time to get this kind of critical fiscal relief through the legislative process. In order to avoid such a delay in the future, Congress should establish a recession trigger to automatically increase the FMAP when there is an economic downturn. This would ensure critical fiscal relief to states in a timely fashion, before they are forced to raise taxes or cut spending, making the recession even more severe.

Unfortunately, the corporate tax cut provisions in both the House and the Senate Finance Committee stimulus packages would increase pressure on New York State's budget by reducing state tax revenues. The House provision in question allows partial expensing of business investments. This provision would allow firms to subtract immediately 30 percent of the cost of new investments in equipment or similar business property when figuring their federal tax liabilities, rather than depreciating the costs of these investments over a number of years as under current law. The Senate Finance Committee bill has a comparable, although smaller, "bonus depreciation" provision to allow firms to

[3] The King bill compares state unemployment rates to the "weighted average unemployment rate" to determine "high unemployment states"while the original Senate Finance Bill used the unweighted national unemployment rate. New York currently qualifies as a "high unemployment state" only when the state's unemployment rate is compared to the weighted average unemployment rate but if the state's unemployment rate continues to rise it may qualify under either mechanism.

subtract 10 percent of the cost of new investments put in place over the next year. Like most other states, New York uses federal rules on expensing and depreciation in the calculation of its state corporate and other business income taxes, and therefore would automatically lose state tax revenue if these federal proposals were to be adopted. For New York State, the revenue loss from the House stimulus package corporate tax cuts is estimated at $710 million dollars in the next year with an additional $386 million revenue loss to New York City. The Senate Finance Committee stimulus provisions would cost New York State $270 million and New York City approximately $143 million.

In fact, as shown in the following table, the net impact of the House stimulus package would be a fiscal drain on New York State because the negative impact of the tax provisions would be greater than the $574 million Medicaid/SCHIP grant. If the tax revenue impacts on New York City are also taken into account, the negative impact of the House proposals are even greater and the even the fiscal relief in the Senate Finance bill is lowered considerably. In addition, the House plan provides three years of bonus depreciation and therefore would adversely affect New York State and City revenues for three years while providing only a single year of Medicaid relief.

Fiscal Impact of Stimulus Bills (in millions)

	H.R. 3414 State Budget Relief Act of 2001 King	H.R. 3090 The Economic Recovery and Assistance for American Workers Act of 2001 Baucus	H.R. 3529 Economic Security and Worker Assistance Act of 2001 House Republicans
Medicaid Relief	$1,609.4	$1,072.9	$574.0
State Tax Revenue Impact from Federal Tax Changes	$0.0	$263.0	$711.0
New York City Tax Revenue Impact from Federal Tax Changes	$0.0	$143.0	$386.0
Net Impact on New York State and local governments	$1,609.4	$666.9	($523.0)

Source Center on Budget and Policy Priorities

III. Protecting our States and Cities from the Direct Effects of War-Like Attacks

When it comes to the special problems faced by New York as a result of the September 11th disasters, some Congressional leaders have suggested that the entire country is in trouble and New York should not expect any special treatment. They have given particularly short shrift to the state's request for help with the revenue shortfalls that are directly attributable to the WTC disaster - arguing that there is no precedent for such assistance. But there is no precedent for an international terrorist attack on an American city that kills thousands of unarmed civilians and destroys millions of square feet of commercial buildings.

On December 18, Congress appropriated approximately $11 billion dollars to New York in disaster relief and rebuilding aid. The package included $4.35 billion for Federal Emergency Management Agency (FEMA) reimbursements, in addition to the $2 billion which had been provided earlier for emergency response, demolition and debris removal, civilian and uniform overtime and other personnel costs, as well as for replacement of lost facilities and infrastructure. The appropriation also included $3.85 billion in non-FEMA aid including $2.0 billion through the Community Development Block Grant for economic development, to bring the total CDBG funding to $2.7 million. The other $1.85 billion was appropriated for a variety of purposes, including hospital costs, safety and security repairs to the Hudson River train tunnels, New York Worker's Compensation claims, worker training, expanded ferry service, enhanced transit security and repair of the West Side Highway and related federal-aid highway repair.

On December 20, 2001, the Victims of Terrorism Tax Relief Act passed both the House and Senate. This act provides about $190 million of tax relief in 2002 to the victims and families of the terrorist attacks. The Act refunds income federal income taxes for 2000 and 2001 and provides a minimum tax relief benefit of $10,000 rebate to the families of victims who did not make enough money to pay tax. The bill also shields the first $3 million in assets from federal and state estate tax and $8.5 million in assets from federal estate tax for 2001.

Both the House stimulus package and the Senate Finance stimulus package include provisions that would directly assist the areas of New York City damaged in the terrorist attacks with the rebuilding effort. The following tables summarize the two packages of tax benefits for the area damaged in the attacks that are currently being considered.

