NYSBA

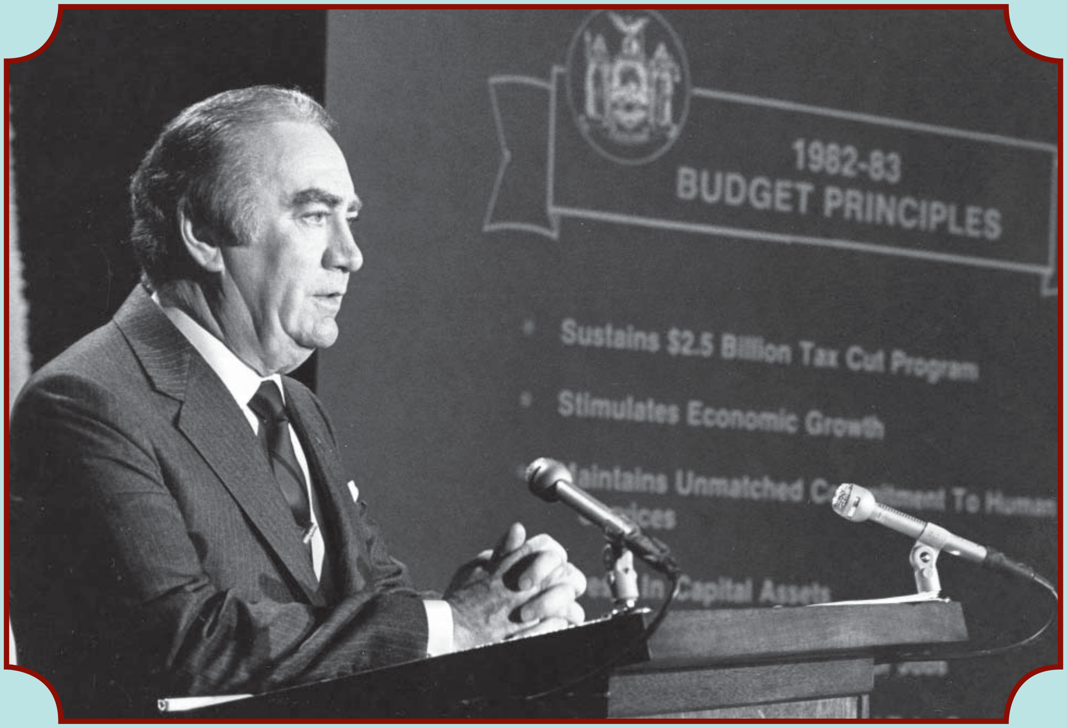
SUMMER 2011 | Vol. 13 | No. 1

Government, Law and Policy Journal

A Publication of the New York State Bar Association
Committee on Attorneys in Public Service, produced in cooperation with the
Government Law Center at Albany Law School

NYSBA

In Memoriam



Governor Hugh L. Carey

1919-2011

The Committee on Attorneys in Public Service dedicates this issue to the enduring memory of Governor Hugh L. Carey and his enumerable contributions to public service

This photograph, which is entitled *Governor Carey Briefs the Press on the Budget*, was made available from the New York State Archives.

SUMMER 2011 | VOL. 13 | NO. 1

NYSBA
Government, Law and Policy Journal

Contents

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Message from the Chair

By Peter S. Loomis

As I write this message for the *Government, Law and Policy Journal* issue devoted to New York State's budget, we have just begun a new Association year, with a new president, Vince Doyle, and several new members of the Committee on Attorneys in Public Service. This will be my third and last year as CAPS chair, and I want to first thank the members who left the Committee as of June 1st for their hard work and devotion during their tenure. CAPS lost several subcommittee chairs, including those who headed up the Annual Meeting and Awards and Citations, and all of the former members will be missed. At the same time, I welcome our ten new members and look forward to their participation in the important work of this Committee. I know they will benefit, as I have, from the opportunities CAPS affords to attorneys working in the public sector to meet, interact with and establish long-term relationships with other public service lawyers they may not otherwise have ever met.

Since my last message, CAPS presented our 2011 Annual Meeting program and hosted our Excellence in Public Service awards reception in January. I mentioned our three Awards winners in my last message, but did not talk about our full-day CLE program. The now traditional morning Supreme Court review with Professors Mazzone and Araiza of Brooklyn Law School was well received, as always, and the afternoon session dealt with the timely topic of state government in a time of economic crisis and the need to do more with less. Our two panels included speakers such as former Lieutenant Governor Richard Ravitch, who also wrote for this issue of the *Journal*, and Chief Administrative Judge Ann Pfau. Each year we have been fortunate to secure excellent speakers on various topics of interest to attorneys in the public sector, and this year was no exception. Putting together this type of program requires many hours of work, and Spencer Fisher and Michael Barrett, the co-chairs of this year's event, and now both former CAPS members, deserve special recognition for their tenacity and dogged pursuit of speakers and materials.

Recently, CAPS selected our third annual honoree for the Committee's Citation for Special Achievement in Public Service, Milinda Reed, of Unity House in Troy. By the time this issue of the *Journal* is in readers' hands, Ms. Reed will have received her Citation at a June reception at the Bar Center in Albany. Ms. Reed was honored for her work beginning in 2000 at Unity House, where she first developed and implemented a program to assist victims of domestic violence, and which she has since then championed over the last 11 years.

This issue of the *Journal* contains some fascinating articles on the often contentious budgeting process in New York, and I want to particularly thank our esteemed Guest Editor, Abraham Lackman, and the authors for their work. As always, the *Journal's* Editor-in-Chief, Rose Mary Bailly, also deserves thanks for her dedication to this publication. As a result of the Committee's partnering with the Government Law Center at Albany Law School, the *Journal* has become one of CAPS' finest products, each issue covering a timely New York topic in a unique way.

Finally, in this message I want to extend my sincerest thanks to Pat Wood, NYSBA's Senior Director of Membership Services, and who, in her nonexistent "spare time," has also served as the staff liaison to CAPS since its inception. Before we existed Pat was, in fact, also one of those who were instrumental in the creation of this Committee. As a result of a reorganization at the Bar Center, Pat has relinquished her CAPS responsibilities. Pat has been an enormous help to me, and I know to every past chair, and I will miss her. Our new staff liaison, Megan O'Toole, works with Pat in Membership Services, and we welcome Megan to the Committee!

Editor's Foreword

By Rose Mary K. Bailly

Governor Cuomo Announces On-time Passage of Historic, Transformational 2011–12 New York State Budget

March 31, 2011 Division of the Budget Press Release, available at http://www.budget.ny.gov/pubs/press/2011/pressRelease11_OnTimePassageofHistoricTRANSFORMATIONAL2011_12NYSBUDGET.html*

For many years New Yorkers have heard about "three men in a room" as the Governor, the Senate Majority Leader and the Speaker of the Assembly struggled to find common ground over New York's annual budget—often concluding the process well after the April 1st deadline. In many respects these reports were just the tip of the iceberg of issues underlying the passage of the state's budget. We were delighted that Abraham Lackman agreed to lead the *Government, Law and Policy Journal*'s examination of various policy and legal aspects of New York's state budget. Abe Lackman is the President of Praxis Insights, a higher education and government consulting firm. In addition to managing Praxis Insights, Abe currently serves as a 2010-2011 Clarence D. Rapplyea Government Scholar in Residence at Albany Law School's Government Law Center. Thank you, Abe, for taking us behind the scenes of New York State's budget. And thank you to all the authors for sharing your expertise on this complex subject.

I would like to especially thank our Executive Editor for 2010-2011, Robert Barrows, Albany Law School, Class of 2011, for his professionalism and enthusiasm. He and his Albany Law School colleagues, Eric Garofano, Lauren Palmer, Jason Riegert, Matthew Robinson-Loffler, and Michael Telfer, Class of 2011, and Oriana Carravetta and Daniel Levin, Class of 2012, worked extremely hard to help create this issue.

We are again indebted to the staff of the New York State Bar Association, Pat Wood, Lyn Curtis and Wendy Harbour, for their expertise and enduring patience. And last, and always, my thanks to Patty Salkin for her loyal support.

Finally, I take full responsibility for any flaws, mistakes, oversights or shortcomings in these pages. Your comments and suggestions are always welcome at rbail@albanylaw.edu or at Government Law Center, 80 New Scotland Avenue, Albany, New York 12208.

**Many of the articles herein were written and submitted for publication prior to the passage of the 2011–12 budget.*

Guest Editor's Foreword

By Abraham M. Lackman

The current issue, "New York State's Budget: Conflicts and Challenges," focuses on the legal and fiscal issues surrounding the State budget. With an annual expenditure in excess of $130 billion, the State budget is the single most important piece of annual legislation proposed by the governor and adopted by the State legislature.

In the past four decades, the budget process has been extremely contentious on at least two fronts. First, we have witnessed a constant struggle between the executive and legislative branches of government over dominance in the budget-making process. Recent court decisions, particularly *Silver v. Pataki*, have tipped the balance of power clearly in favor of the executive. The first five articles of the issue focus on these and related legal matters, culminating with former Lieutenant Governor Richard Ravitch's retrospective of this struggle and potential reforms.

The next series of articles highlights the second key contentious issue—budget-making in the context of a State economy that has been in long-term secular decline. As measured by key economic indicators, New York's economy—at least since the 1970s—has weakened substantially in relation to the economies of most other states and of the nation as a whole. This relative and recent absolute decline comes against a backdrop of ever-increasing pressure to raise taxes in order to support a high level of spending for education and health care.

Not surprisingly, given this tension between limited available resources and the pressure to spend, New York State's budget has been in a seemingly endless state of crisis. The second portion of the issue concludes with Seymour Lachman's analysis of Governor Hugh Carey's handling of the State's first in a series of fiscal crises. Finally, the issue ends with three articles that discuss the function of the state comptroller in the budget process, the role of debt in the budget process, and the tension between New York City and upstate New York with regard to setting budget priorities.

I want to extend my warm thanks to the authors and to all of those behind the scenes whose hard work has made serving as guest editor an intellectually enjoyable experience.

Upon concluding his tenure as the sixth President of the Commission on Independent Colleges and Universities (cIcu) in November 2009, Abraham M. Lackman launched the educational and governmental consulting firm, Praxis Insights. In addition to managing Praxis Insights, Lackman currently serves as a 2011–2012 Clarence D. Rapplyea Government Scholar in Residence at Albany Law School's Government Law Center. At cIcu, Lackman was responsible for leading and coordinating the state and federal public policy advocacy of more than 100 college presidents of New York State's private, nonprofit, independent institutions of higher education. Before joining cIcu, Lackman was Secretary of the New York State Senate Finance Committee—where his responsibilities included evaluating the fiscal and budgetary implications of all major state legislation—as well as Special Advisor to the Senate's Majority Leader. Preceding that, he was Budget Director of the City of New York.

Lackman has served on numerous community, state, and national boards and committees. He has served on the boards of the Metropolitan Transit Authority, the New York Academy of Sciences, the New York State Commission on Higher Education, the Public Authority Governance Advisory Committee, the New York State Deferred Compensation Board, and the Special Commission on the Future of the New York State Courts. Currently, he serves on the boards of Le Moyne College, the Public Policy Institute of New York State, and the Saratoga Performing Arts Center (SPAC). Lackman earned a bachelor's degree from New York University. He holds a master's degree in economics from the State University of New York at Albany, where he completed course work for a doctorate in economics. Lackman has also received honorary doctorates from Metropolitan College of New York and Nyack College.

Legal History of the New York State Budget—An Overview

By David S. Liebschutz and Mitchell J. Pawluk

Introduction

David S. Liebschutz

The legal history of the New York State budget can best be characterized as an ongoing struggle for control over the purse strings between the governor and the legislature. Although the courts and localities have also been a part of the struggle, most of the legal battles have been between the executive and legislative branches. Since the late-1920s, however, the governor's role in the process has been preeminent. This article will present an overview of the legal history of the New York State budget with the other articles in this edition of the *Government, Law and Policy Journal* detailing how recent events have helped shape the legal debate about the budget process as well as a brief discussion about some attempts to reform the system.

Early History

In order to better understand the modern legal history of the budget, it is useful to look back to its origins. Prior to the twentieth century, New York had four versions of the state constitution—1777, 1821, 1846 & 1894—all of which had an impact on the role of the respective parties in the state budget process.[1] As will be discussed in more detail below, each of these versions of the constitution changed some aspects of the relationship among the branches of state government. In this sense, New York's experience was fairly typical when compared to other states in that weak governors were mostly powerless to exert influence over the administration of a largely decentralized state government.

The very first New York State Constitution, as adopted in 1777, characterized the governor as a "nominal executive branch leader…who had virtually no relationship to the actual daily business of governing New York."[2] The role of the governor was as a figurehead, with the few agencies that existed at the time run by strong independent leaders who went directly to the legislature for funding requests. In 1821, the constitution was changed to constrain legislative power; however, the governor still "remained enfeebled for the remainder of the century due to the short term of office (which was reduced from three to two years)…[and a] lack of executive branch authority over the various state agencies."[3] The constitutional amendments of 1846 continued to weaken both the legislature and governor by expanding the number of legislators, shortening their terms of office (from three to two years), and continuing to constrain legislative powers.[4]

Mitchell J. Pawluk

By the late nineteenth century, however, the reform movement afoot in many states and in Washington, D.C. urged the centralization of the budget process in the executive branch. This movement would come to fruition in most places by the end of the 1920s.[5] In New York, however, the budget reform process took longer than in many states, and there were only incremental changes in the balance of power between the branches of government. For example, even in the 1894 Constitution, the legislature's powers were further weakened as were those of the statewide officials whose terms of office were reduced to two years.[6] More significantly, without any central budget office to reconcile spending with available revenues, New York (and most other states) could not maintain a true picture of state spending, causing the need on many occasions for emergency revenue or borrowing bills to cover the greatly expanded state responsibilities.[7]

In sum, the first 130 years of New York's legal budget history can be characterized as a decentralized process with a weak governor, relatively weak legislature, and individual state agencies as the primary drivers of the budget process.

Changes in the Early Twentieth Century

With the onset of the twentieth century and the continued spirit of reform, many states began to embark on initiatives to expand the government's role and how to pay for that role. Accompanying these changes, many states enacted statutory changes to create a central budget function in the governor's office that would be accountable for keeping track of state spending and revenues on an annual basis.

