February 25, 2009

Dear Legislator:

The good news is that the federal government has committed an enormous sum—$787 billion over 27 months—to aid the economy. By Governor David Paterson's estimate, New York will receive $24.6 billion of this money.

It is easy to get euphoric about a federal aid package as large as this one. But the reality is far more unpleasant. There is no guarantee that the severe economic hardship New York and the nation are now suffering will be over in two years. The federal aid is limited and temporary, meant to avoid harmful short run actions and buy time until restructuring and recovery measures can take effect. New York's state government will not be out of the woods until its spending commitments are brought down to more sustainable levels.

The large multi-year federal commitment translates into about $4.8 billion[1] to help the State's operating budget in fiscal year 2009-10; the rest is for other years, for capital projects or does not pass through the State's coffers. This sum must be contrasted with a budget gap for fiscal year 2009-10 estimated at $13.7 billion in December and revised today to $14.0 billion to account for $300 million in net changes since the Executive Budget was released—gap-closing measures of $800 million were enacted against additional revenue losses of $1.1 billion. In year three of the financial plan the budget gap is a whopping $18.7 billion, and it may get worse.

The challenge now is to use the federal money available for next year's budget wisely; that is, in ways that avoid harmful cuts and harmful tax increases. Much of what Governor Paterson has proposed in gap-closing measures is still necessary. But about $4.4 billion in harmful actions should be avoided. Proposed school aid cuts to the neediest districts should be restored with $1.2 billion; economically harmful tax hikes should be avoided and replaced in the financial plan with $1.7 billion; and fiscal gimmicks and one-shots in the plan should be eliminated with $1.5 billion. The remainder of the federal funds should be used to lower the State's high debt burden. More specifically we suggest ten "do's and don'ts" for using the federal funds and closing the budget gap:

1) **Don't adopt harmful tax increases** – In particular, increases in the personal income tax and the gross receipts tax on utilities should be avoided. These would damage New York's economic competitiveness and put its economic recovery at risk. New York depends heavily on its high earners to foot the bills, and there are fewer of them now than a year ago. Power costs in New York are already high; per kilowatt charges rank third among the 50 states and are twice the national average. Less harmful revenue proposals are still needed, including base broadening and loophole closing initiatives, the SUNY/CUNY tuition increase, the auto user fee increases, and the tax on sugared beverages, which makes sense from a public health perspective.

2) **Do form a commission to examine the question of how to reform New York's tax structure** – Issues of fairness, stability, and the division of

responsibilities among State and local governments should be thoroughly aired. Personal income tax reform may ultimately be warranted, but only as one feature of a comprehensive reevaluation of the entire tax structure.

3) **Do roll back assessments on health insurance providers that recently were enacted as part of the deficit reduction program for this fiscal year** – Higher costs will be passed on to consumers, making coverage less affordable and increasing the number of uninsured New Yorkers. Other assessments not yet enacted should also be avoided.

4) **Do make the changes in the Medicaid program that the Governor proposed** – To be sustainable for the long haul, the cost of New York's Medicaid program must be brought more in line with that of other states. The Governor's proposals to make nursing home and hospital rates more reasonable and rational should be adopted.

5) **Don't adopt the foundation aid cuts to school districts proposed in the budget** – New York's multi-year commitment to increasing aid to needy districts should continue. About $1.2 billion of the $1.7 billion in school aid cuts proposed in the Governor's budget can be restored and should be targeted to the poorest districts in the State least able to raise their local contribution.

6) **Do phase out unnecessary payments to the wealthiest school districts** – School aid should be given on the basis of need and ability to pay. Now is the time to end the "high tax" and "hold harmless" aid increases added two years ago to make reformed aid formulas more palatable to the wealthiest districts.

7) **Do end middle class STAR** – The program is poorly crafted and difficult to administer. Local tax relief can be delivered more effectively in other ways.

8) **Do eliminate programs that are ineffective or unnecessary** – The Empire Zones program can be eliminated, and underutilized institutions including prisons can be closed. Studies by the CBC, the State Comptroller, and ATKearney have shown the ineffectiveness of the Empire Zone program. The number of prisoners under the supervision of the Department of Corrections has shrunk but the number of facilities has not, and the State is running juvenile justice and developmental centers that are underutilized and in some cases empty.

9) **Do adopt a new pension tier and other compensation changes for public employees** – Local officials have been clamoring for relief from State mandates, and two Commissions empanelled by Governors to study the causes of high local taxes have issued recommendations. All have raised the issue of a new tier for the pension system, which is overly generous even by public sector standards and gets more so over time as the costs of dozens of

pension sweeteners kick in. With larger pension costs stemming from market losses on the horizon and rising taxpayer anger, local officials need immediate action at the State level. Other measures, such as requiring retirees to contribute modest additional amounts toward the cost of their health insurance and eliminating one 3 percent increase in the final year of contracts negotiated in more prosperous times are reasonable concessions to expect from organized labor.

10) **Don't raid public authorities or rely on other one-shots** — The deficit reduction program adopted several weeks ago contains about $200 million in one-shots; they should be reversed. The Governor's Executive Budget proposes still more, including a transaction with the Battery Park City Authority that is a thinly disguised device that would allow the Authority to borrow $500 million so that the State can take half of it to cover operating costs. Raids and gimmicks like this are not necessary—temporary federal funds are better than one-shot State funds to close the gaps until other savings can be implemented.

After following the CBC's 10 suggestions for using the money to help balance the budget any funds that are available should be used to pay off State debt. New York's debt burden is high compared to other states and to its capacity to pay. Less debt yields recurring savings by lowering future debt service payments.

The new federal funds can benefit New York greatly, if they are used wisely and do not perpetuate the status quo. The assistance can make the next few years a little easier, but it cannot change the future. Wall Street, upon which we have depended so heavily, is shrinking, and as a consequence so must New York State's spending. Not restoring every cut in the budget is a beginning, but ultimately profound structural spending reforms will be required.

Thank you for considering our recommendations. More detail is provided in the attached chart. Please do not hesitate to contact us if we can provide additional information or be helpful to you.

Sincerely,

Carol Kellermann
President

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[1] The amount of federal aid likely to become available fiscal year 2009-10 was calculated by multiplying the $11 billion FMAP Medicaid money by an expected local participation rate of 28 percent, as provided by the Division of Budget, adding the $1.3 billion in school and other governmental aid, and multiplying that number by 12/27 to arrive at an annual estimate.