Looking Beyond Fiscal Year 2004:
Guidelines for Resolving New York State's Fiscal Crisis

Citizens Budget Commission
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Foreword

Founded in 1932, the Citizens Budget Commission (CBC) is a nonpartisan, nonprofit civic organization devoted to influencing constructive change in the finances and services of New York State and New York City governments.

This report was prepared under the auspices of the CBC's Budget Policy Committee. The Budget Policy Committee has responsibility for developing the Commission's positions on the New York State and New York City annual operating budgets. The members of the Committee are: Eugene J. Keilin, co-chair, Heather L. Ruth, co-chair, Lawrence D. Ackman, Stephen Berger, Lawrence B. Buttenwieser, Denis Curtin, Evan A. Davis, Stephen DeGroat, Cheryl Cohen Effron, Roger Einiger, Paul E. Francis, Bud H. Gibbs, Kenneth D. Gibbs, James F. Haddon, Walter Harris, Craig M. Hatkoff, Fred Hochberg, Peter C. Kornman, Robert Kurtter, Stephen Langowski, Richard A. Levine, Jeffrey Lynford, Norman N. Mintz, Lionel I. Pincus, Robert E. Poll, Lester Pollack, Carol Raphael, Laraine S. Rothenberg, Edward L. Sadowsky, Bart Schwartz, Richard J. Sirota, Joan Steinberg, Barry F. Sullivan, Merryl H. Tisch, Lesley Daniels Webster, Stephen H. Weiss, and H. Dale Hemmerdinger, ex-officio.

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Introduction

The State of New York is in serious financial trouble. In the fiscal year that ended March 31, 2002 it incurred a deficit of $4.4 billion, paying for rapid spending growth in a year of recession and traumatic terrorist attacks by using the reserves accumulated during the preceding national economic boom. In the current fiscal year spending expanded even further, despite the declining economy, and the gap between outlays and recurring revenues will exceed $5 billion. With dwindling reserves, the State will have to rely on some form of borrowing to finance its operations in the current fiscal year.

Governor George Pataki's Executive Budget for the fiscal year beginning April 1, 2003 does not solve the problem. While discipline finally is imposed on spending with cuts of $5.6 billion, this is not adequate to balance the budget. Under the Governor's plan, the State would incur another annual deficit of about $2.5 billion, including the sums to be borrowed through an "off-budget" entity that draws on future revenues from the national settlement with tobacco companies.[1] Moreover, the deficits would continue beyond fiscal year 2003-04, recurring as far as any official projections go.[2]

Unfortunately, the State's legislative leaders are not offering meaningful alternatives. Their debate with the Governor revolves mostly around how to borrow (tobacco bonds versus other instruments) rather than whether to borrow or to close the deficit. The debate ignores the basic problem, and seeks only to avoid its short-run consequences by postponing difficult choices.

This paper presents an alternative framework for addressing the State's fiscal crisis. It suggests three interdependent guidelines for the Governor and the members of the Legislature.

1. Bring the budget into balance over three years by reducing expenditures to what the current revenue system supports by making productivity gains and by cutting services in a way that protects the neediest New Yorkers.
2. Close the gap between spending and revenues in the three-year, interim period by imposing a temporary and declining tax and by avoiding borrowing. This "disappearing" tax should be authorized *only* if there is a credible plan for bringing the budget into balance by fiscal year 2005-06.
3. Make these decisions in a more accountable and transparent budget process.

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[1] The Executive Budget proposes that the $2.4 billion in borrowing against tobacco settlement revenues be counted as a miscellaneous revenue rather than a long-term borrowing and shows a smaller deficit of $149 million. See State of New York, Division of Budget, *2003-2004 New York State Executive Budget*, Appendix II, p.70.