Although New York was relatively late to budget reform, when it did reform its process it did so on a grander scale, and yet, as shown below, these changes became harder to alter. The first twentieth century New York governor to take on significant budget reform was Republican Governor Charles Evans Hughes. After his election in 1908, Hughes advocated for major reorganization proposals that would have centralized administrative powers under his office.[8] In 1910, however, Hughes resigned to take a seat on the United States Supreme Court and little further progress was made on budget reform.[9]

In 1912, the next elected governor, Democrat William Sulzer—a former Speaker of the New York State Assembly—embarked on a budget reorganization process through the creation of a "Committee of Inquiry."[10] This Committee proposed the creation of a "Department of Efficiency and Economy" which would have had the governor coordinate state administrative services with the Assembly and Senate.[11] This effort was thwarted, however, after a scandal over campaign expenditures caught up with Sulzer, and he was impeached for lying about such expenditures—temporarily slowing the reform initiative.[12]

Yet, just three years later in 1915 (a year ahead of the 1916 mandate from the 1894 constitutional convention), there was a constitutional convention that again took up the mantle of budget reform. The convention had three major themes: "(1) consolidation of executive agencies; (2) gubernatorial control of these agencies, and (3) [the creation of] an executive budget [process]."[13]

The major change that the convention proposed was to balance power between the governor and legislature, so that the governor would be responsible for putting the budget together and the legislature for approving or changing it but only under a narrow set of methods.[14]

The voters, however, rejected the proposed constitutional changes because of several factors that had little to do with the merits of the individual items but more to do with external factors (e.g., voting the changes as a single package and not as individual proposals; political factors; and World War I).[15] Yet, much of what was proposed in 1915 became the blueprint for the 1927 constitutional changes ratified by voters in 1928 under the leadership of Democratic Governor Alfred E. Smith.[16]

1927 and 1938 Constitutional Amendments

In 1920, Governor Smith proposed enacting the 1915 convention changes into law.[17] The proposed changes stalled, however, for five years (during which Governor Smith lost a reelection bid only to be reelected in 1922) until Smith brought back former-Governor Hughes to chair a commission that adopted the proposed changes.[18] The legislature adopted the Hughes Commission amendments in 1927 and voters easily ratified them later that same year.[19] The major provisions of the amendments were contained in four sections of Article IV-A of the New York State Constitution.[20] Section I required that executive departments submit itemized estimates of the appropriations for the next fiscal year by October 15 and that hearings on these estimates be held.[21] Section II required that, on or before January 15, the governor would submit a complete plan of expenditures and revenues.[22] Section III provided for legislative hearings on the budget.[23] Finally, Section IV provided that no further appropriations could be made until the governor's appropriations had been made, that appropriations be made in a single bill, and that emergency appropriations could be made as needed.[24] Much of what was contained in the 1927 amendments was repackaged in 1938 as detailed below, but the substance remained and largely carries forward to the present. Governor Smith "submitted the first executive budget" in 1929 under the new amendments.[25]

The 1938 constitutional amendments made minor modifications to the 1927 amendments and repackaged them into a single Article VII of the Constitution with the following key provisions: Section II required a "complete plan of expenditures…and revenues" submitted by the governor to the legislature;[26] Section III specified how the budget bills and any authorizing legislation necessary were to be submitted;[27] Section IV limited the power of the legislature so that:

> it may not alter any appropriation bill submitted by the Governor except to strike out or reduce items therein, but it may add thereto items of appropriation provided that such additions are stated separately and distinctly from the original items of the bill and refer each to a single object of purpose;[28]

Section V required the legislature to address the governor's appropriations first;[29] and Section VI mandated that no appropriations except from the governor "shall be made except for separate bills each for a single object or purpose."[30]

Although there have been attempts since 1938 to make large changes in the constitution to modernize it—most notably in the 1967 constitutional convention—these attempts have failed and what remains in place today is the budgetary framework laid out in the constitution nearly seventy-five years ago. As will be seen in the discussion below and in the articles to follow, these changes have created a somewhat uneasy relationship among the branches of state government and between the state and its localities over the budgetary power vested in the governor.

The *Tremaine* Cases

The first two major cases to test the new constitution's budget framework were *People v. Tremaine*[31] (*Tremaine I*) in 1929 and a second *People v. Tremaine*[32] (*Tremaine II*) in 1939. In *Tremaine I*, the main issue to be decided was whether the governor had the authority to include in his Executive Budget a provision that made him the sole arbiter of future itemizations from lump sum appropriations.[33] The New York State Court of Appeals held that members of the legislature could not be in a position to approve segregation of funds on the premise that legislators could not hold both elected and administrative offices simultaneously.[34] Although the grounds for the decision were not based strictly on the budgetary provisions in the constitution (i.e., Article IV-A), it was clear that the court recognized that the 1927 amendments made a "fundamental redistribution of power from the Legislature to the Executive."[35] In *Tremaine II*, decided 10 years later, the issue for the New York Court of Appeals was whether the legislature could convert an itemized Executive Budget submission into a lump sum for various government departments.[36] The court held that the legislature could not substitute its own preferences for the same appropriations that the governor had put into the budget.[37] Moreover, *Tremaine II* further solidified the preeminent role of the governor in setting the budgetary agenda and constraining the legislature's power to change that agenda.

Recent Cases

After *Tremaine II,* there was little activity of note regarding the budget in the courts until 1969 and the court's opinion in *Schuyler v. South Mall Constructors*.[38] The issue in *Schulyer* was whether non-budget bills could be added onto the governor's budget by the legislature. Interpreting Article VII, section 6 in light of *Tremaine I*, the Appellate Division, Third Department held that the purpose of the constitution was to "eliminate the legislative practice of tacking onto budget bills propositions which had nothing to do with money matters; that is, to prevent the inclusion of general legislation in appropriation bills."[39] This case continued to follow the themes of *Tremaine I* by restricting the legislature's ability to modify the executive budget.

The next case of note came nearly ten years later in 1978 with *Saxton v. Carey,*[40] which addressed how detailed the budget must be in itemizing specific provisions contained within it. However, an even larger issue in the case was the role of the courts in accommodating the various parties in the budget process. The Court of Appeals refused to decide, finding the extent of itemization to be a matter for the executive and the legislature to decide, as noted below:

> Today, we simply refuse to extend the power of the robe into an arena in which it was never intended to play a role. We hold only that the degree of itemization and the extent of transfer allowable are matters which are to be determined by the Governor and the Legislature, not by judicial fiat.[41]

Two years later in *Oneida County v. Berle*,[42] the Court of Appeals dealt a blow to unfettered executive authority when deciding the issue of whether the governor has the inherent authority to impound funds appropriated by law as part of an obligation to maintain a balanced budget. The court held that "under the State Constitution, the executive possesses no express or inherent power based upon its view of sound fiscal policy to impound funds which have been appropriated by the Legislature."[43] This was one of the few recent cases that held the governor's power in check, noting that "[h]owever laudable its goals, the executive branch may not override enactments which have emerged from the lawmaking process. It is required to implement policy declarations of the Legislature, unless vetoed or judicially invalidated."[44]

The next year in *Anderson v. Regan*,[45] the Court of Appeals decided the issue of whether a formal legislative appropriation was necessary before the Executive Department could disburse federal funds held in a joint custody account with the state. The court held that the practice of disbursing federal funds *without* appropriations violated the requirement in Article VII, section 7 that *all* funds must be formally appropriated.[46] The court noted "when the appropriation rule is bypassed,…the balance of power is tipped irretrievably in favor of the executive branch."[47] The court was concerned that without following the budget process laid out in Article VII—and keeping the proper balance of power between the branches of government—there might be a loss of liberty for the citizens of the state.[48]

In 1993, the court decided a similar budget process issue in *N.Y.S. Bankers Ass'n v. Wetzler*,[49] that involved the question of whether the legislature may insert a provision into a budget bill *after* the governor submits it to the legislature, provided the governor signs it into law and does not delete it. The court distinguished this case from *Saxton* (which involved discretionary decisions) and held once again that the actions here were expressly prohibited by Article VII, section 4. The court again framed the issue of separation of powers as one of preserving liberty.[50]

By contrast the following year, in *Schulz v. State,*[51] the the Supreme Court, Albany County decided that the use of lump-sum appropriations for "member-items" did not violate the separation of powers doctrine by allowing the legislature to allocate appropriations (an executive function) as an insufficiently itemized addition by the legislature. The court distinguished *Schulz* from *Tremaine II* and instead likened the case to *Saxton* in that the level of itemization required is not appropriately decided by the judiciary, but by the legislature and political process.[52]

Silver v. Pataki and *Pataki v. N.Y.S. Assembly*

In 2004, the court consolidated and decided a pair of cases (*Silver v. Pataki* and *Pataki v. N.Y.S. Assembly*) that solidified the governor's preeminent role in the budget process.[53] In *Silver*, the issue was whether the legislature could change the purpose and conditions (though *not* the dollar amounts) attached to the governor's appropriation bills, through the use of subsequently passed non-appropriation budget bills.[54] The court held "[t]he Governor will be able to perform his constitutional role only if the no-alteration clause of article VII, § 4 applies to the details of the appropriation bills he submits to the Legislature."[55] In *Pataki*, the court addressed two related issues in the constitutionality of the legislature's use of single-purpose bills as substitutes for items struck from the governor's appropriation bills, and the extent to which the governor could include language not traditionally included in appropriation bills (and *still* be protected from alteration by Article VII, section 4).[56]

The court in *Pataki* found the legislature's use of single-purpose bills to substitute for items deleted from the governor's appropriation bills to fall directly within *Tremaine II* (items must be additions, *not* substitutions in order to be constitutional), therefore making the legislature's acts unconstitutional.[57] The Court of Appeals did not establish a bright line as to when a governor's appropriation language exceeds an appropriation and becomes policy, thus exceeding the protections of section 4. Instead, a plurality found that such a problem was not confronted in this case because "there is nothing in the appropriation bills before us that is essentially nonbudgetary."[58]

Both the *Silver* and *Pataki* cases seem to stand for the notion that the legislature is a "critic" of the governor's budget and not a "rival constructor,"[59] and that the particulars of the budget process should be one to be worked out between the two branches and not by the courts.[60] Two years later, the next major budget case, *Campaign for Fiscal Equity v. State of New York*[61] (*CFE III*) was handed down by the Court of Appeals. *CFE III* concerned the constitution's mandate that the state provide a "sound basic education" to all of the schoolchildren across the state.[62] The case bolstered the "Legislature as critic" theme by holding that it was not the judiciary's role to determine "the best way to calculate the cost of a sound basic education in New York City" because it was a matter of budgeting and policymaking.[63] As stated by the court,

> [d]eference to the Legislature is especially necessary where it is the State's budget plan that is being questioned. Devising a state budget is a prerogative of the Legislature and Executive; the Judiciary should not usurp this power. The legislative and executive branches of government are in a far better position than the Judiciary to determine funding needs throughout the state and priorities for the allocation of the State's resources.[64]

Therefore, the court found the judiciary's role was only to determine whether the state's calculation was rational.[65] Since the Supreme Court commissioned a de novo review rather than a limited review, the court agreed with the Appellate Division in part that the Supreme Court erred in its review.[66]

The Way Forward?

While this article is a general overview of the legal history of the New York State budget process, there are some recurring themes that emerge from this history that are useful to bear in mind when thinking about the specific topics discussed below.

The first theme is that (notwithstanding some legislative efforts to make it otherwise) the role of the governor in the budget process is preeminent and has been since the constitutional changes in 1927 shepherded forward by Governor Al Smith. Furthermore, while New York is one of many states that share this strong executive model of budgeting, this model is not the only model that exists in the United States.[67]

This raises the question then, given the strong role of the governor in New York's budget process, what is the role of the legislature in crafting budgets? Are they merely "critics" of the process (as noted by the court in *Silver*), or do they have a more robust role in setting budgetary policy? Government reform experts such as Dr. Gerald Benjamin of SUNY New Paltz[68] and Richard Briffault of Columbia Law School[69] have each called for a more inclusive budget process that would make the legislature more of an equal partner in the negotiations and not weigh the process so heavily in favor of the governor.

The second major theme is the role of the courts in refereeing budget disputes. Since they do not have the "power of the purse or the sword" to enforce rulings, how can they be effective in enforcing their rulings to make either the governor or the legislature accountable for budgetary changes? The *CFE* cases are a good example of how limited the powers of the judiciary are when it comes to enforcing politically difficult decisions.

While this article does not address the legal issues of local aid in the state budget process (except pertaining to school aid in the *CFE* case), it is most often a political matter as opposed to a legal one, with other potential legal issues that may surface in the future such as the sanctity of employee benefits (i.e., pensions and health care), and the enforceability of state mandates, particularly as they relate to labor laws (e.g., the Triborough Amendment).[70]

Finally, a word about budget reform.[71] Although there have been some modest changes in the state's constitution and state finance law in recent years,[72] it is notable that there have been no major changes in the constitution since 1938 to modernize the state's budget process. Proponents of reform, such as Gerald Benjamin, have argued that a twenty-first century state government needs a more modern legal framework governing its budget than one from the late 1920s.[73] Only time will tell if they are correct in this view.