Summary of Federal Recovery Assistance to New York
January 17, 2002

Program	Public Law 107-117
Department of Labor -- Emergency Employment Clearinghouse administered by NY Labor Council and NY City Partnership	$32.5 million
Workers Compensation	$175 million
Unreimbursed hospital costs (HHS)	$140 million
Department of Education Programs	$10 million.
Safety Screening Programs (CDC)	$12 million
Environmental Assessment Programs (NIH)	$10.5 million
Public TV/Radio facilities (NTIA)	$8.25 million
Federal Buildings in New York City	$174.582 million
Small Business Administration	$150 million
Transportation Programs	$298.5 million
Justice Department Programs	$224.67 million
Economic Development (HUD -- Community Development Block Grant)	$2 billion
FEMA	$4.357 billion
Released by Administration from funds made available to the President by P.L. 107-38	$3 billion $2 billion from FEMA $700 million from HUD $300 million from other federal agencies
TOTAL	**$10.59 billion**

Source: New York State AFL-CIO, Public Policy Department.

Tax Benefits for Areas of New York City Damaged in Terrorist Attacks on September 11, 2001

		Federal Budget Impact (millions)		
		2002	**2002-06**	**2002-11**
	Economic Security and Worker Assistance Act of 2001 - H.R. 3529 - *Passed House of Representatives on December 19*			
1.	Special depreciation allowance for certain property	-$785	-$3,834	-$2,913
2.	Treatment of leasehold improvements	-$27	-$350	-$706
3.	Temporary increase in section 179 expensing	-$42	-$182	-$46
4.	Authorize issuance of tax-exempt private activity bonds for rebuilding the portion of New York City damaged in the September 11, 2001 terrorist attack	-$15	-$729	-$2,057
5.	Incentive for reinvestment in New York City	-$163	-$358	-$327
	Subtotal	**-$1,032**	**-$5,453**	**-$6,049**
	Interaction with general business tax provisions	$609	$1,317	$568
	Total	**-$423**	**-$4,136**	**-$5,481**
	The Economic Recovery and Assistance for American Workers Act of 2001 - *Twice received 51 votes in the Senate but failed to garner the 60 votes required for passage.*			
1.	Expansion of Work Opportunity Tax Credit categories to include certain employees in New York City	-$1,199	-$2,000	-$2,000
2.	Authorize issuance of tax-exempt private activity bonds for rebuilding the portion of New York City damaged in the September 11, 2001 terrorist attack	-$38	-$981	-$2,684
3.	Incentive for reinvestment in New York City	-$584	-$973	-$432
	Reenact exceptions for qualified mortgage bond financed loans to victims of Presidential declared disasters	-$3	-$33	-$73
4.	One-year expansion of authority for Indian tribes to issue tax-exempt private activity bonds	-$1	-$41	-$121
	Total	**-$1,825**	**-$4,028**	**-$5,310**

Source: Joint Committee on Taxation, December 14, 2001, JCX-90-01

A. Reimbursing states and localities for the direct revenue losses from international attacks

While the Stafford Act — the law that establishes the Federal Emergency Management Agency and governs the provision of federal disaster assistance - has been refined over the years to deal with floods, earthquakes and hurricanes, it does not provide an appropriate framework for federal assistance in the case of war-like attacks such as those of September 11th. As Governor Pataki and Mayor Giuliani have said, the attack on the World Trade Center was an attack on the entire country and not just on New York.

There is also an important constitutional distinction between the federal government's responsibilities in the case of emergencies of the kind that are covered by the Stafford Act and its responsibilities in regard to war-like events such as the World Trade Center attacks. In drafting and agreeing to the U. S. Constitution, the founding states ceded significant powers to the new national government. One of the important considerations that the states received in return was that the new national government would "provide for the common defence." More specifically, in regard to instances such as those of September 11th, Article IV Section 4 of the Constitutions guarantees that the United States shall protect every state in the union against invasion. It is clearly a good thing that the federal government provides assistance to state and local governments in the case of fires, floods, explosions and natural catastrophes that are determined by the President to be major disasters. But the obligation of the federal government to the states in the case of a foreign attack is of a higher constitutional order.

The loss of lives, the closing of businesses - some temporarily and some permanently, the loss of customers and revenue, and the relocation of some businesses to New Jersey and Connecticut in order to keep operating in the face of the loss of over 25 million square feet of prime office space, and related reductions in important parts of the state's tax base, such as Wall Street bonuses, have combined to cause major reductions in the state's main revenue source - the Personal Income Tax. Corporate and sales taxes have also been hit hard. Overall, New York State's budget director has estimated that state tax revenues will be down by up to $9 billion over the course of the next 18 months as a direct result of the September 11th attacks. Even for a state with a tax supported budget of about $43 billion this is not an insignificant loss. To accommodate this loss without federal assistance would mean that New York would have to reduce spending and/or increase taxes by that amount thus causing additional damage to the state's economy. It is neither logical nor consistent with the federal government's responsibilities under the U. S. Constitution for a single state to have to run its economy into the ground in order to deal with the fallout from a national defense disaster.