[2] *Ibid*.,p.6 and p.68. The Executive Budget provides a projection of the General Fund using Generally Accepted Accounting Principles for fiscal years 2004-05 and 2005-06; the respective deficits are $2.9 billion and $4.4 billion. The Executive Budget provides a projection for All Funds only on a cash basis for fiscal years 2004-05 and 2005-06; the respective deficits are $2.9 billion and $4.2 billion.

In addition, State leaders should begin a longer-run program to make the high combined state and local tax burden in New York more competitive with other jurisdictions. The current fiscal pressures make it difficult to begin implementing a transfer from local to statewide responsibility, but a program to control spending required of local governments by State mandates is a feasible first step.

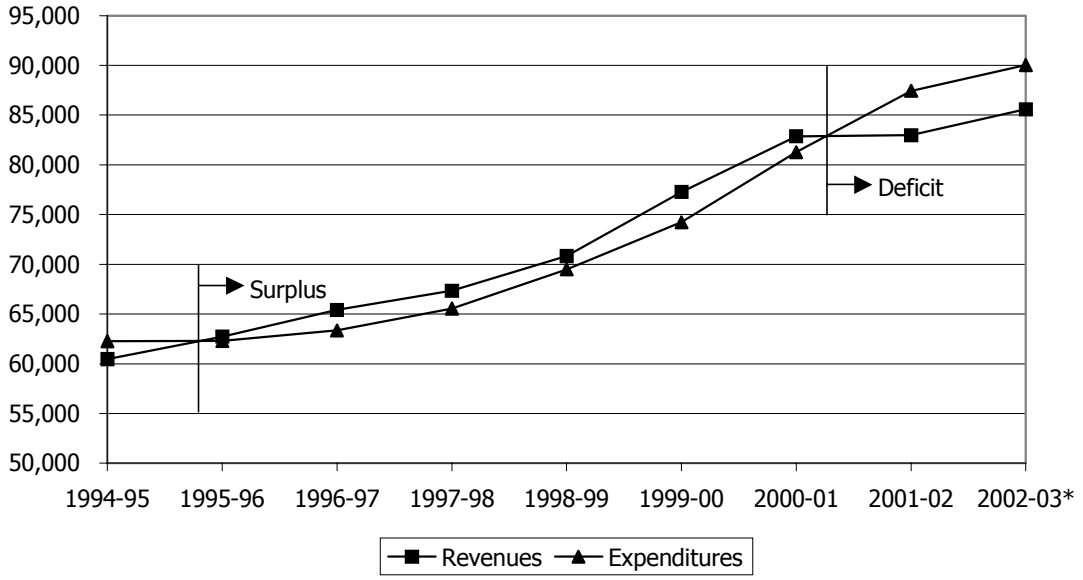
Balancing the Budget

The current crisis is rooted in decisions made in prior years. After the gubernatorial election of 1994, the State curbed its spending and shifted from repeated deficits to a modest surplus in fiscal year 1995-96. (See Figure 1.) As the national economy entered a boom in the mid-1990s, the State also benefited. While taxes were cut, expenditures also grew rapidly. From fiscal year 1995-96 to fiscal year 1999-2000, State spending increased $12 billion or about 3.6 percent annually. Yet the economy was sufficiently robust to accommodate this growth and yield annual surpluses that reached $3 billion in fiscal year 1999-2000.

Although the stock market decline began in fiscal year 2000-01, the State's finances held up reasonably well. Expenditures were increased $7 billion or 9.5 percent, and the State still closed the year with a surplus about half that of fiscal year 1999-2000.

In fiscal year 2001-02 events took a dramatic turn for the worse. The State's leaders adopted a "bare bones" budget, yet spending still rose $6.2 billion or 7.6 percent. The onset of a national recession, amplified in New York by the traumatic terrorist attacks of September 11, 2001, eroded revenues. The State incurred a deficit of more than $4.4 billion, financed by using most of the reserves built up during boom times. (See Table 1.)