Endnotes

1. Much of this early history is taken from two excellent sources: N.Y.S. Div. of the Budget, The Executive Budget in New York State—A Half Century Perspective (1981) [hereinafter Div. of Budget] and John T. Buckley, *The Governor—From Figurehead to Prime Minister: A Historical Study of the New York State Constitution and the Shift of Basic Power to the Chief Executive,* 68 Alb. L. Rev. 865 (2005).
2. Buckley, *supra* note 1, at 869.
3. *Id.* at 872.
4. *See id.* at 872–873.
5. For example, the Bureau of the Budget, the predecessor to the federal Office of Management and Budget, was established as a part of the Department of the Treasury by the Budget and Accounting Act of 1921. *See* Budget and Accounting Act of 1921, Pub. L. No. 67-13, § 207, 42 Stat. 20, 22 (1921) (codified as amended in scattered sections of 31 U.S.C.).
6. Buckley, *supra* note 1, at 875–76.
7. An example of this haphazard state budgeting process can be found in a provision of the State Care Act of 1890 which transferred the responsibility for the treatment of the mentally ill from localities to the State, but the legislation did not come with a clearly defined way to pay for this treatment in the long-term. *See* Div. of Budget, *supra* note 1, at 4–6.
8. Buckley, *supra* note 1, at 877–78.
9. *Id.* at 878. Hughes did manage to reorganize the state insurance department and two public service commissions, which started to move the State toward some modernization. *Id.*
10. *Id.* at 878–79.
11. *Id.*
12. *Id.* at 879. Sulzer is the only governor in New York State history to be impeached and convicted. *Id.*
13. *Id.* at 879–80.
14. *Id.* at 880.
15. *Id.* at 882.
16. *Id.* at 882–883.
17. *Id.*
18. *Id.* Hughes had resigned from his Associate Justice position on the Supreme Court to run for President in 1916 and had served as U.S. Secretary of State prior to serving in this post for Governor Smith. *See generally*, Autobiographical Notes of Charles Evans Hughes (David J. Danelski & Joseph S. Tulchin eds., 1973).
19. Comm. on State Aff., *The New York State Budget Process and the Constitution: Defining and Protecting the "Delicate Balance of Power,"* 58 Rec. Ass'n B. City N.Y. 345, 350 (2003) [hereinafter Comm. on State Aff.].
20. *Id.*
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.*
25. Comm. on State Aff., *supra* note 19, at 350. This budget was challenged in the *Tremaine* cases discussed below.
26. *Id.* at 351.
27. *Id*. at 351–352. This section gives rise to the name "Article VII" bills and along with Sections IV and VI on the nature of the Legislature's power to amend the governor's budget has given rise to the bulk of the litigation on the budget as discussed below.
28. *Id.* at 352.
29. *Id.*
30. *Id.*
31. 168 N.E. 817 (N.Y. 1929).
32. 21 N.E.2d 891 (N.Y. 1939).
33. *See Tremaine I*, 168 N.E. at 819.
34. *See id.* at 820–21.
35. Buckley, *supra* note 1, at 890.
36. *See Tremaine II*, 21 N.E.2d at 892.
37. *See id.* at 894–95.
38. 303 N.Y.S.2d 901 (3d Dep't 1969).
39. *Id.* at 903.
40. 378 N.E.2d 95 (N.Y. 1978).
41. *Id.* at 99.
42. 404 N.E.2d 133 (N.Y. 1980).
43. *Id.* at 138.
44. *Id.* at 137.
45. 425 N.E.2d 792 (N.Y. 1981).
46. *See id.* at 796–97.
47. *Id.* at 797.
48. *Id.* at 798 (citing People ex rel. Burby v. Howland, 49 N.E. 775, 779 (N.Y. 1898)).
49. 612 N.E.2d 294 (N.Y. 1993).
50. *See id.* at 297 (citing People ex rel. Burby v. Howland).
51. 610 N.Y.S.2d 711 (Sup. Ct. Albany County 1994).
52. *See id.* at 748.
53. Pataki v. N.Y.S. Assembly, 824 N.E.2d 898 (N.Y. 2004). There is much more detail about this case in the article in this issue written by James McGuire.
54. *Id.* at 904–05.
55. *Id.* at 906.
56. *See generally, id.* at 906–12.
57. *Id.* at 910–11.
58. *Id.* at 910.
59. *Pataki*, 824 N.E.2d at 900 (citing to terms used in a report submitted to the 1915 Constitutional Convention by a committee chaired by Henry L. Stimson).
60. *Id.* at 910–11.
61. 861 N.E.2d 50 (N.Y. 2006). Michael Rebell's article in this issue deals with the history and importance of this case in much more detail.
62. *See id.* at 52.
63. *Id.* at 57. Chief Justice Kaye in her dissent felt that since the Executive and Legislature were at odds as to how to calculate the remedy (and not acting together on matters within their province), the issue was not a state budgeting issue and should not be given deference by the courts. *See id.* at 62.
64. *Id.* at 58.
65. *Id.*
66. *Id.* at 57.
67. For example, the role of the governor in a number of states is limited by statutory restrictions on things like rainy day funds or veto authority. The National Association of State Budget Officers (NASBO) has a compilation of these restrictions in its publication, *Budget Process in the States* (2008), available at http://nasbo.org/

LinkClick.aspx?fileticket=AaAKTnjgucg=&tabid=80 (last visited March 14, 2011).

68. *See e.g.*, Gerald Benjamin, *Reform in New York: The Budget, The Legislature, and The Governance Process*, 67 ALB. L. REV. 1021 (2004).

69. *See e.g.*, Comm. on State Aff., *supra* note 19 (with Prof. Richard Briffault drafting substantial portions of the article).

70. The 1982 Triborough Amendment to the Taylor Law that governs collective bargaining for public employees in the state prohibits a public employer from altering any provision of an expired labor agreement until a new agreement is reached. *See* N.Y. CIV. SERV. LAW § 209-a(1)(e) (McKinney 20).

71. For more details on reform proposals, see the fifth article in this issue by Richard Ravitch.

72. For example, there have been some modest changes in the first four sections of Article VII governing the budget process and the format of budget bills. *See generally,* N.Y. CONST. art. VII, §§ 1–4.

73. *See generally* Benjamin, *supra* note 68.

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Pataki v. Assembly: The Unanswered Question

By Hon. James M. McGuire

The principal issue in the two lawsuits decided in *Pataki v. New York State Assembly*[1] was the meaning and effect of a key provision of the system of executive budgeting adopted by the people in 1926 and now embodied in the first six sections of Article VII of the New York State Constitution: the no-alteration rule of the first sentence of Section 4—applicable to all the items of appropriation in the governor's appropriation bills other than those for the legislature and the judiciary. Five judges of the New York Court of Appeals essentially held that the rule means what it plainly states,[2] so that, except as specified in Section 4, the legislature cannot directly or indirectly alter an item of appropriation in an appropriation bill submitted by the governor.[3] To hold otherwise, as Judge Robert Smith stated, "would be to countenance the effective abolition of executive budgeting."[4] The arguments in support of that enormously important holding are marshaled in Judge Robert Smith's comprehensive plurality opinion, the opposing arguments are marshaled in Chief Judge Kaye's equally comprehensive dissent,[5] and I will not restate or discuss them.

Rather, I will focus on an important question the court did not resolve: whether the New York Constitution imposes any judicially enforceable limits on what the governor may include in an appropriation bill other than those set forth in the so-called anti-rider clause of Section 6 of Article VII. The plurality opinion expressly left that question for another day;[6] Judge Rosenblatt's concurring opinion, in which Judge G.B. Smith joined, decided it would have had the court create a multi-faceted balancing test "to determine when an appropriation becomes unconstitutionally legislative."[7] Before turning to that question and whether the position of the concurrence is defensible, a brief review of the constitutional history and some first principles will be helpful.

The framers of executive budgeting in New York, a group that included eminent citizens, attorneys and public officials, such as Henry Stimson and Elihu Root, had studied the history of legislative budgeting in New York and concluded it was one of financial excess and profligacy, borne of the parochial interests of the individual members of the legislature, "responsible to, and dependent upon, a single district of the State."[8] The baleful result was the process of "give and take which has become so common as to be stigmatized by the terms 'log rolling' and 'pork barrel.'"[9] The framers reposed their hopes for fiscal prudence in the governor, reasoning that the governor:

> [A]s the head of the State is the one who can best explain and defend a given fiscal policy to the people…and the one who, above all others, is interested in upholding before the people…a policy of economy and who should be held responsible for the success or failure of such a policy.[10]

The solution they recommended, and the people approved, was to grant new powers, legislative in nature, to the governor, and to limit the powers the legislature had exercised over the enactment of the budget. The powers granted to the governor include the power to author the appropriation bills, i.e., the bills that authorize specified amounts of money to be spent for more or less specific purposes and specify "when, how [and] where,"[11] i.e., the terms and conditions under which spending of each appropriation may occur. The power to author the items of appropriation is a significant one, particularly because it entails the log-rolling power to include within an item of appropriation both spending (or terms and conditions of that spending) that may be necessitous or otherwise uncontroversial and spending (or terms and conditions) that is controversial. Of the limitations on the legislature's powers, the most critical is the no-alteration rule, pursuant to which the "legislature may not alter an item of appropriation in an appropriation bill submitted by the governor…except to strike out or reduce items therein,…[and] add thereto items of appropriation provided such items are stated separately and distinctly from the original items of the bill and refer each to a single object or purpose."[12] In addition, prior to taking final action on the governor's appropriation bills, the legislature is prohibited, absent the consent of the governor, from even considering, let alone enacting, its own appropriation bills.[13]

In sum, consistent with their view that legislative budgeting presented "a singular reversal of the proper relation which should maintain between the Legislature and the Executive,"[14] the framers of executive budgeting reversed the roles of the governor and the legislature with respect to appropriation bills. At the outset of the budget process, the governor exercises powers the legislature previously exercised by authoring the proposed items of appropriation; at the conclusion of the process, when it takes final action on each item of appropriation by enacting, reducing or striking it out, the legislature exercises a power that (putting aside the legislature's authority to reduce an item of appropriation) is tantamount to the line-item veto power the governor previously exercised. The governor's voice in the appropriation process is strengthened. Whenever the governor and the legislature disagree over a proposed item of appropriation, the no-alteration rule amplifies the voice the governor had under legislative budgeting through the line-item veto by precluding the legislature from overriding it. Consistent with their view that the governor should be held responsible for the success or failure of any policy of economy, the framers made the governor the equal of the legislature in the appropriation process; the consent of both branches is necessary to enact any item of appropriation.

The governor's role in the appropriation process under our executive budgeting system, however, hardly represents an unprecedented intrusion into the province and prerogatives of the legislature. Although the powers of the three branches are separate, a familiar precept of both the federal and New York constitutions is that the separation is far from absolute.[15] As Hamilton stated, there is a "partial intermixture"[16] of powers. The veto power reflects such an intermixture as it provides the chief executive with a share of the legislative power.[17] As Professor Tribe has observed, "[t]he President's veto power…gives him an often decisive role in lawmaking."[18] Moreover, as Hamilton stated, the veto power "establishes a salutary check upon the legislative body, calculated to guard the community against the effects of faction, precipitancy, or of any impulse unfriendly to the public good, which may happen to influence a majority of that body."[19]

That the role of New York's governor in the appropriation process is not unprecedented can be seen by considering the power of a governor with line-item veto authority in a state with legislative budgeting. Whenever such a governor has the political support to prevent a veto in at least one house of the legislature, that governor has power over the enactment of appropriations that is at least comparable (even if it may not be equal) to the power the no-alteration rule confers on New York's governor. Consider, for example, a controversial proposal to curb spending on health care or education that both governors might think critical to a policy of economy. Although New York's governor must propose it at the outset of the budget process (thereby ensuring it is subject to public scrutiny), neither governor can do more than compel the legislature to negotiate, the one armed with the no-alteration rule and the other with line-item veto authority.

This brings us to the anti-rider clause of Article VII, Section 6. It applies to both the appropriation bills submitted by the governor and the one multi-purpose appropriation bill, denominated a "supplemental appropriation bill for the support of government,"[20] that Section 6 authorizes the legislature to submit after taking final action on the governor's appropriation bills. The clause, the second and final paragraph of Section 6, reads as follows: "No provision shall be embraced in any appropriation bill submitted by the governor or in such supplemental appropriation bill unless it relates specifically to some particular appropriation in the bill, and any such provision shall be limited in its operation to such appropriation."[21] The predecessor to this clause was Section 22 of Article III, added to the Constitution of 1894, during the regime of legislative budgeting.[22] As the Third Department stated, "[i]ts purpose was to eliminate the legislative practice of tacking onto budget bills propositions which had nothing to do with money matters; that is, to prevent the inclusion of general legislation in appropriation bills."[23] Interestingly, and I think not inadvertently for the reason noted below, although Section 22 was left intact when executive budgeting took effect in 1927, the framers of executive budgeting did not make it apply to the governor's appropriation bills. It did not apply to the governor's items of appropriation until 1938, when the original executive budgeting provisions of the Constitution were reconstituted, with minor language changes, as the first six sections of Article VII.[24]

In any event, the only limitations on the provisions of the governor's appropriation bills to be found in the Constitution are the two set forth in the anti-rider clause. First, each provision must "relate specifically to some particular appropriation in the bill." Second, each provision must "be limited in its operation" to the appropriation to which it relates.

Thus, the question I will focus on, the one the court left for another day, is this: despite the absence of any additional textual limitations on the governor's authority to author the items of appropriation, does the Constitution nonetheless bar the governor from including certain provisions even though they "relate specifically to some particular appropriation" and are "limited in [their] operation" to the appropriation to which they relate? As is demonstrated by the hypotheticals posed in the plurality opinion—e.g., the "insert[ion] into an appropriation for state construction projects a provision that Labor Law § 240 (the Scaffold Law) would be inapplicable"[25]—a governor "could purport to shield by the no-alteration clause… legislation whose primary purpose and effect is not really budgetary."[26] Although the plurality apparently regards such provisions as an "abuse"[27] of the power to author the items of appropriation, it is not clear whether the plurality is evaluating them in light of a legal or a non-legal norm.[28] Even if the characterization is sound, as the plurality recognized, it does not follow that there are constitutional checks against the abuse of the power to author the items of appropriation that are enforceable by the judiciary.

Before turning to the concurrence's conclusion that there are such checks, it is important to recognize that the same potential for such "abuse" exists when the power to author the items of appropriation is exercised by the legislature under a legislative budgeting regime. Under legislative budgeting, the governor's line-item veto power is a check against the legislature's power to author the items of appropriation, but is itself subject to the legislature's power to override. By contrast, under executive budgeting, the legislature's absolute power to strike any item of appropriation is not only a check against the governor's power to author the items of appropriation, but is one the governor has no constitutional power to counter. In short, even though they believed a policy of fiscal prudence would be served by transferring to the governor the power to author the items of appropriation, the framers of executive budgeting provided for a more complete check against its possible abuse.

Other aspects of the plurality opinion should be noted. After surveying prior decisions in which the court suggested or held that disputes between the governor and the legislature over the roles assigned to the two branches under Article VII were non-justiciable, the plurality writes that "[t]he dissent makes a valid point that political stalemate over a budget is an unattractive prospect."[29] Although the plurality opinion is unequivocally agnostic on the question of whether there are judicially enforceable limits on the governor's power to author the items of appropriation other than those set forth in the anti-rider clause, the plurality goes on to observe as follows: "On the other hand, to invite the Governor and the Legislature to resolve their disputes in the courtroom might produce neither executive budgeting nor legislative budgeting but judicial budgeting—arguably the worst of the three."[30]

However troubled the concurrence may be by the specter of judicial budgeting, it is more troubled by the plurality's agnosticism. Although the concurrence implicitly acknowledges that deciding the appeals did not require the court to resolve the question of whether the governor's constitutional power to author the items of appropriation is circumscribed by judicially enforceable limitations other than those stated in the anti-rider clause, it would resolve the question just the same. Specifically, the concurrence would exercise and thereby enhance the judicial power by imposing, i.e., authoring, additional limitations on the governor's power, thereby enhancing the legislature's power over the budget process. In its view, the "plurality's writing does not go far enough to describe where the line exists to protect the Legislature's lawmaking preeminence."[31] According to the concurrence,

> A proper resolution of these lawsuits requires a test, consisting of a number of factors, no single one of which is conclusive, to determine when an appropriation becomes unconstitutionally legislative. To begin with, anything that is more than incidentally legislative should not appear in an appropriation bill, as it impermissibly trenches on the Legislature's role. The factors we consider in determining whether an appropriation is impermissibly legislative include the effect on substantive law, the durational impact of the provision, and the history and custom of the budgetary process.[32]

The analysis of the concurrence is fatally flawed in numerous respects. Among them is that it simply assumes that the anti-rider clause does not describe the constitutional line. Why it regards the clause as insufficient is never discussed. Indeed, the only mention of it is a mistaken or confused one at the outset of the writing. The concurrences writes that "[t]he clause was designed to preserve the separation of powers,"[33] as if to suggest that the clause furthers the legislature's preeminence. In fact, as noted above, it originated as a check against the powers of the legislature over the budget process and thus protected the role of the governor in that process. Moreover, in its current form, the anti-rider clause also operates as a check against the legislature's power to author the items of appropriation in the one multi-purpose appropriation the framers permitted it to enact. Nor does the concurrence discuss how its multi-factor balancing test can be reconciled with the absence of support for it in the text of the Constitution or the court's precedents on justiciability, either those dealing with justiciability generally or those in the specific context of disputes over the budget process.