This does not mean that New York should be given special treatment. While we have never before had to deal with such terrorist attacks on American soil, we now know that such attacks are possible. And, we should put into place laws that will treat New York, and any other areas that might bear the brunt of such attacks in the future, in a fair and equitable manner.

Rather than thinking about this as if it is a matter of dealing with a single state with a special problem, Congress and the President should agree on a general law that specifies the kinds of costs that the federal government will pick up in the case of a war-like invasion of this type. Such a general law should then guide what the federal government does in the current New York case and what it would do in case any other part of the country is ever the target of such a foreign attack. It should include, at a minimum, restoration of tax revenues lost due to the direct impact of the attack.

B. A moratorium on using relocation subsidies to "poach" from disaster areas

There is another area where the federal government could provide a very critical support for the efforts to rebuild lower Manhattan. While public and private sector leaders have come together to discuss the plans for the long-term rebuilding of lower Manhattan, many businesses have been forced to relocate in order to resume normal (or as close to normal as possible) operations in the aftermath of the disaster. According to news reports, some of these displaced businesses had difficulty finding sufficient blocks of space in Manhattan while some others relocated elsewhere for psychological reasons. These same news reports hint that other jurisdictions were attempting to influence relocation decisions by offering subsidies and incentives.

While most people who care about maintaining the city's economic vibrancy would have preferred to see all the affected businesses find acceptable space at reasonable prices as close as possible to their former locations, this was not possible. At the very least, however, these decisions should be guided by normal market forces not by governmental interventions designed to encourage affected firms to leave the city. Quite simply, the rebuilding of New York will be made incredibly more difficult if other governments, at a time like this, offer monetary inducements to displaced businesses to encourage them to leave the city. Such relocations will make it less likely that the firms involved will participate in the rebuilding of the city thus placing more of a burden on the federal treasury and on the New York State and New York City governments.

Utilizing its powers to regulate interstate commerce, the Congress should move immediately to place a moratorium on the provision of state and local government subsidies to encourage businesses to relocate from jurisdictions affected by substantial man-made and natural disasters. The federal government should also consider providing relocation and other assistance to displaced businesses that relocate withing the affected jurisdiction and commit their insurance settlements and other resources to the rebuilding of the affected area.

IV. Ongoing Federal Policy Debates Also Impact the New York State Budget

In addition to the economic stimulus packages and the direct relief for the individuals and areas of New York directly damaged in the terrorist attacks, there are several policy debates going on at the federal level that impact on the ability of New York State to balance its budget.

A. Reauthorization of the Temporary Assistance for Needy Families (TANF) Program and the Food Stamp Program

Authorization for the Temporary Assistance for Needy Families (TANF) program expires in October 2002. Currently, New York receives $2.4 billion dollars per year in a block grant which is used to fund a broad variety of services and programs for needy New York families. There is the possibility that the level of New York's block grant may be changed in the reauthorization process. If the block grant is reduced, particularly at a time when caseloads may be going back up, state's ability to continue the myriad of programs and services that are financed with these funds would be severely challenged. On the other hand, an increase in the block grant would provide an opportunity to invest in programs and services for low-income families even in a year of spending austerity.

The Food Stamp program is also up for reauthorization this year. If full food stamp benefits are restored to legal immigrants, New York can expect a significant increase in federal revenues. While food stamps go directly to recipients and their families, there may be an element of fiscal relief if the federal program's coverage is expanded in that less state funds will be needed to cover the nutritional needs of individuals and families not currently covered by the federal program.

B. Reform of the Medicaid Upper Payment Limit (UPL)

While states have broad flexibility in setting the Medicaid rates that they pay to hospitals, nursing homes and other providers, federal medicaid rules specify that states may not pay more for Medicaid services than Medicare would have paid for the same services. This is known as the "upper payment limit." Last year, the Health Care Financing Administration (HCFA) and members of Congress became concerned about an accounting method that increasing numbers of states, including New York, were using to calculate the UPL and claim federal matching funds. Moreover, after certain states claimed federal funds based on such payments, they required county and city-owned facilities to return some or all of the extra money to the state's general fund for other health and/or non-health related items. In December 2000, Congress passed the Medicare, Medicaid and SCHIP Benefits Improvement and Protection Act of 2000 (BIPA) which directed the Department of Health and Human Services to issue a final regulation relating to the calculation of the Medicare Upper Payment Limits for Medicaid services and the new rule went into effect on March 13, 2001. The rule does not eliminate the use of intergovernmental transfers (IGT) as a financing mechanism but rather limits them by phasing out the payments that result from pooling and aggregating public and private provider payment rates. The old rule required states to calculate an UPL for two groups of facilities – state owned facilities and all other providers (e.g., private facilities, county facilities, or city facilities). The new rule prevents states from grouping private and public facilities together when applying upper payment limits.