Figure 1
State of New York
Revenues and Expenditures, Fiscal Years 1994-95 to 2002-03
All Funds, GAAP Basis
(dollars in millions)



Sources: Fiscal year 1995 to 2002 data are from State of New York, Office of the State Comptroller, *Comprehensive Annual Financial Report*, fiscal year 1995 to 2002 editions; and fiscal year 2003 data are from State of New York, Division of the Budget, *2003-2004 New York State Executive Budget*, Appendix II, January 29,2003.
* Fiscal year 2002-03 revenues do not include the miscellaneous receipts associated with the proposed tobacco borrowing.

The biggest mistake involved the budget for the current fiscal year.[3] It increased spending $2.6 billion or 3.0 percent despite the prior year's deficit and the weakening economy. Revenue projections proved optimistic. In January the Governor's Executive Budget recognized a $2.9 billion deficit for fiscal year 2002-03, after a proposed long-term loan of $1.5 billion and the use of a variety of one-shot measures to help sustain spending. Since the proposed long-term borrowing of $1.5 billion against future tobacco settlement revenues is unlikely to occur by the end of the fiscal year, the actual deficit will approach $5 billion. This deficit will be financed by some form of borrowing, probably involuntary loans from vendors and school districts through deferral of payments due them.

[3] See Citizens Budget Commission, *Achieving A Better Balance: Recommendations for the New York State Budget for Fiscal Year 2003*, March 21, 2002.

Table 1
State of New York
Annual and Accumulated Surplus/(Deficit)
In Accordance with GAAP
Fiscal Year 1994-95 to 2005-06
(dollars in millions)

Fiscal Year	General Fund Annual Surplus/(Deficit)	General Fund Accumulated Surplus/(Deficit)	All Funds Annual Surplus/(Deficit)	All Funds Accumulated Surplus/(Deficit)
1994-95	(1,426)	(3,308)	(1,791)	(1,666)
1995-96	380	(2,928)	433	(1,234)
1996-97	1,933	(995)	2,060	826
1997-98	1,562	567	1,800	2,626
1998-99	1,078	1,696	1,323	4,000
1999-00	2,229	3,925	3,031	7,994
2000-01	245	3,910	1,587	9,320
2001-02	(3,418)	492	(4,445)	5,125
2002-03 (estimated)	(2,555)	(2,063)	(2,949)	2,176
2003-04 (budgeted)	(138)	(2,201)	(149)	2,027
2004-05 (projected)	(2,896)	(5,097)	NA	NA
2005-06 (projected)	(4,437)	(9,534)	NA	NA

Sources: Fiscal years 1994-95 to 2001-02 data are from State of New York, Office of the Comptroller, *Comprehensive Annual Financial Report,* fiscal year 1994-95 to 2001-02 editions; fiscal years 2002-03 to 2005-06 data are from State of New York, Division of Budget, *2002-2003 New York State Executive Budget, Appendix II,* January 29, 2003.

NA= Not Available.

The Executive Budget estimates the problem in fiscal year 2003-04 as a gap of $9.3 billion. (See Table 2.) The gap is due to rising baseline spending ($4.6 billion), as well as prior-year spending supported by disappearing reserves and other one-shots and declines in recurring revenues ($4.7 billion). In addition, to the extent the fiscal year 2002-03 deficit is financed by some form of short-term loan, the State will have to repay that loan. Thus, the total problem on a cash basis in the coming year approaches $11 billion, assuming a $1.5 billion short-term loan.[4]

[4] See State of New York, *op. cit*., pp. 4-5. On a Generally Accepted Accounting Principles (GAAP) basis the prior-year deficit results in a variety of increased liabilities, including any loans; on a cash basis short-term loans are a cash-need in the subsequent year but other ways of financing the GAAP deficit may not result in a cash need. Thus, the $2.9 billion GAAP deficit in fiscal year 2002-03 does not necessarily cause an equal cash-need in the subsequent year; however, a short-term loan to replace the planned long-term tobacco borrowing would create a cash need equal to the amount of the loan plus interest.