Although I will return to these flaws later, and in particular the latter, another flaw is that the concurrence does not discuss the following question: why is there any need for additional and judicially enforceable limitations on the governor's power to author the items of appropriation? Suppose a governor proposes an item of appropriation that is too legislative, i.e., "unconstitutionally legislative," even though each provision of the item specifically relates to the appropriation and is limited in its operation to the appropriation. If a majority of both houses of the legislature approves the item, its subsequent judicial invalidation would undercut rather than protect what the balancing test is designed to protect, the "Legislature's lawmaking preeminence."[34] Moreover, to the extent that the minority opposing the item coalesces around political party lines, permitting the minority to challenge the appropriation in court would empower the minority and give it a basis for seeking concessions (such as member items) from the majority and the governor in return for dropping its opposition.

If a majority of both houses disapproves of the item on public policy grounds or for any other reason, it is free to exercise its absolute power to strike the item and force the governor to negotiate. In that situation, judicial invalidation of the provision can be justified only if that absolute power is not sufficient to protect the legislature. Although I will have more to say on the subject momentarily, suffice it to say for now that its insufficiency is hardly obvious.

That leaves situations in which a majority in one house approves of the item and a majority in the other house disapproves.[35] To permit the minority in the house that approves the item to challenge the provision in court undercuts the preeminence of the majority in that house. To permit the majority in the house that disapproves the provision so to challenge it makes no sense unless the absolute power of that house to strike the appropriation is not sufficient to protect its preeminence.

Is that power to strike insufficient so that it makes sense to permit a judicial challenge by the legislature, when both houses disapprove, or by the house that disapproves, when only one disapproves? The first point to be made is that any benefit to the legislature would not come without costs to the public. The inherent vagueness of the balancing test would stand as a virtual invitation to the legislature to seek judicial intercession and thereby avoid the hard work of negotiations with the governor. The judiciary would pay a price, too, because its stature as the neutral guardian of the rule of law could not be unaffected as it both became enmeshed in disputes that necessarily would be politically charged and issued decisions that must be ad hoc in character due to the vagueness of the balancing test.

The latter point comes into focus by considering what must be true of any provision that would be invalidated by the balancing test but not the anti-rider clause. That is, it affects spending of the item to which it specifically relates and does not apply more broadly. The extent of the effects will be more or less substantial but the provision must implicate public policy considerations and the governor, accordingly, will be able to make a public case for it. To invalidate the provision because it "is more than incidentally legislative"[36] entails a judicial determination that its spending implications are too insubstantial.

The declaration of the provision's unconstitutionality would have an odd status. Suppose that after it is invalidated, its merits and demerits are an issue in the next ensuing general election. If the provision is supported by a majority of both houses and the governor accedes to the requests of the members or the leaders for its inclusion in the budget, it would be incoherent to invalidate it anew on the ground that it is inconsistent with the "Legislature's lawmaking preeminence." But if the provision would not be invalidated under these changed circumstances, it follows that the initial judicial declaration of its invalidity would be provisional. Of course, even if the views of the legislature did not change, changing socioeconomic considerations could increase the fiscal effects of the provision. Presumably, the governor would be free to include the provision in a subsequent budget and enmesh the judiciary in arguments over whether the increased effects were significant.

That said, judicial invalidation by the Court of Appeals, if not a lower court, would give the legislature or the objecting house a leg up in subsequent negotiations with the governor, as the governor could not continue to insist on the ostensibly too legislative provision consistently with his or her duty to abide a final judgment of New York's highest court. But, and this is one of the critical points invalidating any effort to discover in the Constitution unstated and judicially enforceable limitations on the governor's power to author the items of appropriation, neither the legislature nor the objecting house is entitled to that advantage. Precluding the governor from insisting on such a provision would put the governor in an inferior position compared to the position of both New York's Governor under legislative budgeting and governors of all other states with legislative budgeting. No case that I am aware of even suggests that in the course of or after vetoing an item of appropriation, the authority of a governor in a state with legislative budgeting is constrained by anything remotely like those that would be visited on New York's governor by the balancing test. Given the freedom of those governors, before and after vetoing a legislative appropriation, to insist on the inclusion of a provision that would flunk this balancing test, it is senseless to think that New York's governor cannot even *propose* such a provision at the outset of the budget process. After all, to the end of improving New York's prospects for fiscal prudence, the framers of executive budgeting strengthened the governor's authority.

Moreover, the point can be made more forcefully by focusing more specifically on what the framers did. Obviously, it is nonsensical to think that under legislative budgeting a particular provision in an appropriation bill could be challenged as "unconstitutionally legislative." Responding to the dismal history of financial excess and profligacy, the framers of executive budgeting took from the legislature the sweeping power it previously enjoyed, restrained only by the anti-rider clause, to author the items of appropriation. And they took this power, the instrument by which log rolling was inflicted upon the state, and transferred it to the governor. The analysis of the concurrences implicitly assumes something that is indefensible: that the framers intended to transfer *less* of that power to the governor. It is indefensible precisely because what the balancing test does is transfer back to the legislature a portion of the very power the framers took from it. The balancing test, in other words, undoes in significant part the "singular reversal" of the respective roles of the two branches that the framers were concerned to reverse. This brings us to another serious flaw in that analysis: it is inconsistent with established precepts governing the interpretation of constitutional and statutory texts. The anti-rider clause specifies two and only two limitations on what may be included in the items of appropriation. Under the maxim *expressio unius est exclusio alterius*, additional limitations should not be read into the text,[37] particularly when two or more terms or things have been expressed that go hand in hand and "support[] a sensible inference that the term left out must have been meant to be excluded."[38] At bottom, acceptance of the balancing test would require us to accept as well that the framers of executive budgeting did not know what they were about when they did not specify limitations akin to those the concurrence would impose on the governor. Even putting aside that these framers and proponents of executive budgeting included many illustrious New Yorkers, we should not accept that—not only for the reasons already stated—but because "a written Constitution [is] an instrument framed deliberately and with care."[39]

Given space limitations, I will discuss more summarily related problems with the approach of the concurrence. First, it is at odds with the justiciability doctrine, a doctrine that is designed to protect separation of powers by preventing the judicial branch from interfering with the powers and prerogatives of the political branches. As the United States Supreme Court made plain in the seminal case of *Baker v. Carr*,[40] an agument that a dispute presents a nonjusticiable political question is most compelling when the dispute implicates a "textually demonstrable commitment of the issue to a coordinate political department; or a lack of judicially discoverable and manageable standards for resolving it."[41] Both considerations are present here. The power to author the items of appropriation is committed by the plain language of the constitutional text to the governor. As is clear from the amorphous character of the balancing test, there are no judicially discoverable and manageable standards for determining whether a provision of an item of appropriation that relates specifically to an item of appropriation and is limited in its operation to that appropriation is too "legislative." Indeed, in *Saxton v. Carey*, the New York Court of Appeals held that the question of whether items of appropriation submitted by the governor were sufficiently itemized was nonjusticiable.[42] A key factor in the rationale for that holding—"itemization is an accordion word"[43] with no concrete meaning—applies with equal force to the question of whether a provision within an item of appropriation is too legislative.

Moreover, as discussed above, because such a provision passes muster under the anti-rider clause, it necessarily is one that affects spending. Accordingly, judicial deference to the governor on this subject is due for the same reason given by the Court of Appeals for deferring to the legislature on budgetary matters: "deference to the Legislature—which possesses the constitutional authority to budget and appropriate—is necessary because it is in a far better position than the Judiciary to determine funding needs throughout the state and priorities for the allocation of the State's resources."[44] As the Court of Appeals emphasized in *Wein v. Carey* and reaffirmed last year, "[j]udicial intervention [in the budget process] may be invoked only in the narrowest of instances."[45] Disputes about whether a provision in an item of appropriation is too "legislative" should not be among them.

Second, and finally, one particular prong of the balancing test warrants comment. According to the concurrence,

> [i]n determining whether a budget item is or is not essentially an appropriation, we must look first to its effect on substantive law. The more an appropriation actively alters or impairs the State's statutes and decisional law, the more it is outside the Governor's budgetary domain.[46]

Again, it should be underscored that the balancing test would apply to provisions in items of appropriation that, because they satisfy the two restrictions of the anti-rider clause, affect the spending of state funds. Why should the validity of those provisions depend in any way on previously enacted laws that also affect spending? The legislature is not and never has been imprisoned by the decisions of prior legislatures. As the United States Supreme Court stated over a hundred years ago, "[e]very succeeding legislature possesses the same jurisdiction and power."[47] Given that the power to author the items of appropriation was transferred to the governor, it makes no sense to conclude that the governor should be imprisoned by the decisions of previous legislatures. Rather, given that the framers transferred this power to the governor to overcome a history of fiscal profligacy stemming from legislative budgeting, it is folly to conclude that the constitutionality of a provision in an item of appropriation submitted by the governor can turn on whether it "actively alters or impairs the State's statutes and decisional law."

Since *Pataki v. New York State Assembly* was decided, the spectre[48] of additional, judicially enforceable limitations on the governor's power to author items of appropriation has loomed over the Capitol. When the occasion arises, the judges of the Court of Appeals should assume a role that is not normally a judicial one: ghostbusters.

Endnotes

1. 824 N.E.2d 898 (N.Y. 2004).
2. Judge Robert Smith authored a plurality opinion joined by Judges Graffeo and Read; Judge Rosenblatt filed a concurring opinion, in which Judge G. B. Smith joined. *See Pataki*, 824 N.E.2d at 912–15.
3. Although not noted by either Judge Robert Smith or Judge Rosenblatt, in this latter respect the holding is consistent with a long line of cases. *See, e.g.*, People ex rel. Burby v. Howland, 49 N.E. 775, 778 (N.Y. 1898) ("[If the Legislature attempts to] evade the Constitution by effecting indirectly that which cannot be done directly, the act is to that extent void, because it violates the spirit of the fundamental law"). *See also* Doubleday, Doran & Co. v. R. H. Macy & Co., 199 N.E. 400 (N.Y. 1936) (overruled in part by Bourjois Sales Corp. v. Dorfman, 7 N.E.2d 30 (N.Y 1937)); Diamond Asphalt Corp. v. Sander, 700 N.E.2d 1203, 1209–10 (N.Y. 1998).
4. *Pataki*, 824 N.E.2d at 908–09.
5. *Id.* at 915 (Kaye, C. J., dissenting).
6. *Id.* at 912.
7. *Id.* at 913 (Rosenblatt, J., concurring).
8. N.Y. State Constitutional Convention, Report of the Committee on State Finances, Revenues and Expenditures, Relative to a Budget System for the State, 8 (1915) [hereinafter Committee Report]; *see also id.* at 21 (under legislative budgeting, "financial legislation has been in danger of degenerating into a scramble for local favor and privilege").
9. *Id.*

10. *Id.* at 15.

11. Saxton v. Carey, 378 N.E.2d 95, 98 (N.Y. 1978).

12. N.Y. Const. art. VII, § 6.

13. *Id.* § 5.

14. Committee Report, *supra* note 8, at 12.

15. *See* Nixon v. Administrator of Gen. Servs., 433 U.S. 425, 443 (1977); Under 21 v. City of New York, 482 N.E.2d 1, 4–5 (N.Y. 1985).

16. The Federalist Papers, No. 66, at 429 (Alexander Hamilton) (Cosimo ed. 2006), *available at* http://www.foundingfathers.info/federalistpapers/fedi.htm.

17. *See* INS v. Chada, 462 U.S. 919, 947–48 (1983).

18. Laurence H. Tribe, American Constitutional Law 137 (3rd ed. 2000).

19. The Federalist Papers No. 73, at 477 (Alexander Hamilton) (Cosimo ed. 2006); *see also id.* No. 66 at 429–30 ("An absolute or qualified negative in the executive upon the acts of the legislative body, is admitted, by the ablest adepts in political science, to be an indispensable barrier against the encroachments of the latter upon the former….").

20. N.Y. Const. art. VII, § 6.

21. *Id.*

22. *See* Schuyler v. South Mall Constructors, 303 N.Y.S.2d 901, 903 (App. Div. 1969).

23. *Id.*; *see also* 1915 Opinion of the Attorney General 368 (N.Y.). Prior to the adoption of Section 22, the Legislature had gone so far as to include provisions creating new criminal offenses in appropriation bills. *See* 1894 N.Y. Constitutional Convention, Revised Rec., Vol. II, 599–600.

24. 1938 N.Y. Constitutional Convention Doc. No. 3, at 4–5.

25. *Pataki*, 824 N.E.2d at 907–08.

26. *Id.* Obviously, if such a provision purported to apply to construction projects generally, not only those funded by the appropriation, it would run afoul of the anti-rider clause.

27. *Id.*

28. Nor is it clear that under all conceivable circumstances such provisions should be so characterized. Suppose, for example, the governor inserted such a provision at the behest of the leaders or a majority of both houses of the legislature.

29. *Pataki*, 824 N.E.2d at 910–11. Although the plurality does not make the point, I would add that the prospect of such stalemate is the necessary consequence of a constitutional scheme in which no item of appropriation can be enacted without the approval of both political branches. Thus, this unattractive prospect is the price paid to avoid being confronted with the even more unattractive prospect of one branch having unilateral authority to enact items of appropriation.

30. *Id.*

31. *Pataki,* 824 N.E.2d at 912–13 (Rosenblatt, J., concurring).

32. *Id*. at 914 (Rosenblatt, J., concurring).

33. *Id*. at 913 (Rosenblatt, J., concurring).

34. I do not mean to suggest that I agree with the unstated premise of the concurrence that the "Legislature's lawmaking preeminence" was unaffected by the transfer of legislative powers to the governor affected by the adoption of executive budgeting. To the contrary, as discussed below, I think it untenable.

35. I will not discuss the possibility that a private party somehow has standing to sue to vindicate the "Legislature's lawmaking preeminence." *See* Soc'y of Plastics Indus. v. Cnty. of Suffolk, 573 N.E.2d 1034, 1041 (N.Y. 1991) (prudential limitation on standing requires that the in-fact injury of the plaintiff be within the "zone of interests" sought to be promoted or protected by the statute in question).