While New York is at risk to lose some Medicaid funding as a result of this rule (in State Fiscal Year 2000-2001 New York's UPL related payments were about $.5 billion), the rule has a multi-year transition period and allowable expenditures will not begin to be reduced this fiscal year. BIPA also included provisions which would increase New York's Medicaid funding, increased the state disproportionate share (DSH) allotments, e.g., eliminating the gradual reductions called for in the Balanced Budget Act of 1997 and increasing the state allotments for fiscal years 2001 and 2002 by freezing the allotments at fiscal year 2000 levels and indexing them for inflation and the final regulation permitted states to make aggregate payments to city and county-owned public facilities of up to150 percent of what Medicare would have paid for the same services.[4]

C. Providng a federal prescription drug benefits for seniors

In January 2001, President Bush made a proposal to fund "Immediate Helping Hand" block grants to states to cover the cost of prescription drug coverage for seniors. The President's proposal would have covered the full costs of a prescription drug program for seniors with incomes at or below 135% of poverty ($11,300 for individuals, and $15,200 for a couple); covered most of the cost of

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[4] The Bush Administration released a final regulation last week to reverse this provision. CBO estimates that the new regulation, which was contained in the President's budget proposal for 2002, would lower federal payments to states by about $700 million in FY 2002 and $900 million in FY 2003.

prescription drugs for seniors with incomes up to 175% of poverty (about $14,600 for an individual, and $19,700 for a couple) and covered any prescription drug costs in excess of $6,000 annually for all seniors The proposal called for $48 billion dollars over four years which could be used by states with existing prescription drug programs to cover eligible costs. At least some of the $360 million budgeted for the EPIC program last year would be covered under New York's share of the Immediate Helping Hand program. The President's proposal was considered "dead on arrival" when introduced last year and the attempt to revive it in July upon release of the President's Medicare study was no more successful.

Other prescription drug proposals might have a positive impact on New York's budget outlook. Any meaningful federal action on prescription drug benefits for senior citizens should reduce the state funds needed for the EPIC program and/or provide enhanced prescription drug benefits for New York's elderly population.

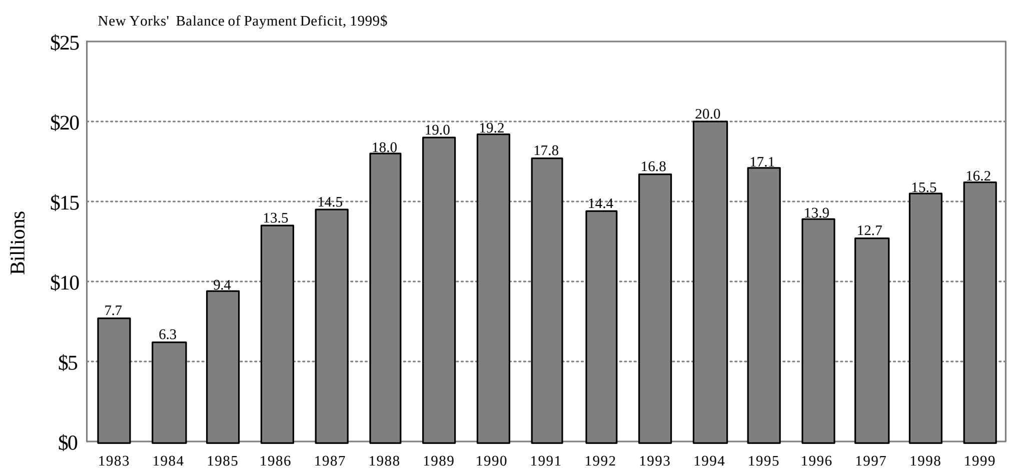
Perhaps more importantly, any federal success in the efforts to reduce prescription drug prices would result in important savings for New York's health care programs, particularly Medicaid. While overall Medicaid expenditures increased by 14% between the first quarter of SFY 1998 and the first quarter of SFY 2001, expenditures on drugs and supplies increased by 84%. In calendar year 2000, Medicaid expenditures for prescription drugs and supplies exceeded $2.6 billion. Aside from the Medicaid program and the EPIC program, New York State spent another $100 million dollars on prescription drugs in the first three quarters of this state fiscal year, an increase of 55 percent over the same nine months of the previous year.[5]

[5]FPI analysis of data provided by the New York State Office of the Comptroller.