Table 2
State of New York
Closing the Fiscal Year 2003-04 Gap
All Funds, Cash Basis
(dollars in millions)

	2003-04
GAP TO BE CLOSED	**($9,264)**
Expense Reductions	**$5,638**
School Aid	1,267
Medicaid (Net of Revenues)	1,024
State Operations	998
Welfare	587
All Other Local Aid	977
Debt Service	516
Capital Projects/Fringes/All Other	269
Revenue Measures in Proposed Budget	**$1,348**
Sales Tax on Clothing Under $110	363
Hospital/Personal Care Provider Assessment	207
Increase Insurance Taxes	158
Cap STAR savings for Seniors at 2003 levels	93
Increase Health Care Provider Surcharges	55
Raise Vehicle Insurance Fee	43
Reduce Dormancy Period of Uncashed Checks	38
Other Fee/Fine Increases	391
Tobacco Borrowing	**$2,278**

Source: Citizens Budget Commission staff analysis, based on State of New York, Division of Budget, *2003-2004 New York State Executive Budget*, Appendix II, January 29, 2003.

The Executive Budget identifies ways to close the $9.3 billion gap. New revenue measures would raise about $1.3 billion, but most of the response is spending cuts totaling $5.6 billion. Yet these substantial actions are still not sufficient to close the gap. The Governor also proposes $2.3 billion in long-term borrowing to pay for operating expenses in the coming fiscal year and does not indicate how any short-term loan from fiscal year 2002-03 will be repaid.

In brief, there is no plan to balance the State's budget. The Governor's plan relies on borrowing for the short-run, and leaves projected deficits in the longer-run. As shown in Table 1, the general fund deficits in fiscal years 2004-05 and 2005-06 are $2.9 billion and $4.4 billion, respectively. A more comprehensive, longer-term plan is required.

New York State needs a multi-year plan to bring its expenditures in line with its recurring revenues. As will be discussed below, the long-run solution should rely on

expenditure cuts because New York is already at a competitive disadvantage due to its high state and local tax burden. If the economy is to prosper, then tax increases cannot be the source of recurring budget balance.

If the solution is to lower spending, how much must be cut? As noted, the fiscal year 2003-04 gap is $9.3 billion. This gap grows, even as the economy improves, to a projected $11 billion in fiscal year 2005-06 due to baseline spending increases.[5] Thus, the long-term need for spending reductions is about $11 billion annually. A three-year plan would allow the State sufficient time to align spending with revenues.

The $11 billion in spending cuts are from a baseline projection for fiscal year 2005-06 of $104 billion in total spending.[6] Based on historical patterns, more than 70 percent of State spending is aid payments to localities, including school aid and Medicaid, and 20 percent is direct provision of services by the State, including higher education, mental health, and corrections. The remainder is debt service and capital spending. The cuts will have to come primarily in local aid and State operations.

The Executive Budget proposes spending reductions of $5.6 billion in fiscal year 2003-04. The largest cut, $1.3 billion, is in school aid. Reductions of about $1 billion each are proposed for Medicaid and for State operations. Reductions of this magnitude are an appropriate start for the multi-year plan. However, these cuts and those that follow in the next two years should be designed to preserve services for the neediest New Yorkers. To do this, productivity improvements should be an explicit part of agency efforts to lower spending. In addition, the school aid and Medicaid reductions should be structured to favor the neediest districts and beneficiaries.

The Governor's $1 billion "cut" in State operations consists of $564 million saved by shifting costs to the federal government and other non-tax sources and $481 million from a hiring freeze. The freeze is expected to reduce Executive branch headcount by 10,000 from November 2001 to reach 186,000 at the end of March 2004.[7] The needed multi-year plan should have larger cuts in State operations and should emphasize productivity gains more.