36. *Pataki*, 824 N.E.2d at 914 (Rosenblatt, J., concurring).

37. *See, e.g.*, TVA v. Hill, 437 U.S. 153, 188 (1978); *see also* Eaton v. N.Y.C. Conciliation & Appeals Bd., 56 437 N.E.2d 1115, 1117 (N.Y. 1982) ("Where as here the statute describes the particular situations to which it is to apply an irrefutable inference must be drawn that what is omitted or not included was intended to be omitted or excluded.") (internal quotation marks omitted).

38. Barnhart v. Peabody Coal Co., 537 U.S. 149, 168 (2003).

39. Matter of King v. Cuomo, 613 N.E.2d 950, 953 (N.Y. 1993).

40. 369 U.S. 186, 210 (1962) ("[t]he nonjusticiability of a political question is primarily a function of the separation of powers"); *see also* N.Y. State Inspection, Security & Law Enforcement Emps. v. Cuomo, 475 N.E.2d 90, 92 (N.Y. 1984).

41. *Baker*, 369 U.S. at 217.

42. *Saxton*, 378 N.E.2d 95, 96–97.

43. *Id*. at 98.

44. Maron v. Silver, 925 N.E.2d 899, 915 (N.Y. 2010).

45. 362 N.E.2d 587, 592 (N.Y. 1977); *see also Maron*, 925 N.E.2d at 915.

46. *Pataki*, 824 N.E.2d at 914 (Rosenblatt, J., concurring). The vagueness of the balancing test is further illustrated by the adverbs, like "actively," that are employed. *See also id.* (noting "anything that is more than *incidentally* legislative should not appear in an appropriation bill") (emphasis added).

47. Newton v. Comm'rs, 100 U.S. 548, 559 (1880).

48. *See Saxton*, 378 N.E.2d at 97 ("The power of the judiciary is as subject to such limitations as is that of its coordinate branches of government, for the spectre of judicial tyranny is no more palatable to a free people than is the threat of an uncontrolled executive or legislative branch.").

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New York State School Finance

By Shawn MacKinnon

Article XI of the New York State Constitution states, "The legislature shall provide for the maintenance and support of a system of free common schools, wherein all the children of this state may be educated."[1] That very powerful broad one sentence mandate has led to an annual statewide political discussion as to what is the appropriate level of funding and what is the appropriate school district distribution. What may appear to be a seemingly simplistic legislative task of distributing available state funding to support a system of "free common schools" has evolved into a hard fought complex "school aid" discourse that over time has become one of the more controversial multifaceted issues that annually dominates New York State politics. School aid began in 1795 with enactment of a law which authorized spending 20,000 pounds annually for five years to support schools.[2] The level of funding for school districts has grown to $20.9 billion which supports 676 public K–12 school districts.[3] Overall general support for public schools (GSPS) includes aid categories ranging from operating aid to school construction support as well as support for special education. School aid has seen the blending of politics, the courts and academia in the development of those formulas in that the current operating aid statute is based on a successful schools model developed by the New York State Education Department in relation to the *Campaign for Fiscal Equity v. The State of New York* court case. State education finance in New York reflects this blending in that the formulas incorporate a number of equalizing factors not likely considered by the drafters of the State Constitution. School aid in the State of New York now employs factors that attempt to address the variation in costs associated with educating the wide spectrum of students as well as regional cost differences that exist across the State. The 1,500 neighborhood schools funded by the 1795 law are now over 4,400 schools educating 2.8 million students statewide. Over time, great levels of spending have made state aid to schools one of the larger components of New York State expenditures. Expenditures on state aid as a share of the State's general fund budget amounts has fluctuated over time.

While there has been some fluctuation, school aid has historically been one of the largest components of New York State's General Fund spending. State Fiscal Year 1964–65 utilized 38 percent of tax revenues towards education local assistance.[4] In the 1999–00 State Fiscal Year 37 percent[5] of the state's general fund was devoted to education funding which dropped by the 2005–06 state fiscal year to 30 percent[6] of all general fund spending, and has increased in State Fiscal Year 2009–10 to 32.1 percent[7] of all general fund spending. The large portion of general fund spending devoted to schools is supplemented by dedicated lottery revenues. Of the $20.9 billion spent on schools during the 2010–11 school year, which includes $2.81 billion in dedicated lottery funds, its distribution is one of the more contentious issues in Albany. It is most commonly characterized as an upstate-downstate fight but in 2011, school aid has broadened beyond the historical regional fights to a more complex school aid distribution struggle waged between the high need large urban school districts, high need small urban districts, low wealth rural school districts, average need school districts and low need wealthier school districts.

School District Fiscal Capacity

While regional balance is always at issue, a developing internal regional struggle is largely a fight over what constitutes need. New York State's school finance system utilizes a number of different indices to determine need including a school district's property wealth per pupil as well as its income wealth per pupil. This index provides a measure of a school district's capacity to raise funds locally. School districts vary dramatically in their wealth per pupil which leads to substantial variation in per pupil spending throughout the state. In fact, higher expenditures per pupil are associated with higher actual property value per pupil. In 2008–09, the average actual valuation per pupil among the lowest wealth ten percent of districts was $150,811, while the average actual value per pupil among the highest wealth ten percent of districts was $2,522,632.[8] For this reason the legislature over time has sought to structure an education finance system that is wealth equalizing. The basic idea in a wealth equalizing formula is that low wealth school districts should receive more state aid than their wealthier counterparts because of their limited ability to raise revenues locally.

In looking at the state's highly progressive aid formulas, low-wealth districts receive more than three times the amount of aid per pupil than the highest wealth districts ($11,502 versus $3,084).[9] In determining each school district's relative wealth, a statewide property and income wealth index is calculated and an individual school district's property and income values are compared to the statewide averages. This makes up the components of the wealth factors used in school aid which are relative measures. The state utilizes a "combined wealth ratio" in determining aid which is a measure of district fiscal capacity based on income and actual valuation. This ratio is calculated by adding 50 percent of a school district's property wealth per pupil relative to the statewide average wealth per pupil to a school district's income wealth per pupil compared to the statewide average. This measure provides a relative comparison of a district's fiscal capacity to the rest of the State. A school district with a combined wealth ratio of 1.00 is an average wealth school district, comparatively speaking. In spite of the State's wealth equalizing formulas, total spending per pupil in lowest wealth districts is less than two-thirds of the spending per pupil in the highest wealth districts ($14,825 versus $23,536).[10] This is due, in large part, to the fact that the lowest wealth districts raise about one-tenth of the local revenue per pupil than the highest wealth districts do ($1,905 versus $19,122).[11] Because of the differences in fiscal capacity, the school districts with higher wealth tend to levy less tax but generate higher revenues. While the lowest wealth districts tax at a rate of $12.65 per $1,000 of full value to generate $1,905 per pupil, the highest wealth districts tax at a rate of only $7.62 per $1,000 to generate $19,122 per pupil. (*See* Table 1 on p. 22).[12] Despite the legislature's significant efforts to equalize resources there remains a tremendous divide among school districts and their fiscal resources available to support education. In 2008–09, operating expense per pupil ranged from $10,096 for the district at the 10th percentile to $19,001 for the district at the 90th percentile, a difference of almost 132 percent.[13] Disparities in spending are closely associated with disparities in property wealth because over half of the funds available for school districts to spend come from local property taxes. The disparities in fiscal resources are due primarily to the varying ability and willingness of school districts to generate local property tax revenue as well as the willingness of property taxpayers to support their local school budgets.

As in most states, property values of residences and businesses vary dramatically from school district to school district, as do local assessment practices, and the level of education services desired by the community. In short, a student's access to educational resources depends in large part on where he or she lives and the community's willingness to spend on education, which may raise concerns about the equity of student opportunities. Parenthetically, a school district may perceive itself as poor or wealthy based on current conditions of the school district, while the combined wealth ratio utilized in state aid is what the school district's wealth is relative to the rest of the state. In New York State public education funding comes from three sources: approximately five percent from federal sources, 46 percent from State formula aids and grants, and 49 percent from revenues raised locally.[14] Local property taxes constitute about 89 percent of local revenues. When property taxes are measured as a percentage of home value, the top ten counties in the nation are all in New York State.[15] New York already has the second highest combined state and local taxes in the nation and the highest local taxes in America as a percentage of personal income—79 percent above the national average.[16] The median 2008 U.S. property tax bill paid is $1,917 but in New York the median bill is $3,755, which is 96 percent higher than the national average.[17] Looking at property tax *amounts*, several New York counties—Westchester, Nassau, and Rockland—were among the top ten counties nationally in terms of property taxes paid on owner-occupied residences in 2007.[18] New York's highest personal income tax rate of 8.97 percent is higher than all but six other states. New York's combined state and local sales tax rate of 8.52 percent is higher than all but five other states.[19]

These sets of facts are important because the State of New York also ranks high nationally in per pupil spending. New York spent $17,173 per student for public education in 2007–08, more than any other state and 67% more than the U.S. average.[20] New York's spending went up 7.4% over the two years. New York's per-student spending was highest in 2006–07 too at $15,981 per student, and the national average was $9,666.[21] The State assumed a significant portion of this local tax burden through the implementation of the School Tax Relief (STAR) program in 1998.[22] For the 2008–09 fiscal year, STAR is estimated to account for about 19 percent of state revenues; other state aid for the public schools comes primarily from the State General Fund (approximately 70 percent) wherein the major revenue source is state taxes (e.g., income and sales) and the balance (approximately 11 percent) comes from a Special Revenue Fund account supported by lottery receipts.[23] All net revenues from the state lottery are statutorily earmarked for school aid. In addition, the General Fund guarantees the level of lottery funds appropriated for education, making up any shortfall in lottery revenues.[24] New York State's capacity to fund education has fluctuated over the years depending on state or national economic prosperity.[25] A review of longitudinal trend shows that state revenue has paralleled the State's economic climate. According to the State Education Department, in the 1970s the State provided relatively modest aid increases to schools caused in part by the economic adjustment to higher energy costs and inflation.[26] After the nation's economy rebounded, between 1983–84 and 1988–89, larger state aid increases were provided. Increases during that period averaged about 10.7 percent annually.[27] As a result, the State revenue portion of Total General and Special Aid Fund Expenditures rose to 44.2 percent for 1989–89. Due to a restructuring of the New York State Teachers' Retirement System (TRS) payments, this percentage declined to 41.6 percent for 1989–90.[28] Even with a $257 million giveback by local districts (1990–91 state aid to school districts was initially reduced $67 million due to restructuring of TRS and Employees' Retirement System payments and further reduced $190 million due to the December 1990 Deficit Reduction Assessment), the 1990–91 percentage rose to 42.9 percent.[29] As a result of the State's $6 billion budget deficit in 1991–92 and the imposition of $926 million deficit reduction assessments against school aid the proportionate share of public school expenditures funded from state sources declined to 40.4 percent.[30] The economic conditions of the state failed to improve in 1992–93 which resulted in continued reductions enacted within the budget. The 1992–93 school aid agreement resulted in a $1.03 billion deficit reduction assessment against school aid, continuing a decline in the state's share of total school expenditures to 39.1 percent. That declining trend continued in the 1993–94 school aid agreement causing the state's share of public school expenditures to continue to decline, to 38.0 percent, in 1993–94 with a -$167 million net transition adjustment. From that point state aid to school districts increased in small increments in the mid 1990s to large dramatic increases in the latter part of that decade. These increases in state revenue have resulted in the state's share of total expenditures rising nearly every year through 2001–02. The state's share of total expenditures peaked at 48.2 percent during the 2001–02 school year. State revenue increased only slightly from 2001–02 to 2002–03 resulting in a drop in the state's share of expenditures from 48.2 percent in 2001–02 to 45.5 percent in 2002–03. While state aid increased through 2006–07, schools experienced a decline in the state's share of expenditures. With the election of Eliot Spitzer to the Governor's office in November 2006 came a dramatic response to the *Campaign for Fiscal Equity v. State of New York.* The response came in the form of a foundation aid formula that utilized a successful schools model to determine a base cost for the education of children. Phase-in to a new foundation aid formula (replacing operating aid) began in 2007–08, providing districts with an increase of $1.1 billion and an increase in the state's share to 45.8 percent. The phase-in continued in 2008–09 with a $1.2 billion increase in foundation aid and an increase in the state's share to 46.8 percent, well above the 19-year average (1990–91 to 2008–09) of 43.4 percent.[31] The 2010–11 education funding enacted reduced spending to schools by $1.1 billion. However, federal funds from the American Recovery and Reinvestment Act were utilized to mitigate the impact of the reduction.

Commissions and the Courts

The politics of "school aid" is not found solely within the legislative or executive domain as it has been the subject of several education reform commissions and court cases such as *Levittown v. Nyquist*, and more recently *Campaign for Fiscal Equity v. State of New York*. These court cases along with several commissions associated with New York State's education finance system have dealt with issues of equity in funding and the demographic differences that arguably lead to disparate educational outcomes. Beginning with the Fleischmann Commission of 1969–72, criticism was levied against New York's school finance system which called for a complete state takeover of financing of public schools, to be supported by a statewide real property tax.[32] The commission, appointed by New York's Republican Governor Nelson Rockefeller and chaired by renowned lawyer Manly Fleischmann, spent nearly $1,000,000 worth of research, and ended up arguing strongly that poor schools must be brought up to the level of rich ones.[33] If property taxes are to be stabilized, then other taxes will have to go up substantially. The commission was charged with investigating the same kind of financial disparities that have troubled educational advocates in relation to their effect on academic outcomes. To even the tax burdens, the Fleischmann Commission proposed that New York become the first state in the nation to take over all the financial powers of its many local school boards.[34] According to the Commission's recommendations property taxes would be frozen at a flat rate of $20.40 per $1,000—which would yield the same overall amount as the prior year.[35] Once the state acquired these local tax revenues, according to the Fleischmann plan, it would redistribute the money so that the lower 65% of the state's school districts would rise to the spending levels of those that are now in the upper 35%.[36] The plan would not require wealthier school districts to "spend down" to poorer school districts but would have allowed them to keep spending at their current rates while the poor districts catch up. After that, however, the rich towns would be forbidden to raise more money by imposing additional taxes on themselves. "Allowing such variations, the Commission said, would only re-create the present inequitable system."[37] The Commission also recommended raising revenue through existing sales and income taxes. In most suburbs, which are already paying heavily for education, the Fleischmann recommendations would slightly lower property tax rates. But property taxes would go up in most cities, which must spend far more of their tax revenues on welfare, firemen and police than the suburbs do. A revised interim state aid formula was enacted in 1974, adding a second tier of compensatory aid for under-performing and handicapped students.