V. Addressing Structural Issues that Affect New York's Balance of Payments with the Federal Government

In December 2000, former Senator Daniel Patrick Moynihan issued his 24th consecutive and apparently last annual report on "New York and the federal fisc."[6] This series has documented that the people and businesses of New York send much more money to Washington each year than they get back in grants, contracts, wages and salaries, transfer payments and all other federal spending. Moynihan refers to this as New York States's "balance of payments" deficit with the federal treasury. For the last several years, this deficit has averaged about $16 billion per year. Using a similar methodology and data sources, we calculate that the state's balance of payments deficit for federal fiscal year 2000 was approximately $15.8 billion.

New Yorkers consistently pay more in federal taxes than the federal government spends in New York.



Source: Herman B. Leonard and Jay H. Walder, "The Federal Budget and the States: Retrospective Issue 1983-1999," December 15, 2000.

On the one hand, it is understandable that New York as one of the nation's wealthiest states in terms of average income pays in more than it gets back. But the extent of New York's balance of payments deficit with the federal treasury is not justified when one takes into consideration such factors as the states' relatively high incidence of poverty and the importance of the New York metropolitan area's infrastructure to the function of the national economy.

Full Page Chart of Federal FISC Analysis

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[6]Since 1992, the body of the report has been prepared by the Taubman Center for State and Local Government at the Kennedy School of Government at Harvard University with an introduction by Senator Moynihan. In response to a question about the release of the Fiscal Year 2000 report, an employee of the Center told FPI staff that the Center was no longer planning to produce the report.

Moynihan's reports have shown that year-in and year-out New York has one of the largest absolute "balance of payments" deficits of any state. For federal fiscal year 1994, for example, it had the largest absolute deficit of all fifty states and in federal fiscal year 1995 it was second only to Illinois. For the past two years, New York has ranked 4th in terms of absolute "balance of payments" deficit, with only California, New Jersey and Illinois registering greater deficits. Two other states have deficits in excess of $10 billion for this year, Michigan and Connecticut.

On a per capita basis, Connecticut has the largest per capita balance of payments deficit with the federal treasury of any state - $3,145 per person. The state with the third largest per capita gap is New York's other tri-state region neighbor, New Jersey, at $2,307. New York's per capita deficit, $832 per person, was 13th largest of the 50 states.

All told, residents and businesses of New York, New Jersey and Connecticut provide approximately $46 billion more to the federal treasury in taxes than they receive back in grants, contracts, wages and salaries, transfer payments and all other federal spending. These three states account of 30% of the net deficit of the 20 states that have balance of payments deficits with the federal treasury.

On the other hand, it is understandable that Connecticut, New Jersey and New York provide large amounts of revenues to the federal treasury since these three states are among the wealthiest states in the nation. In 1999, they ranked, respectively, first, second and fourth among the fifty states in terms of per capita income. But it is also important that the federal government address those needs of national significance which are located in the tri-state area.

It is also important to note that the relationship between current federal revenue and expenditure policies leave New York in a particularly difficult position because of our states' unusual mix of wealth and poverty. New York is the only state in the United States that ranks among the top ten states in terms of per capita income **and** among the top ten states in terms of the percentage of its population that lives below the poverty line. Another way of thinking about this situation is to focus on the fact that New York is like the other Northern states in terms of per capita income (and in terms of cost of living) but like the Southern states in terms of its level of poverty. The result of this anomalous situation is that New York contributes greatly to the federal treasury, but safety net programs which distribute funds among the states on the basis of per capita income tend to give New York short shrift.

New York's overall "balance of payments" deficit can only be reduced through diligent efforts over time on an issue-by-issue basis. Some of these efforts will involve defending against proposals that would increase that deficit (such as the proposal in the mid-1980s to eliminate the deductibility of state and local income taxes), while others will involve the advancement of creative initiatives for effectively addressing national needs that have a substantial local impact.