Improving productivity should be the first order of business in reducing expenditures. Productivity initiatives are savings that do not harm, and may even improve, public services. In recent years, productivity gains in the private sector have averaged about 2 percent annually. A 2 percent gain in spending for State operations would equal about $250 million annually or $750 million over a three-year plan.

Other targeted efforts to streamline operations are possible in areas where studies have demonstrated even greater potential savings. Three examples illustrate the potential.

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[5] See State of New York, *op. cit*., p. 6.
[6] See *Ibid*., p. 6 and p. 46. The $104 billion is the sum of $98.3 billion in projected disbursements and $5.7 billion in spending restraint in the Governor's plan.
[7] See *Ibid*., p. 20.

First, in 2000 the Citizens Budget Commission released a report titled *Making More Effective Use of New York State's Prisons*. The report concluded that the State could save $100 million per year without jeopardizing public safety by expanding well-tested programs that substitute drug treatment and other alternatives for the later part of prison sentences. Even greater savings due to a smaller inmate population would be achieved by reforming the Rockefeller Drug Laws in order to avoid or reduce prison sentence for additional offenders.

Second, the judiciary could be modernized. Chief Judge Judith Kaye has called for reforms that would save $130 million annually. The proposals include simplifying the structure of the court system by merging the trial courts, streamlining the process for handling domestic violence, and restructuring family court.[8]

Third, collective bargaining could be used to enhance labor productivity. Contracts with the Public Employees Federation and Civil Service Employees Association expire by the beginning of April 2003. These unions represent about 128,000 employees. The goal of negotiations should be obtaining work rule and benefit changes that preserve service and save money. Examples of such changes are increasing the hours for employees currently on a 37.5-hour workweek to 40 hours and adding a Tier V to the pension system with a reduced benefit package to help curb future pension obligations.

The larger part of the State budget is aid to localities, with aid to public schools and Medicaid being the two largest such programs. The Governor has proposed substantial cuts to these programs in fiscal year 2003-2004, and even more must be accomplished in subsequent years. However, in designing these cuts, care should be given to protecting those with the greatest need. This means that school aid reductions should be concentrated in the wealthiest districts and protect poorer districts; Medicaid cuts should be targeted to those who can best afford to pay for their care and should impose cost constraints on providers rather than deny benefits to individuals.

The Governor's proposal to reduce school aid $1.3 billion is modest and well justified in light of recent trends. From school years 1995-96 to 2002-03 school aid increased more than $7.3 billion or an average of $913 million annually.[9] Even greater cuts of $1.5 billion would still leave aggregate aid above 2000-01 levels.

Significant school aid cuts should be designed to be concentrated in the wealthiest districts in the State, where the spending per pupil is well above the statewide average. The Governor's proposed cuts disproportionately affect the wealthiest districts, but they also put a heavy burden on the poorest districts. For the 50 wealthiest districts, State aid would be reduced 11.4 percent; for the 50 poorest, aid goes down 6.8 percent.[10] A more

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[8] See State of the Judiciary Address*, Confronting Today's Challenges*, January 13, 2003, Judith S. Kaye, Chief Judge of the State of New York <www.courts.state.ny.us/ctapps/soi.htm > (March, 19, 2003).
[9] See State of New York, Division of the Budget, *Description of New York State School Aid Program*s, Table II-E, school years 1996-97 to 2003-04 editions.
[10] See State of New York, Division of the Budget, *Description of New York State School Aid Program*, 2003-04 edition, January 29, 2003.

rational distribution of aid would give a district State funds only if it cannot raise the median spending per pupil, after weighting for need, by taxing itself at a rate that represents a statewide standard of equity.

The proposed $1 billion Medicaid cut also falls short of what is needed and what can be accomplished humanely. In federal fiscal year 2000 Medicaid spending in New York exceeded $26 billion, of which about $8 billion was State funds.[11] In the current fiscal year the State's share approaches $9 billion. As shown in Table 3, total expenditures per beneficiary are more than double that in the rest of the country. If no current beneficiaries were denied Medicaid coverage and average costs per beneficiary were 150 percent of the national average, then total Medicaid spending could be reduced $7.6 billion. The State share of the savings would be $2.4 billion.