In 1978, a group of school districts filed *Levittown v. Nyquist*, to challenge the State of New York's education funding system. In *Levittown v. Nyquist,* the N.Y. Supreme Court declared that New York's entire school finance system was unconstitutional because it did not afford pupils equal protection under the law.[38] In a subsequent decision, the Court of Appeals—New York State's highest court—ruled that while substantial inequities in funding did exist, the state constitution does not require equal funding for education.[39] However, the court also held that the state's constitution guarantees students the right to the opportunity for a "sound basic education."[40] The Court of Appeals' reversal in 1982 deferred to the legislature's responsibility to finance public education as it exists with New York State's Constitution. New York's highly complex state aid system had remained largely untouched between *Levittown v. Nyquist*[41] and the more recent *Campaign for Fiscal Equity v. State of New York.* In 1993, the Campaign for Fiscal Equity (CFE) filed a constitutional challenge to the State of New York's school finance system, claiming that it underfunds New York City's public schools and denies its students their constitutional right to the opportunity to a sound basic education. In 2003, the Court of Appeals ruled in favor of CFE and ordered the State of New York to:

> (1) Ascertain the actual cost of providing a sound basic education in New York City

(Note: The decision and remedy specifically apply only to New York City);

(2) Reform the funding system to ensure that every school in New York City has the resources necessary to provide the opportunity for a sound basic education; and

(3) Put in place a system of accountability that will ensure the reforms adopted actually provide this opportunity.[42]

After a lengthy appeals process on November 20, 2006 the Court of Appeals, in a 4–2 decision in *Campaign for Fiscal Equity v. State of New York*, ruled that an additional $1.93 billion must be spent on operating expenses for New York City schools adjusted for inflation.[43] This ruling was important for two reasons. First, the Court of Appeals found that lower courts had erred in attempting to develop their own school aid formula and impose it on the state. The decision noted: "The roles of courts is not, as the [State] Supreme Court assumed, to determine the best way to calculate the cost of a sound basic education in New York City schools, but to determine whether the State's proposed calculation of that cost is rational."[44] Second, the court found that Governor Pataki's approach was rational and found that the Zarb Commission's[45] CFE numbers are the appropriate floor to provide the opportunity for a sound basic education.

Governor Pataki's CFE plan came out of the work of the Zarb Commission he established in 2003 after the original Court of Appeals ruling against the state.[46] The Zarb Commission contracted with Standard and Poor's Financial Services to determine the actual additional dollars needed to provide the opportunity for a sound basic education in New York City. Governor Pataki's proposal was advanced to the legislature in July 2004 during a Special Session and called for increasing school spending to New York City by $1.93 billion over four years. This translated into $2.5 billion when the approach was applied statewide. The Court of Appeals endorsed these figures as rational and set them as the minimum floor for additional school spending. The plaintiffs had been seeking increased state aid to New York City of $4.6 billion, which grew to $8.6 billion when their formula was applied statewide.

The Laws of 2007 reformed the state's method of allocating resources to school districts by consolidating some thirty existing aid programs into a new foundation aid formula that distributes funds to school districts based on the cost of providing an adequate education, adjusted to reflect regional costs and concentrations of pupils who need extra time and help in each district.[47] The foundation aid formula was structured in response to *Campaign for Fiscal Equity v. State of New York*.[48]

The court did not speak to how much progress the state made toward the $2.5 billion statewide figure. The Assistant Attorney General who argued the case on behalf of the state before the Court of Appeals in November 2006 stated to the court that New York City (total state and local funds) was about $1 billion towards closing the $1.93 billion spending gap. The state has provided additional operating funds beyond the consumer price index as well as $420 million in Sound Basic Education funding to provide New York City children with the opportunity for a sound basic education. The legislature in historic fashion came together and passed the Expanding our Children's Education and Learning (EXCEL) capital program.[49] The 2006–07 State Budget provided New York City with over $11 billion in additional capital funding from state and local sources.[50] Additional funding for school districts outside of New York City was provided on a per capita basis so that all school districts can meet their unique capital needs. The $11.2 billion in additional capital funding (over 5 years) for New York City is consistent with what was recommended by the Appellate Court in March 2006, as well as Judge DeGrasse's February 2005 order and CFE's request.

In addition to EXCEL, the legislature increased the bonding cap of the New York City Transitional Finance Authority (TFA) by $9.4 billion, which is to be used for school construction.[51] The legislature authorized New York City to utilize its building aid reimbursement as a pledge against the bonds sold through the TFA. The state expected to contribute approximately $4.7 billion in building aid to offset the local cost of the $9.4 billion TFA funded building program. Therefore, New York City school capital funding increased by $11.2 billion with the state contributing $6.5 billion of that total.

Governor Spitzer entered the fray in 2007–08 by going beyond the court ordered increase, advancing a statewide multi-year school aid package that included a four-year plan that would spend $7 billion in additional aid by the 2010–11 school year.[52] Within that $7 billion, Spitzer's Executive Plan consolidated 30 school aid formulas into one foundation aid formula that was statutorily expected to grow by $5.5 billion over four years.[53] The remainder of the $7 billion in growth over four years can be found in reimbursable aids including school construction, transportation, BOCES, as well as pre-kindergarten funding.[54] The Executive Plan, the majority of which was accepted by the legislature, went well beyond the funding plan set by the court. The court order recommended an additional $1.93 billion in funding for New York City only. Governor Spitzer's plan over four years was expected to provide New York City with an infusion of over $5.4 billion in additional operating funds.[55] The $5.4 billion in additional funding had $3.2 billion coming from the state and $2.2 billion being provided by New York City consistent with their four-year city school funding plan.

State financing of schools since the foundation aid phase was enacted has been impacted by changing economic times. The State of New York no longer has the deep pockets to sustain a funding plan that spends an addition $3 billion in operating funds alone over the course of the next two years. While there has been significant change over time in how the state funds schools, what has not changed is the fact that the economy drives increases and in 2010–11 decreases in aid to education. School funding has evolved over time through various studies, commissions, court cases, and legislative battles with the executive branch over what constitutes fairness both on the per-pupil level and the regional level. Invariably it is a discussion and debate that has many political components which is why it dominates the annual Albany budget negotiations.

Endnotes

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27. *Id.*
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39. Levittown v. Nyquist, 439 N.E.2d 359 (N.Y. 1982).
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APPENDIX A

Total Aidable Pupil Units (TAPU): The pupil measure for Formula Operating Aid through the 2006-07 aid year. It includes combined adjusted ADA (weighted for half-day kindergarten), weighted pupils with special educational needs, weighted summer school pupils, dual enrollment pupils, and additional pupils weighted for secondary school. Aidable evening school pupils were included in TAPU through the 1984-85 school year. For Operating Aid from 1997-98 through 2006-07, one year older ADA, adjusted by an enrollment index, is used.

Total Aidable Pupil Units for Expense (TAPU for Expense): TAPU for Expense is used to compute the approved operating expense per pupil. This is the same definition as TAPU except it includes additional weightings for students with disabilities and does not use enrollment index-adjusted ADA.

Total Wealth Pupil Units (TWPU): TWPU is based upon the AADA of pupils resident in the district plus additional weightings for PSEN, students with disabilities and secondary school pupils.

TABLE 1

2008–09 Wealth, Expenditure, Revenue and Aid Data Ranked by Actual Valuation per TWPU Deciles for All Major Districts Excluding New York City

ACTUAL VALUATION/ TWPU*	AOE/TAPU for Expense**	Total Expenditures Per TAPU for Expense***	Actual Valuation Per TWPU	Income per TWPU	State Aid Per TAPU For Expense	Tax Revenue Per TAPU for Expenses	Tax Rate Per $1,000 Full Value	Enrollment 2008-09
1 poor	$10,096	$14,825	$150,811	$67,952	$11,502	$1,905	$12.65	207,672
2	$9,521	$13,342	$218,214	$88,702	$9,552	$3,303	$15.24	108,202
3	$9,786	$13,684	$258,222	$96,897	$8,935	$4,159	$16.19	114,410
4	$9,878	$13,582	$303,348	$111,295	$7,992	$4,869	$16.08	165,385
5	$10,746	$14,092	$378,391	$116,086	$7,919	$5,644	$14.98	202,027
6	$11,198	$14,698	$474,419	$137,743	$7,163	$6,929	$14.72	170,648
7	$12,348	$15,577	$611,006	$137,718	$6,837	$8,285	$13.69	266,757
8	$13,450	$16,767	$802,176	$184,370	$5,922	$10,184	$12.82	241,728
9	$15,606	$19,280	$1,141,242	$248,313	$4,374	$14,100	$12.42	183,095
10 wealthy	$19,001	$23,536	$2,522,632	$484,295	$3,084	$19,122	$7.62	92,537
NYC	$12,100	$15,983	$569,726	$203,198	$7,539	$6,471	$11.43	1,035,819

Source: THE STATE EDUCATION DEP'T FISCAL ANALYSIS AND RESEARCH UNIT, ANALYSIS OF SCHOOL FINANCES IN NEW YORK STATE SCHOOL DISTRICTS 2008–09, at 17 (2009).

*TWPU: see Appendix A.

**AOE/TAPU for expense: see Appendix A.

*** TAPU for expense: see Appendix A.

Table 2

Total Revenues, Elementary and Secondary Education
New York State Public School Districts

1990–91 to 2009–10 (thousands)

School year	Total General Fund Expenditure	State Revenue		Federal Revenue		Local Revenue	
		Amount	Percent of Total Revenues	Amount	Percent of Total Revenues	Amount	Percent of Total Revenues
2009-10	$56,323,309	$23,500,000	41.7	$4,400,000	7.8	$28,423,309	50.5
2008-09	$55,056,998	$25,309,746	46.0	$2,614,226	4.7	$27,133,026	49.3
2007-08	$52,293,190	$23,601,417	45.1	$2,587,422	4.9	$26,104,351	49.9
2006-07	$49,437,635	$21,593,657	43.7	$2,746,120	5.6	$25,097,858	50.8
2005-06	$46,437,635	$19,821,003	42.8	$2,837,247	6.1	$23,648,374	51.1
2004-05	$43,185,271	$18,725,271	43.4	$2,674,247	6.2	$21,785,776	50.4
2003-04	$40,151,547	$17,520,589	43.6	$2,593,597	6.5	$20,037,361	49.9
2002-03	$37,470,378	$17,179,094	45.8	$2,149,320	5.7	$18,141,964	48.4
2001-02	$35,179,401	$17,093,224	48.6	$1,771,551	5.0	$16,341,626	46.4
2000-01	$33,816,802	$15,728,255	46.5	$1,488,430	4.4	$16,600,117	49.1
1999-00	$31,197,395	$13,691,138	43.9	$1,429,909	4.6	$16,076,348	51.5
1998-99	$29,437,657	$12,538,457	42.6	$1,350,041	4.6	$15,549,159	52.8
1997-98	$27,363,011	$10,964,334	40.1	$1,095,722	4.0	$15,302,954	55.9
1996-97	$26,132,515	$10,401,326	39.8	$1,049,139	4.0	$14,682,050	56.2
1995-96	$25,408,873	$10,188,856	40.1	$1,134,569	4.5	$14,085,448	55.4
1994-95	$24,488,976	$9,832,201	40.1	$1,047,208	4.3	$13,609,567	55.6
1993-94	$23,497,040	$9,065,209	38.6	$1,086,491	4.6	$13,345,340	56.8
1992-93	$22,266,332	$8,817,919	39.6	$992,456	4.5	$12,455,957	55.9
1991-92	$21,247,060	$8,659,401	40.8	$879,886	4.1	$11,707,773	55.1
1990-91	$21,009,179	$8,982,872	42.8	$714,265	3.4	$11,312,042	53.8

Source: NYS Education Department.

CFE v. State of New York: Past, Present and Future

By Michael A. Rebell

In 2007, following the determination by the state's highest court in *Campaign for Fiscal Equity, Inc. v. State of New York*[1] that the existing state system for financing public education was unconstitutional, the legislature adopted far-reaching reforms to ensure all students their constitutional right to "the opportunity for a sound basic education." To reach this goal, it promised New York City's schools an increase of over $5 billion in operating aid, and schools in the rest of the state increases of approximately $4 billion, to be phased in over four years. Now, at the end of that four-year period, the promised increases have been stalled, and, with the legislature's acceptance of the bulk of the extensive reductions that Governor Andrew Cuomo proposed for next fiscal year, virtually all of the funding gains that New York City and other high need districts have achieved since 2007 will be wiped out.

Are the budgetary actions that the New York State Legislature has taken in recent years constitutional, in light of the *CFE* decisions? If not, are the state's school children entitled to full funding of the amounts promised in the 2007 budget act, or could another approach to constitutional compliance that responds to the realities of the state's current economic conditions pass constitutional muster? This article seeks to answer these questions and to inform public policy deliberations about current education funding issues in New York State. It begins with a short summary of the history of the *CFE* litigation and then discusses (1) the courts' specific findings and holdings regarding budget issues, and (2) the extent to which the state's actions since 2009 violate constitutional requirements as set forth in the court decisions. In the final section, I offer some recommendations about how the continuing constitutional right of all children in New York State to a sound basic education can best be implemented in light of current economic realities in New York State.

I. The CFE Litigation: An Overview

In 1993, the Campaign for Fiscal Equity (CFE) filed a constitutional challenge to New York State's school funding system. It alleged that the state's school finance system under-funded New York City's public schools and denied its students their constitutional right to the opportunity to a sound basic education. CFE's membership consisted of most of New York City's education advocacy organizations, parent organizations, and about half of the city's community school boards. The litigation was not finally terminated until November 2006.

Plaintiffs won a significant initial victory in 1995 when New York's highest court, the Court of Appeals, denied the state's motion to dismiss by distinguishing a prior New York State equity case, and allowed the case to proceed to trial.[2] The lengthy seven-month trial resulted in a strong victory for the plaintiffs, as the judge defined the students' right to a "sound basic education" as involving the skills students need to be capable citizens and competitive workers in the global economy, determined that the current educational system was not providing the opportunities for all students to obtain such skills and held that there was a significant causal link between the state education finance system and these deficiencies.[3] At the same time that it was preparing for this extensive trial, CFE mounted a major, statewide public engagement process to solicit public input on many of the issues that were being presented to the court and to build statewide support for an eventual remedy.