A. Restructuring the Federal Medicaid Match

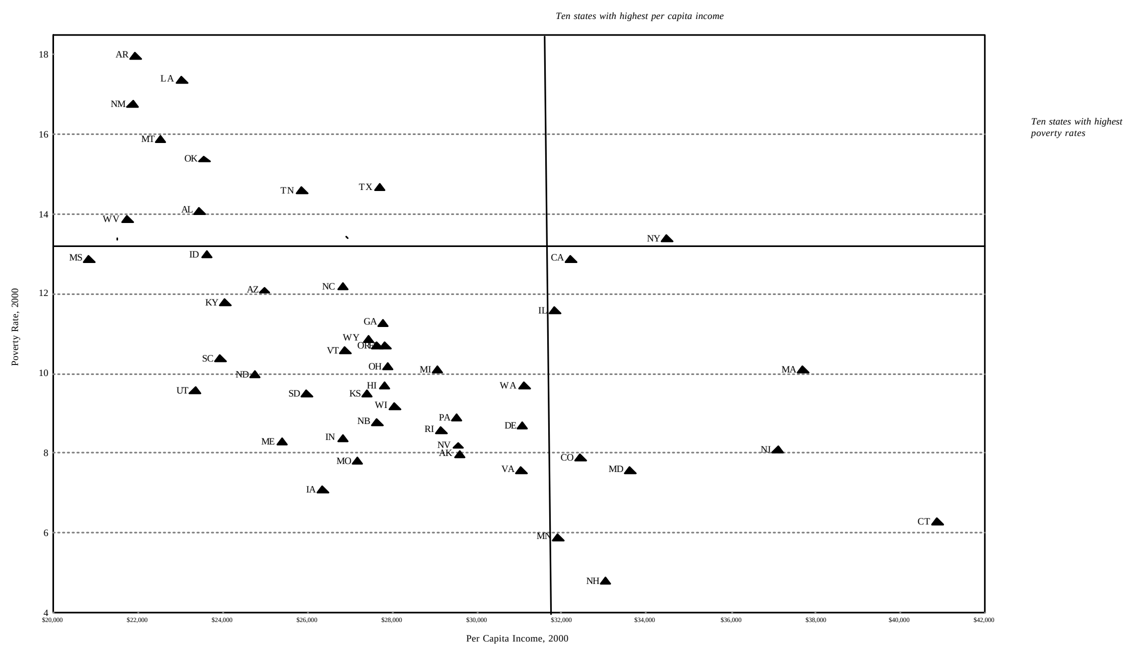
While the current economic stimulus packages appropriately discuss ways to temporarily increase the matching rate during the current economic downturn, New Yorkers must continue their struggle to permanently increase the percentage of Medicaid expenditures covered by the federal government. Currently, the portion of a state's Medicaid costs that are paid by the federal government is based only on ability-to-pay as measured by per capita income, with no recognition of differences in

States' Balance of Payments with Washington

State	Federal Fiscal Year 2000 Surplus/Deficit (millions)	Rank	Per Capita Surplus/Deficit	Rank	Federal Fiscal Year 1999 Surplus/Deficit (millions)	Rank	Per Capita Surplus/Deficit	Rank
Alabama	$11,011	48	$2,476	43	$9,139	48	$2,091	42
Alaska	$2,168	31	$3,458	48	$1,720	31	$2,777	45
Arizona	$4,354	37	$849	29	$4,319	38	$904	31
Arkansas	$4,512	38	$1,688	36	$4,166	37	$1,633	38
California	($28,682)	1	($847)	12	($22,688)	1	($685)	12
Colorado	($3,904)	12	($908)	10	($2,514)	14	($620)	13
Connecticut	($10,710)	6	($3,145)	1	($9,320)	6	($2,840)	1
Delaware	($746)	18	($952)	9	($772)	18	($1,025)	8
Florida	($334)	20	($21)	20	$707	25	$47	20
Georgia	($540)	19	($66)	19	($228)	19	($29)	19
Hawaii	$2,665	35	$2,200	41	$2,350	34	$1,982	41
Idaho	$1,690	28	$1,306	33	$1,038	27	$829	30
Illinois	($20,989)	2	($1,690)	5	($20,241)	2	($1,669)	4
Indiana	($2,600)	14	($428)	15	($2,373)	15	($399)	16
Iowa	$620	25	$212	22	$2,151	33	$750	29
Kansas	$248	22	$92	21	$990	26	$373	26
Kentucky	$7,730	44	$1,913	38	$6,317	43	$1,595	37
Louisiana	$7,909	46	$1,770	37	$6,892	46	$1,576	36
Maine	$1,826	30	$1,432	35	$1,660	29	$1,324	35
Maryland	$11,220	49	$2,118	40	$9,155	49	$1,770	39
Massachusetts	($5,609)	8	($883)	11	($5,526)	8	($895)	9
Michigan	($11,518)	5	($1,159)	7	($10,277)	5	($1,042)	7
Minnesota	($7,853)	7	($1,596)	6	($6,180)	7	($1,294)	6
Mississippi	$8,919	47	$3,135	47	$7,431	47	$2,684	44
Missouri	$7,837	45	$1,401	34	$6,490	44	$1,187	33
Montana	$2,305	32	$2,554	44	$2,745	35	$3,109	49
Nebraska	$807	26	$472	27	$533	24	$320	24
Nevada	($3,849)	13	($1,926)	3	($2,865)	13	($1,583)	5
New Hampshire	($2,193)	15	($1,774)	4	($2,147)	16	($1,787)	3
New Jersey	($19,408)	3	($2,307)	2	($19,076)	3	($2,342)	2
New Mexico	$7,529	43	$4,139	50	$6,862	45	$3,944	50
NEW YORK	**($15,796)**	4	**($832)**	13	**($16,189)**	4	($890)	10
North Carolina	$2,378	33	$295	24	$1,115	28	**$146**	21
North Dakota	$2,597	34	$4,044	49	$1,928	32	$3,043	47
Ohio	($1,907)	16	($168)	18	($3,873)	10	($344)	17
Oklahoma	$7,060	42	$2,046	39	$6,266	42	$1,866	40
Oregon	($1,344)	17	($393)	16	($1,601)	17	($483)	15
Pennsylvania	$4,251	36	$346	25	$3,076	36	$256	23
Rhode Island	$957	27	$913	30	$523	23	$528	28
South Carolina	$5,173	39	$1,289	32	$4,914	39	$1,265	34
South Dakota	$1,771	29	$2,346	42	$1,706	30	$2,327	43
Tennessee	$6,150	41	$1,081	31	$5,270	41	$961	32
Texas	($5,116)	10	($245)	17	($3,789)	11	($189)	18
Utah	$602	24	$270	23	$490	22	$230	22
Vermont	$235	21	$386	26	$203	21	$343	25
Virginia	$21,437	50	$3,028	45	$21,094	50	$3,069	48
Washington	($4,786)	11	($812)	14	($3,070)	12	($533)	14
West Virginia	$5,534	40	$3,061	46	$5,074	40	$2,808	46
Wisconsin	($5,166)	9	($963)	8	($4,659)	9	($887)	11
Wyoming	$283	23	$574	28	$185	20	$386	27
DC	$22,939		$40,099		$22,065		$8	