Table 4
Medicaid Expenditures by Service Type
New York State and United States*
Federal Fiscal Year 2000

	NYS Expense/ Beneficiary	Rest of U.S. Expense/ Beneficiary	NYS Expense/ Beneficiary as a Percent of Rest of U.S.
Acute Care Service	**$1,304**	**$824**	**158.3%**
Inpatient Hospital	$7,861	$4,506	174.5%
Physician Services	228	367	62.1%
Dental Services	253	236	107.0%
Other Practitioner Services	60	147	40.6%
Outpatient Hospital Services	766	499	153.5%
Clinic Services	1,766	680	259.9%
Lab and X-RAY Services	60	119	50.9%
Prescribed Drugs	1,089	962	113.2%
Capitated Payment Services	1,357	1,137	119.4%
Other Care Services	2,772	1,501	184.7%
PCCM Services	108	30	365.3%
Sterilization Services	1,953	877	222.8%
Long-Term Care Services	**$12,605**	**$7,436**	**169.5%**
Nursing Homes	$25,680	$19,478	131.8%
Home Care	2,944	$3,211	91.7%
ICFs/MR	168,855	$68,724	245.7%
Psychiatric Hospitals	19,529	$17,223	113.4%
Personal Support Services	7,412	$2,079	356.5%
Other	**$429**	**$5,903**	**7.3%**
Total	**$7,646**	**$3,613**	**211.6%**

Source: United States Department of Health and Human Service, Centers for Medicare and Medicaid, available at <http://cms.hhs.gov/medicaid/msis/oototal.pdf.>
Note:* Excludes $2.2 billion in Disproportionate Share Hospital payments.

[11] United States Department of Health and Human Service, Centers for Medicare and Medicaid, available at <www.http://cms.hhs.gov/medicaid/msis/oototal.pdf> (March 19, 2003)

Closing the Gap

Bringing the budget into balance over the next three fiscal years would mean that operating deficits must be financed in each of those years. If the dollar value of the Governor's recurring measures was taken as a starting point in fiscal year 2003-2004 and the additional cuts were implemented in the next two years, then the cumulative deficit to be financed would be about $6.3 billion. This includes the $1.5 rolled into fiscal year 2003-04 from 2002-03, the nearly $2.3 billion additional in fiscal year 2003-04, and an assumed additional $1.5 billion in fiscal year 2004-05 and $1 billion in fiscal year 2005-06.

How should this $6.3 billion be raised? The clearest answer is that it should *not* be from long-term borrowing.

Using borrowed funds to finance current services is unfair to future generations. Borrowing for operating expenses violates a basic principle of public finance—that the benefits enjoyed correspond to the payment schedule for those benefits. Paying for $6.3 billion of services in fiscal years 2003-06 with borrowed funds would reduce resources available for future needs, because the bonds will be repaid, with significant interest costs, over many years. Solving today's problem at a cost to tomorrow's taxpayers is inherently unfair.

The long-term burden imposed by borrowing for operating expenses is a lesson New Yorkers ought to have learned. In 1990 future New Yorkers were obliged to foot the bill for past services. In that year the State created the Local Government Assistance Corporation (LGAC) to finance an accumulated deficit with long-term bonds backed by future sales tax collections. Over three years, LGAC borrowed $4.7 billion. The bonds are being repaid over thirty years at a total cost of $7.4 billion. Annual debt service—sales tax payments not available for other purposes—will average $246 million until 2026, the last year of repayment.[12] An even larger future burden should not be imposed because State leaders again have run up a large operating deficit.