Then-Governor George E. Pataki appealed the decision. Although the intermediate appeals court upheld his position that the state constitution guarantees that schools provide the opportunity to learn at an eighth-grade skill level and found that the current funding system sufficiently allowed for this,[4] that ruling was promptly reversed by the Court of Appeals in 2003.[5] The high court, in a landmark 4–1 opinion, rejected the eighth-grade standard, finding that a "high school education is now all but indispensable" to prepare students for competitive employment and civic engagement.[6] It held that the constitution requires the state to provide all students the opportunity for "a meaningful high school education, one which prepares them to function productively as civic participants."[7] The court then issued a tripartite remedial order that required the state to (1) determine the actual cost of providing a sound basic education; (2) reform the current system of school funding and managing schools to ensure that all schools have the resources necessary to provide a sound basic education; and (3) ensure a system of accountability to measure whether the reforms actually provide the opportunity for a sound basic education.[8] The order gave the state thirteen months, until July 30, 2004, to implement this remedy.[9]

The state's failure to meet that deadline triggered a further round of compliance litigation. The trial court, based on a detailed evidentiary hearing conducted by three special referees, concluded that New York City schools needed an additional $5.63 billion in operating aid and $9.2 billion for facilities to provide their students their constitutional right to the opportunity for a sound basic education.[10] The legislature subsequently adopted a plan to provide the full amount of facilities funding but failed to agree on a plan for providing operating aid. On appeal, the Court of Appeals, in 2006, determined that the requisite "constitutional floor" for operating aid was approximately $2 billion, although in concurring and dissenting opinions, three of the six justices emphasized that the legislature was not limited to the constitutional minimum and indicated that it should give serious consideration to an increase of approximately $5 billion.[11]

Subsequently, in 2007, the legislature adopted a plan that would provide approximately $5.4 billion in increased operating aid for New York City's schools, and an additional $4 billion for schools in the rest of the state, to be phased in over four years, together with a "Contract for Excellence" accountability plan. The 2007 budget bill also substantially revised the state aid system, combining about 30 previously separate funding streams into a foundation allocation that would provide about 70% of all state aid to local school districts.

After providing school districts almost all of the promised state aid increases pursuant to the new foundation budget system during the first two years of the four-year phase-in period, for FY 2010, the governor and the legislature deferred the scheduled third installment of the increase, and, for FY 2011, the governor and the legislature extended the deferral and, in addition, reduced basic foundation funding statewide by $740 million. For the coming fiscal year, the legislature has extended the basic freeze in the phase-in of the new formula and the scheduled aid increases, and, in addition, it has cut overall state aid for educational operations by an additional $1.5 billion (or 8.5%).

II. The Courts' Rulings on Budgetary Issues

CFE's complaint alleged that students in New York City received approximately $400 per student (or 12%) less in state education aid during the 1992–1993 school year than their "peers in the rest of the state," even though New York City enrolled at the time approximately 70% of the state's low income students, over 51% of the state's students with severe disabilities, and 81% of the state's pupils with limited English proficiency.[12] The thrust of the rest of the complaint, however, dealt not with the "equity" of funding for New York City in relation to amounts received by other school districts in New York State but rather with the substance of the education students were actually receiving in the classroom. In legal terms, the key issue raised by this approach was whether students were receiving "adequate" educational resources, or, more specifically, the opportunity for a "sound basic education" guaranteed to them under article XI, section 1 of the state constitution.

The "equity" versus "adequacy" distinction is important for a number of reasons. First, it provided the rationale for the Court of Appeals to distinguish a prior "equity" ruling[13] and permit this case to proceed to trial. Second, the adequacy approach focused attention on the quality of the education the students were receiving and allowed the plaintiffs to demonstrate how far the achievement levels of students in New York City were from the academic expectations spelled out in the state standards.

Third, the adequacy approach bolstered the remedy the court would issue to achieve constitutional compliance. Since a substantive concept of educational opportunity was constitutionally mandated, the state could not comply with constitutional requirements by equally "leveling down" educational funding for all school districts, as has happened in some other states.[14] It should be emphasized, however, that although "equity" *per se* is not a constitutional criterion, "need" is still a primary constitutional factor. In order to ensure that *all* students receive the constitutionally mandated sound basic education services, the Court of Appeals emphasized that "inputs should be calibrated to student need and hence that state aid should increase where need is high and local ability to pay is low."[15]

In remanding the case for trial in *CFE I*, the Court of Appeals directed the trial court, among other things, to determine whether students in New York City were receiving the opportunity for a sound basic education, and, if they were not, to determine whether there was a "causal link" between the inadequacy of the education being provided and the state funding system.[16] To answer the latter question, the trial court analyzed voluminous evidence regarding the workings of the state aid system. The trial court summarized its findings as follows:

> The State's school aid distribution system has for over a decade prevented the New York City public school system from receiving sufficient funds to provide its students with a sound basic education. As SED [the State Education Department], the Regents, and numerous State-appointed blue ribbon commissions have repeatedly reported to the State Legislature, the State aid distribution system does not provide adequate funding to all districts. As recently stated by SED: "resources are not aligned with need. Those schools with the greatest need frequently have the fewest fiscal resources.… The situation in New York City illustrates this point."
>
> The evidence demonstrates that the State aid distribution system is unnecessarily complex and opaque. It is purportedly based on an array of often conflicting formulas and grant categories that are understood by only a handful of people in State government. Even the State Commissioner of Education testified that he does not understand fully how the formulas interact.

> However, more important than the formulas' and grants' needless complexity is their malleability in practice. The evidence at trial demonstrated that the formulas do not operate neutrally to allocate school funds—at least with respect to annual increases in State aid. Rather the formulas are manipulated to conform to budget agreements reached by the Governor, the Speaker of the State Assembly, and the State Senate Majority Leader.[17]

In addition, the trial court alluded to a number of other specific deficiencies of the state aid system, including that (1) wealth equalization as calculated in the "combined wealth ratio" is undermined by the state's School Tax Relief Program (STAR) property tax rebate system, which systematically disadvantages New York City residents; (2) the wealth equalization system does not accurately reflect current district property wealth and residents' income; and (3) the system does not accurately reflect student need because the formulas and weightings "do not accurately account for the costs of education caused by large numbers of at risk students."[18]

The Court of Appeals did not discuss the workings of the state aid system in detail. It accepted the findings and conclusions of the trial court in general terms,[19] but in the course of its opinion it also emphasized several important cross-cutting themes that relate to budget issues. The first of these was that the state's arguments about New York City's failure to provide sufficient local funding and its allegations regarding the New York school system's operating inefficiencies were legally irrelevant because as a matter of law, compliance with constitutional sound basic education requirements is ultimately the state's responsibility.[20] Second, comparative analyses of New York's spending in relation to other cities and states are immaterial because the issue is not abstract levels of spending but whether students are receiving a sound basic education pursuant to New York State standards.[21] Finally, in discussing specifics of the changes in the current system that the state must put into effect, the high court stated that state aid calculations must take into account STAR property tax considerations[22] and emphasized that the share of state aid that that New York City—and by extension other school districts—receive must "bear a perceptible relation to the [students'] needs."[23]

III. New York State's Compliance with the Constitutional Requirements

Shortly after the *CFE III* decision was issued in 2006, a new governor, Eliot Spitzer, and a new legislature took office. Responding to the court's order, Governor Spitzer issued an executive budget that proposed a four-year "Educational Investment Plan" that would provide increases in state aid over four years of $3.2 billion for New York City[24] and $4 billion for the rest of the state. The core of the plan was the creation of a new foundation aid program, combining approximately thirty previously separate funding streams that would "ensure that each district receives sufficient State and local resources to meet State learning standards."[25] The base amount of foundation aid to be allocated to particular school districts would be calculated in accordance with the "successful school district" methodology that had been utilized by the state education department and the commission appointed by Governor Pataki in response to the Court of Appeals order in *CFE II*.[26] The base amount representing the amount actually needed to provide a sound basic education in a successful district would then be adjusted in the foundation formula for district enrollment, poverty rates, and cost of living factors.[27] New York City and other school districts receiving substantial increases under the plan would be required to implement new accountability measures and enter into a "Contract for Excellence" with the state.[28]

The legislature adopted virtually intact the Governor's plan in the State Budget and Reform Act of 2007.[29] The foundation amounts needed to provide all students in the state a sound basic education, based on the legislature's analysis of the actual costs of successful school districts, would require a total statewide appropriation increase of $5.5 billion. This increase was to be phased in over four years as follows: 20% in 2007–2008, 22.5% in 2008–2009, 27.5 % in 2009–2010, and the remaining 30% in 2010–2011.[30]

In 2007–2008, the governor and the legislature provided the 20% increase called for under the Act, and in 2008-2009 it provided a further significant increase, 17.5% (which was, however, a reduction from the original 22.5% commitment for that year). Thus, during the first two years of the phase-in period, foundation aid statewide was increased by approximately $2.1 billion, leaving a balance of $3.4 billion to be appropriated over the next two years.

For 2009–2010, the third year of the scheduled phase-in, the newly inaugurated governor, David Paterson, and the legislature failed to provide the level of funding called for under the statutory scheme. Instead, they modified the statute to freeze foundation funding at the prior year's level, thereby deferring the scheduled increases. They also pushed back the date for completing the phase-in of the promised *CFE* amounts for an additional three years.[31]

The 2010–2011 school year should have been the fourth and final year of the phase-in. However, for that year, the state further extended the freeze on foundation aid, and further deferred the date for fully funding the promised increases. In addition, through a "gap elimination adjustment," basic foundation funding for education was actually reduced by about $740 million for the 2010–2011 fiscal year. Although foundation aid was substantially reduced, the legislature at the same time allowed certain "expense-based aids" such as Building Aid, Transportation Aid, and Boards of Cooperative Educational Services

(BOCES) Aid to increase, resulting in a total net budgetary reduction of approximately $520 million.[32]

The budget that the governor and the legislature have now adopted for 2011-2012 continues the freeze on foundation aid for a third year and deepens the "gap elimination" cuts in operating aid to a total of $2.56 billion, with foundation aid, on average, absorbing about 80% of that cut.[33] These cuts will reduce state operating aid by 8.9%,[34] and, in addition, the governor is proposing that school districts be precluded from raising local property taxes by more than 2% without a super-majority vote of local taxpayers. The deferral of full funding for the promised *CFE* amounts would now be extended to 2016–2017, that is, five years from the beginning of the new fiscal year.

Both the freezing of foundation funding at the prior year's level and the substantial reductions in actual spending implemented through the "gap adjustment program" raise substantial constitutional questions. As a result of these budgetary actions, education funding last year, the fourth year of the promised four-year phase-in, fell far short of the level the legislature itself had determined in 2007 was necessary to meet constitutional sound basic education requirements. The major budget cuts that will be put into effect for next school year will obviously intensify these constitutional concerns. Although the total cut in state operating aid for next year will be 8.9% and the governor talks in terms of an approximately 2.5% reduction in total education spending in the state (by assuming that despite the local property tax cap he has proposed, local and federal funding amounts remain stable),[35] the decrease in foundation aid, which most directly corresponds to core constitutional services, is approximately $5.3 billion or 30% below the foundation amount that would have been in place if the scheduled phase-in of the *CFE* settlement increases had proceeded in accordance with the anticipated statutory timetable.[36]

Funding reductions of this magnitude clearly will jeopardize school districts' abilities to maintain essential services at constitutionally acceptable levels. In states that have experienced comparable cuts, schools have been closed for "furlough days," class sizes have been increased to unworkable levels, and vital services to disadvantaged students have been eliminated. The governor has argued that in this time of fiscal constraint extra efforts to eliminate unnecessary legal mandates, utilize all existing reserve funds, improve operating efficiencies, and reduce nonessential costs are in order, and that these efforts might allow schools to maintain core constitutional services at reduced appropriations levels. Arguably, the governor may be right, but from a constitutional point of view, he and the legislature have an obligation not merely to exhort school districts to "do more with less," but to demonstrate how constitutionally appropriate services can and will actually be maintained despite the budget cuts they are putting into effect.

In 2007, the legislature, after much deliberation, and after reviewing a number of extensive cost studies, specified the precise amount of increased funding that it considered necessary to eliminate the constitutional violations the court had found in New York City and to remedy similar constitutional violations in other high need school districts around the state. If under current economic conditions, the governor and the legislature now think that the constitutional requirements can be met with a lower level of funding, they have an obligation to specify that level and to demonstrate specifically how constitutional requirements can now be met with foundation appropriations that are 30% lower than they determined were necessary four years ago. Decreeing major state aid reductions to meet fiscal constraints simply is not sufficient to satisfy the requirements of Article XI, § 1 of the New York Constitution, especially when such cuts have a disproportionately negative impact on the poorest school districts with the greatest needs.

Maintaining on the books a commitment *someday* to fund education at the statutory levels that were adopted in 2007 is not an acceptable response to the constitutional mandates. Technically, the state has been in violation of the sound basic education requirements of Article XI, § 1 at least since the court issued its *CFE II* ruling in June 2003. Strictly speaking, the constitutional violation that was found in 2003 should have been remedied at once. The Court of Appeals held, however, that because the reforms needed to effectuate constitutional compliance "cannot be completed overnight," the state should be accorded approximately a one-year grace period to determine the actual cost of a sound basic education and to implement the necessary funding and accountability reforms.[37] The Court of Appeals further accepted the trial court's recommendation that a four-year phase-in period be allowed for achieving full constitutional compliance.[38] Once the phase-in of a constitutional remedy began in 2007–2008, the progress that began toward compliance needed to be maintained for the students' constitutional right to the opportunity for a sound basic education to be respected. There is a strong presumption of impermissibility of any retrogressive measures taken in relation to complying with a constitutional right.

In light of the judicial specification of a four-year phase-in period, there is no legal justification for the attempt to lengthen the phase-in period called for by the court's order. These delays are, in essence, saying to children currently in inadequate schools that their constitutional rights do not matter and the impact of insufficient educational opportunities on their futures can be written off. Arguably, a court might approve some slight adjustment of the phase-in process upon a showing that "efficient planning" required a bit more time, but neither the legislature, Governor Paterson in the past nor Governor Cuomo at the present time has offered any educational or administrative justification whatsoever for postponing the phase-in for three years or now for five years. In fact, this delay is so extensive that it is, in essence, a euphemistic way of saying that these funding increases will never actually be realized. Budget constraints, the actual reason for the deferral here, are not a constitutionally acceptable excuse for delaying the implementation of students' right to the opportunity for a sound basic education,[39] especially when at least part of the reason that state deficits are so large is that, for the past four decades, tax cuts have often been adopted irresponsibly and without regard for the state's future obligations to maintain educational services.

In short, the governor and the legislature have thus far not met their constitutional burden of proof to show that students throughout the state can be provided the opportunity for a sound basic education at the current and proposed funding levels. This burden of proof is especially heavy in a state like New York where the highest court has specifically ruled that (1) all students in the state have a constitutional right to a sound basic education, (2) the *state* is responsible for ensuring that each school district is in fact providing such an opportunity; and (3) that hundreds of thousands of public school students in New York City were in fact being denied their constitutional rights.

The governor has claimed in very general terms that the costs of providing necessary educational services can be reduced through mandate relief measures and by providing incentives for school districts to undertake management efficiencies. At this point, however, he has provided no specifics concerning what these mandate relief items or management efficiencies might be and how many dollars might actually be saved through these measures. To be in compliance with constitutional requirements, the governor and the legislature need to do much more. They need to demonstrate affirmatively and with specificity how the appropriations they are providing will, in fact, be sufficient to provide school districts throughout the state—and especially New York City and other high need districts—with a level of services sufficient to meet the constitutional mandate.