in poverty rates or cost of living. The result is that New York's federal Medicaid match rate is the minimum 50% even though the state has one of the highest poverty rates of all states and, in the New York metropolitan area, one of the highest cost of living. In 1994, President Clinton expressed support for addressing this situation, and in 1995, Senators Moynihan and D'Amato succeeded in adding a provision to that year's balanced budget act which increased the minimum federal match rate. That bill, however, also converted Medicaid to a block grant and was vetoed by President Clinton.

New York is the only state in the nation with one of the 10 highest poverty rates
and one of the 10 highest per capita income levels.



B. *Infrastructure and Mass Transit*

The impact of the September attacks on the national economy leaves no question about the critical importance of the New York region's infrastructure to the national economy. The federal government should therefore invest in improving this infrastructure, above and beyond the efforts to repair the damages from the terrorist attack. Likewise, mass transit operating aid is very important to the New York metropolitan area because of its high proportion of the nation's entire mass transit ridership. Given the population density of the region, mass transit is essential to the functioning of the area's economy. The extensive nature of the area's mass transit system also generates substantial energy savings which are of benefit to the nation as a whole.

C. Immigration

Along with the nation's other large states and its regional neighbors, New York is particularly impacted by the federal government's efforts to shift many of the cost of immigration to state and local governments. Immigrants are an important source of our country's and our region's historic and current vitality. Moreover, the federal government is responsible for immigration policy. Recent efforts which successfully limited the federal government's contribution to the costs of health care, nutrition and other programs that serve immigrants (while working immigrants continue to pay taxes) have exacerbated New York's balance of payments problem with the federal treasury.

D. The deductibility of state and local taxes is not a tax preference and should not be treated as such.

Many observers thought that New York would benefit from President Bush's 2001 tax cut plan since it was skewed to high income taxpayers and New York has a large number of rich people. This turns out not to be the case. Despite its concentration of high income taxpayers, New York did not do well under the President's plan for a number of demographic and policy reasons.

The main reason for New York's poor showing under the President's plan involves the interaction of the President's plan and the Alternative Minimum Tax (AMT). As Citizens for Tax Justice has pointed out in its study, ***The Bush Tax Cuts, State by State***, "a very large portion of the Bush income tax reductions that would otherwise go to taxpayers in the top income quintile-excluding the top one percent-would be offset by increases in the Alternative Minimum Tax. A key part of the AMT calculation involves disallowing itemized deductions for state and local taxes, with state income taxes being the primary state tax paid by upper-income taxpayers in most states. In effect, the Bush tax cut wipes out federal tax deductions for state and local taxes for a large portion of itemizers in most states. Better-off taxpayers in the handful of states that have no state income tax are much less likely to be affected by the AMT than taxpayers in "normal" states. As a result, these no-income-tax-state taxpayers get larger federal tax cuts under the Bush plan than do taxpayers with similar incomes in other states."

For affected taxpayers, the AMT calculation involves replacing regular tax deductions for personal exemptions and either the standard deduction, if taken, or certain itemized deductions, primarily state and local taxes (but also employee business expenses for travel and meals which are also higher in some states than others), with a flat exemption of $45,000 for couples and $33,750 for unmarried taxpayers and then applying at tax rates of 26 percent on the first $175,000 of this "Alternate Taxable Income" and 28 percent on amounts above that.