Another reason to avoid long-term borrowing for operating purposes is that New York State's debt burden is already high. A recent analysis by the Citizens Budget Commission using a comprehensive comparative approach found the State of New York's debt burden to be in a "danger zone" relative to other states.[13] According to Moody's Investor Services, New York ranks fifth among the 50 states in tax-supported debt per capita and fourth in debt relative to personal income.[14] Despite the danger signal and the unfavorable rankings, debt will continue to rise at a rapid rate. Under the Governor's Executive Budget state-supported debt (excluding the proposed tobacco

[12] *$1,000,000 New York Local Government Assistance Corporation*, multiple series bonds, Official Statement, February 18, 2003, Notes to Financial Statements, p.12.
[13] See Citizens Budget Commission, *An Affordable Debt Policy for New York State and New York City*, October 2000.
[14] Moody's Investor Service, *2002 State Debt Medians*, April 2002, as cited in State of New York, Office of the Office of the State Comptroller, *2003-04 Budget Analysis: Review of the Executive Budget*, February 11, 2003, p. 84.

bonds) will grow from $37.7 billion in fiscal year 2001-02 to $41.0 billion at the end of fiscal year 2003-04, an increase of 9 percent in two years.[15] New York should not add several billion dollars more in debt to this total to finance new, repeated operating deficits.

New York State should levy a temporary tax surcharge that would be phased out over three years. New York State cannot afford to raise taxes permanently without reorganizing its relationship with local governments—the combined burden of State and local taxes already places the State at a serious competitive disadvantage. However, temporary tax increases are preferable to long-term borrowing to cover operating deficits. Unlike borrowed funds, taxes have the advantage of charging the same people who benefit from the service they finance.

Any new tax should be temporary by statute, phasing out automatically by the third year, and limited to amounts needed to avoid deficits or borrowing. The worst possible scenario for the State of New York is to borrow to deal with revenue shortfalls and to increase taxes to support added spending. This combination would severely constrain New York's future as a world center of business and commerce.

As noted earlier, the amounts likely to be needed in order to avoid borrowing are $3.8 billion in fiscal year 2003-04, $1.5 billion in fiscal year 2004-05, and $1 billion in fiscal year 2005-06. These sums could be raised with a surcharge on the personal income tax averaging 8.5 percent but structured to phase out from 15 percent in fiscal year 2003-04, to 10 percent in fiscal year 2004-05, and to 5 percent in fiscal year 2005-06. These surcharges would represent an increase in the marginal rate paid by top bracket taxpayers from the current 6.85 percent to 7.88 percent in the first year and 7.19 percent in the last year, thereafter returning to 6.85 percent.

More Accountable and Transparent Budgeting

In enacting a plan to eliminate the deficit, State leaders should also reform the budget process that led to the current crisis. It is clearer than ever that the current practices are failing New Yorkers.

The dismal results of the past two years point to a number of chronic problems in the State's fiscal management that can and should be remedied. Simply put, elected leaders spend too much, plan too little, rely too heavily on one-shot remedies to ongoing structural problems, and use short-sighted cash accounting coupled with a myriad of "off-budget" entities that mask looming difficulties until it is too late.

This is the second time in a decade that future taxpayers might be asked to foot the bill for past problems. The first time around, when LGAC was created to deal with the deficit accumulated due to repeated, short-term borrowing, many civic groups in the state, including the Citizens Budget Commission, called for greater accountability and

[15] See State of New York, Division of Budget, *2003-04 New York State Executive Budget*, *op.cit*., p.316.

higher standards in the budget process.[16] Many of these recommendations were ignored. Now is the time to resurrect them and abolish permanently the practices that lead the State to trouble. Three changes would be prudent first steps.

First, the State should be required to balance its budget based on Generally Accepted Accounting Principles (GAAP) in order to prevent the accumulation of a deficit. The State's current practice of managing on a cash basis has led to manipulation of the financial plan to fill holes in the short-run at the expense of long-run balance. GAAP provides a clearer picture of how well the State is staying within the boundaries of what it should spend on a recurring basis.

Second, the Division of Budget should be required to prepare a four-year financial plan with quarterly updates. Currently, the Executive Budget contains only a two-year financial plan, and it is not updated to reflect the actions taken in the enacted budget. Baseline assumptions for the out-years should be fully described and the out-year impact of any actions by the Legislature to modify the Executive Budget should be detailed.

Third, all off-budget accounts should be brought on budget. The use of off-budget accounts, such as the large ones for health care, should be eliminated. A unified statement of all planned revenues and expenditures is critical to public accountability. New York State voters should be able to see the priorities of their elected officials fully reflected in the budget documents.

Adopting these basic reforms should be part of what the public demands in exchange for supporting an effort to close projected deficits with a temporary tax. The broken budget process in Albany has eroded public faith in government for long enough.

Restructuring and Reducing the Combined State and Local Tax Burden

The immediate challenge facing State leaders is to balance the budget and avoid borrowing for operating purposes. The actions taken to achieve this goal should also be consistent with longer-run objectives. The combined State and local tax burden should be reduced in order to enhance the State's competitiveness. This will require the State playing a larger role in financing Medicaid and controlling its costs, and that the State developing a more equitable system of public school finance.

In the last decade New York State made progress by cutting taxes, but the reductions were paid for by the economic boom and not by lowering spending. At the same time, the local tax burden remained non-competitive—the highest in the nation. Local governments pay for an unusually large share of Medicaid and finance much of school spending that in some districts tops $25,000 per pupil. As a result, the combined State and local tax burden is the highest in the nation. (See Table 4.)

[16] See Citizens Budget Commission, *Establishing Fiscal Reform in New York State*, March 1992.

Table 4
State and Local Tax Burden Per $1,000 of Personal Income
Fiscal Year 1999

	State Taxes		Local Taxes		State & Local Combined	
	U.S. Average=$67.71		U.S. Average=$42.77		U.S. Average=$110.48	
State	% of US Avg.	State Rank	% of US Avg.	State Rank	% of US Avg.	State Rank
New York	**98%**	**30**	**174%**	**1**	**127%**	**1**
New Jersey	90%	40	123%	3	103%	13
Illinois	87%	44	108%	9	95%	34
Ohio	91%	39	112%	6	99%	23
Texas	75%	48	108%	10	88%	46
Connecticut	116%	14	100%	16	110%	8
Georgia	92%	36	106%	13	98%	29
Pennsylvania	97%	32	97%	21	97%	32
Florida	88%	43	96%	22	91%	44
Massachusetts	106%	21	86%	31	98%	26
California	116%	15	82%	34	103%	15
Michigan	123%	12	71%	40	103%	14

Source: State of New York, Department of Taxation and Finance, *New York State Tax Sourcebook*, March 2002.

The local burden for Medicaid exceeds $5.1 billion per year. The State should pursue a long-run effort to both lower total Medicaid costs and finance them more from statewide sources. A county's tax burden should not be a function of the size its indigent population. The State should control Medicaid spending and spread the financial burden across its broadest tax base.

The structural Medicaid changes in the Executive Budget move in the wrong direction. It proposes to shift an additional share of the Medicaid burden for acute care services to the counties in exchange for State assumption of the full cost of covered prescription drugs. Under the proposal, the county share of inpatient, outpatient, and clinic service costs would increase from 25 percent to 37 percent. The Governor and the New York Association of counties dispute the long- and short-run fiscal consequences of this change, due to varying assumptions about growth rates in each type of cost. However, it seems clear that the City of New York will suffer fiscally from the change. It is preferable that future structural changes clearly move greater financial responsibility to the State without imposing new risks on counties and the City.

Factors other than Medicaid contribute to the high local tax burden in New York. High public school spending and a network of multiple overlapping local jurisdictions are prominent features. The State's long-run agenda should also include school finance reform that helps narrow gaps in per-pupil spending between rich and poor school districts and an effort to consolidate inefficient local governments.