New York Taxpayers with No Tax Cut, by Income Range

Income Range	Total number of filing units (in thousands)	Number with no tax reduction (in thousands)	Percent
$1,000 - 15,000	1,878	1,426	76 %
$15,000 - 27,000	1,636	530	32 %
$27,000 - 44,000	1,650	166	10 %
$44,000 - 72,000	1,579	99	6 %
$72,000 - 147,000	1,344	99	7 %
$147,000 - 373,000	391	55	14 %
$373,000 or more	98	25	26 %
Total	**8,700**	**2,526**	**29 %**

The AMT exemptions are **not** indexed for inflation, so by 2008 they will decline to about $37,600 and $28,200 in 2001 dollars. So with or without the President's tax proposal, the number of taxpayers paying under the AMT is projected to increase from 1.5 million this year to about 8.7 million in 2006. BUT, the President's plan would greatly accelerate the growth, over the coming decade, in the number of middle, upper-middle and upper income taxpayers who will be affected by the AMT. For example, the U. S. Congress's Joint Committee on Taxation has estimated that the President's plan would more than double the number of taxpayers affected by the AMT in 2006 to about 18.8 million. This trend would be particularly pronounced for taxpayers in New York and other states with relatively high state and local tax deductions. Taxpayers affected in this way would get no benefit from the President's plan or a smaller benefit than has been advertised for taxpayers at their income level.

The President's plan will increase the number of taxpayers affected by the AMT since it lowers the current 28 percent and 31 percent regular tax rates to 25 percent, but does not reduce the current 26 percent and 28 percent Alternative Minimum Tax rates. As a result, a very large portion of taxpayers whose regular top marginal tax rate is cut from 28 or 31 percent will find themselves in the AMT. The AMT effect dissipates at the highest income levels, because the top Bush regular tax rate is 33 percent (replacing the current 36 percent and 39.6 percent rates).

Other important factors driving New York's lower than proportionate share of the Bush tax cut are (1) the large percentage of New York children who live in families that would not benefit at all or not be able to take full advantage of the increase in the per child credit, (2) the state's lower than average number of children per return, and (3) the fact that a substantially lower than average percentage of New York returns (particularly in the middle and upper-middle income ranges) come from joint filers - the category of taxpayers who receive the greatest breaks under the President's plan.

In all income categories, except the very highest, the average income tax cut for New Yorkers, under the President's plan would be well below the average for the rest of the country. These differences are particularly pronounced in the upper middle income ranges: 17.7% below the average for rest of the U.S. in the $44,000 to $72,000 income range ($781 for New York vs. $919 for the rest of the country excluding New York and $913 for the U.S. as a whole) and 52.8% lower in the $72,000

Bush Tax Plan's Average Income Tax Cut, by Income Categories, New York State and Rest of United States

	Average Income Tax Cut			
	New York	Rest of U. S.	Dollar Difference	Percent Difference
Income Range				
$1,000 - 15,000	$39	$51	($12)	-30.3 %
$15,000 - 27,000	$230	$239	($9)	-3.8 %
$27,000 - 44,000	$495	$549	($54)	-11.0 %
$44,000 - 72,000	$781	$919	($138)	-17.7 %
$72,000 - 147,000	$1,010	$1,543	($533)	-52.8 %
$147,000 - 373,000	$697	$1,356	($659)	-94.6 %
$373,000 or more	$38,824	$27,776	$11,048	28.5 %
A L L	$910	$906	$4	0.4 %

to $147,000 range ($1,010 for New York vs. $1,543 for the rest of the country excluding New York and $1,509 for the U.S. as a whole).

One way to correct some of the inequities of the Bush tax cuts to New Yorkers would be to end the practice of treating the deduction of state and local taxes as an item of tax preference. This means that a taxpayer would no longer have to add back the deduction taken for state and local taxes when they compute there "alternative taxable income." Last year, Sen. Fred Thompson (R-Tennessee) introduced legislation (S. 291) to do this. Thompson's bill would also give taxpayers the option of deducting either the state and local sales taxes they pay or the state and income taxes they pay, but not both. The deductibility of state and local sales taxes was eliminated as part of the tax reform of 1986 and Thompson is trying to do something helpful for taxpayers in states like Tennessee who do not have broad-based income taxes (Tennessee has an income tax but it is only on investment income.) or who have no income tax at all. Letting a taxpayer deduct only their state and local income tax or only their state and local sales tax would make sense for a state that has one of these two taxes but not the other, or for a state (like Tennessee) that relies much more heavily on one than the other. But it would not be fair to taxpayers in a state that uses both taxes in some balance. While Thompson's bill would be helpful to New York taxpayers, it would be better to simply restore deductibility of the sales tax rather than given the taxpayer the choice of deducting one or the other.

The revised version of the President's plan that was finally adopted by the Congress included some general but temporary AMT relief. Under this enactment, the AMT exemption will be increased, but only temporarily, during the middle of the decade. Whether or not a permanent increase in the general AMT exemption is enacted, the deduction for state and local taxes should be eliminated from the AMT calculation. Paying for state and local government services is not a tax preference and should not be treated as such.