IV. Recommendations for Constitutional Compliance

When the new school year begins on July 1, 2012, New York State's education funding system will be in violation of Art. XI, Section 1 of the state constitution. State statutes continue to affirm that the full foundation amounts the legislature adopted in 2007 are needed to provide all students the opportunity for a sound basic education, but because of budget deficits, they have decided to postpone constitutional compliance. This is clearly constitutionally unacceptable—unless the state can show that a sound basic education can, in fact, be provided at these reduced funding levels, which thus far it has not even attempted to do. As the Court of Appeals held in *CFE III*, when constitutional compliance is at issue, the state has a responsibility to show that its budget provides a reasonable "estimate of the cost of providing a sound basic education."[40]

Although I believe that taxpayers, and especially those in the higher income brackets, can and should be expected to do more to meet the state's obligation to its school children, I also accept the fact that the changed economic climate may require a reconsideration of the amounts that the legislature determined were necessary to provide a sound basic education in 2007. But if these funding levels are to be modified, the state must do so in accordance with the constitutional principles that the Court of Appeals articulated in *CFE*, which clearly remain in effect. Under those principles, the state has a continuing obligation to ensure that its education funding system (1) provides a funding level that reflects the actual cost of providing a sound basic education; (2) utilizes a foundation funding mechanism that ensures that state aid reflects school district needs. In addition, the state must create and implement an accountability system that (3) ensures that school districts actually use the funds effectively to provide all students a meaningful opportunity for a sound basic education.

A. Adequate Funding Level for Sound Basic Education

Assuming that the state is no longer committed to providing the full amount of funding promised in the 2007 budget act, it should abjure the fiction that it will meet those appropriation targets by some mythical date in the future, and, instead, establish a valid set of procedures for determining the amount of state and local funding that will be needed to meet constitutional requirements under current conditions, and on a stable basis for the years to come. The specific steps that the state would need to undertake in order to do so would include:

1. Identifying in operational terms the resources and procedures needed to provide all students the opportunity for a sound basic education.
2. Identifying cost-efficient and cost-effective mechanisms for providing those services (including specific methods for restructuring the delivery of educational services, or particular managerial and operational efficiencies, and/or specific statutory, regulatory or contractual provisions that can be modified to provide "mandate relief").
3. Undertaking a cost analysis[41] to determine for the current year, and projecting for the next three years, the actual, efficient cost (including appropriate regional cost adjustments and extra weightings for low income students, students with disabilities and English language learners) for each school district to provide its students the opportunity for a sound basic education.

B. Equitable Foundation Formula

The Court of Appeals has specified that the current system of financing New York's schools must be reformed to "address the shortcoming of the present system" to ensure that "every school" has the resources necessary to provide the opportunity for a sound basic education. The changes in the state education finance system the legislature adopted in 2007 would have moved the state substantially toward the kind of equitable state aid system that could meet these requirements. The manner in which the budget reductions were effected over the past three years have, however, actually moved the state further from meeting the implicit equity requirements of the *CFE* decree.

Freezing basic foundation aid, while allowing expense aids like transportation and building aid to continue to increase, places a disproportionate burden on high need districts that benefit much more substantially from foundation aid than do more affluent districts. Moreover, even though methodology used to determine the gap adjustment amount for each school district favors high need districts, this beneficial adjustment is in many cases relatively inconsequential in relation to the much more significant fact that high need districts, which tend to have low tax bases and have less ability to raise funds locally, depend much more extensively on state aid for their basic operating funds than do average or low need school districts.[42]

To accomplish the necessary reforms at the present time, the state needs to:

1. Create a true foundation formula by including all educational appropriations needed to provide a sound basic education in the foundation allocation.
2. Ensure that every school district receives an amount of state aid and an amount of *guaranteed* local funding[43] that is sufficient to provide the total foundation funding identified in the cost analysis as being necessary to provide all students in that district the opportunity for a sound basic education.
3. Guarantee that funding is provided on a sustained and stable basis that promotes effective programming and efficient operations.

C. Monitoring and Accountability

In order to ensure that local school districts actually provide sufficient resources to each of their schools and that these funds are used in an effective manner, the legislature, as the entity entrusted with the constitutional responsibility to "establish and maintain" a system that ensures that all students are provided the opportunity for a sound basic education, must

1. Develop an accountability system that will ensure that each school district actually provides all of its students the opportunity for a sound basic education. This means that the state needs to "establish and maintain," through the State Education Department or otherwise, systems that ensure that funds are used efficiently and effectively at the local school level to provide all students the opportunity for a sound basic education. This will require monitoring and evaluating:
   a. Program quality;
   b. Equitable distribution of resources;
   c. Efficient use of resources.

Endnotes

1. Campaign for Fiscal Equity, Inc. v. State, 861 N.E.2d 50 (N.Y. 2006) (hereinafter *CFE III*).
2. Campaign for Fiscal Equity, Inc. v. State, 655 N.E.2d 661, 665–66 (N.Y. 1995) (hereinafter *CFE I*).
3. Campaign for Fiscal Equity, Inc. v. State, 719 N.Y.S.2d 475, 485–87 (Sup. Ct. N.Y. Cnty. 2001) (hereinafter *CFE Trial Court Decision*).
4. Campaign for Fiscal Equity, Inc. v. State, 744 N.Y.S.2d 130, 138–39, 144 (App. Div. 2002).
5. Campaign for Fiscal Equity, Inc. v. State, 801 N.E.2d 326, 349–50 (N.Y. 2003) (hereinafter *CFE II*).
6. *Id.* at 363 (Graffeo, J., taking no part in the decision).
7. *Id.* at 332.
8. *Id.* at 348.
9. *Id.* at 349.
10. Campaign for Fiscal Equity v. State, No. 0111070/1070, 2005 WL 5643844 (Sup. Ct. N.Y. Cnty. Feb. 14, 2005).
11. *CFE III*, 861 N.E.2d 50 (N.Y. 2006).
12. Complaint at ¶¶ 29, 31, Campaign for Fiscal Equity, Inc. v. State, 616 N.Y.S.2d 851 (Sup. Ct. N.Y. County 1994) (No. 93/111070).
13. Levittown v. Nyquist, 439 N.E.2d 359, 369–70 (N.Y. 1982) (holding that New York State's education finance system does not violate the equal protection clause of the state constitution).
14. *E.g.*, Serrano v. Priest, 569 P.2d 1303, 1307 n.6 (Cal. 1977) ("The equal-protection-of-the-laws provisions of the California Constitution mandate nothing less than that all such persons shall be treated alike. If such uniformity of treatment were to result in all children being provided a low-quality educational program, or even clearly a clearly *inadequate* educational program, the California Constitution would be satisfied.").
15. *CFE II*, 801 N.E.2d 326, 348 (N.Y. 2003). Note also that under an "adequacy" approach, no absolute dollar amounts are constitutionally guaranteed—but meaningful levels of educational services are.
16. *CFE I*, 655 N.E.2d at 667.
17. *CFE Trial Court Decision*, 719 N.Y.S.2d 475, 529–30 (Sup. Ct. N.Y. Cnty. 2001).
18. *Id.* at 531–33.
19. *CFE II*, 801 N.E.2d at 329.
20. *Id.* at 342–44.
21. *Id.* at 341–42.
22. *Id.* at 346.
23. *Id.* at 348.

24. New York City would be obligated to provide an additional $2.2 billion in local funds for education over the four-year period.

25. N.Y. State Div. of the Budget, Investing in Education Reform (2007), *available at* http://www.budget.state.ny.us/pubs/archive/fy0708archive/fy0708littlebook/Education.html.

26. *Id.*

27. *Id.*

28. *Id.*

29. The Act provided for a foundation aid formula that "shall reflect the average per pupil cost of general education instruction in successful school districts, as determined by a statistical analysis of the costs of special education and general education in successful school districts [adjusted for inflation factors]." N.Y. Educ. Law § 3602(4)(a)(1) (McKinney 2009).

30. *Id.* § 3602(4)(b)(2).

31. *See id.* Governor Paterson had originally proposed cutting educational funding by $1.1 billion. Availability of federal stimulus aid allowed the state to avoid that actual dollar reduction. The state used approximately 50% of the total federal education stabilization funding allocated for K-12 education for this purpose.

32. The "Gap Elimination Adjustment" for 2010–2011 was actually $2.1 billion, but this was offset by the use of the remaining $726 million in federal aid available under the federal stimulus act, and an additional $600 million from the federal jobs bill that was adopted later in the fiscal year. In addition to Foundation Aid, funding for certain other smaller budgetary categories was reduced, such as Teacher Centers (reduced $25 million), and Schools under Registration Review ($2 million reduction).

33. N.Y. State Educ. Dep't, 2011-12 State Aid Projections, Run No. SA111-2 (2011). *See also* N.Y. State Div. of the Budget, Description of 2011-2012 Executive Budget Recommendations for Elementary and Secondary Education 2 (2011), *available at* http://publications.budget.state.ny.us/eBudget1112/fy1112localities/schoolaid/1112schoolaid.pdf. Although foundation aid has been cut substantially, the budget proposes increases for transportation, BOCES aid, pre-kindergarten and a few other categories. In addition, the legislature approved $500 million in new incentive grants for management efficiency and performance improvement; actual funding of this program was deferred until the state's 2012-2013 fiscal year begins on April 1, 2012, when the first $50 million of this money is now scheduled to be appropriated, but the apparent intent is to make the first awards before the end of the 2011–2012 school year. The state will receive $696 million in federal Race to the Top Funds that will be spent over the next four years; although these funds must be allocated for specific educational initiatives, they may be considered a partial offset to the proposed cuts.

34. This figure does not include building aid, for which there will be a 6.9% increase. If building aid (and a number of small categorical programs that generally are being funded at the previous year's levels) are included, the total cut is 6.6%.

35. N.Y. Div. of the Budget, 2011-2012 Executive Budget Briefing Book 20 (2011), *available at* http://publications.budget.state.ny.us/eBudget1112/fy1112littlebook/BriefingBook.pdf.

36. The total foundation funding amount projected for 2011–2012 assumed inflation adjustments of approximately 2.5% per year. The above figures are based on those projections and have not attempted to calculate actual inflation figures through 2011–2012.

37. *CFE II,* 801 N.E.2d at 348–49.

38. The four year phase-in period was originally proposed by the special referees appointed by the trial court to hear evidence on the state's compliance with the *CFE II* order. Campaign for Fiscal Equity, Inc. v. State, Reports and Recommendations of the Judicial Referees 4 (2004). This recommendation was explicitly adopted by the lower courts. Campaign for Fiscal Equity, Inc. v. State, 814 N.Y.S.2d 1, 13 (App. Div. 2006). The Court of Appeals did not specifically refer to the phase-in issue in its decision, but the final decretal paragraph of its *CFE III* decision affirmed the order of the Appellate Division, and provided that that order is "modified… in accordance with this opinion." 861N.E.2d 50, 61 (N.Y. 2006). Since "this opinion" said nothing about the phase-in period, the four-year phase-in requirement specified in the Appellate Division Order stands as an incorporated part of the final order of the Court of Appeals.

39. *See, e.g.,* Watson v. City of Memphis, 373 U.S. 526, 537 (1963) ("vindication of conceded constitutional rights cannot be made dependent upon any theory that it is less expensive to deny than to afford them"); Rose v. Council for Better Educ., 790 S.W. 2d 186, 208 (Ky. 1989) (the "financial burden entailed in meeting… [constitutionally mandated education adequacy provisions] in no way lessens the constitutional duty"; Klostermann v. Cuomo, 463 N.E.2d 588, 594 (N.Y. 1984) (failure to provide suitable treatment to mental health patients could not be "justified by lack of staff or facilities"); Hurrell-Harring v. State, 930 N.E2d 217, 227 (N.Y. 2010) (although upholding sixth Amendment claim to right to effective counsel might "necessitate the appropriation of funds and perhaps, particularly in a time of scarcity, some reordering of legislative priorities," this did not relieve the court of its "essential obligation to provide a remedy for violation of a fundamental constitutional right.") .

40. *CFE III,* 861 N.E.2d at 59.

41. Because the "successful school district" methodology currently used by the state does not identify a specific range of sound basic education services or specific efficient methods for providing them, the state probably will have to adopt one or more of the professionally accepted alternative methodologies, or devise a new methodology for determining the actual cost of a sound basic education.

42. The State Education Department has also specifically highlighted this point: "Experience has shown that when State Aid is frozen, there are inequitable consequences that have a disproportionate negative effect on high need school districts. These districts' resources are farthest from adequate and have a larger portion of their budget dependent on State Aid. The freeze affects a greater share of their budgets than districts that are less dependent on State Aid …." N.Y. Educ. Dep't, New York State Regents, Proposal on State Aid to School Districts for School Year 2010-11, at 10 (2009), *available at* http://www.p12.nysed.gov/stateaidworkgroup/2010-11RSAP/RSAP1011final.pdf.

43. Currently, the calculation of foundation amounts for school districts provides for an "expected" but not a required or guaranteed minimum local contribution. N.Y. Educ. Law § 3602(4)(a) (McKinney 2009). The proposed 2% cap on local property taxes may impede the ability of many school districts to provide the requisite amount of local funding.

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Changing the Terms of New York State's Budget Conversation

By Richard Ravitch

In July of 2009, Governor David Paterson appointed me to the post of New York Lieutenant Governor in response to what he called a "crisis of governance" in the state. The most visible part of the crisis was the 31-31 party split that had paralyzed the New York State Senate for more than a month. The deeper crisis was the state's inability to face its growing budget gaps and the troubled budget system that had produced them. Governor Paterson asked me to devise a plan to address the gaps and recommend changes to the state's budget process. In March, 2010, I submitted a plan to eliminate the state's structural deficits and prevent such deficits from recurring in the future.

The plan was not adopted. But over the course of that year, it became unavoidably clear that the state's existing budget practices and assumptions were not sustainable. A fundamental change occurred in the public conversation about the budget, culminating in the election of a new governor, Andrew Cuomo, on a platform promising budget cuts. The governor's first budget is a serious attempt to deliver on this promise. At the time of this writing we do not yet know the details of the budget as it will be enacted. What remains to be seen is whether New York can and will make the changes needed to begin a process of sustainable budgeting and investment in the state's future.

The Nature of the Problem

At the beginning of 2010, the New York State Division of the Budget estimated that the state's spending would grow over the following four years at an average annual rate of 7.5 percent. In contrast, the state's revenues would grow over the same period at an average rate of only 3.6 percent. The historical picture was just as discouraging: Over the 10 years from State Fiscal Years 1997-98 to 2007-08, the state's spending grew at a rate that was 20 percent more than its revenue growth.

These figures reflect, in part, revenue declines caused by the recession and the subsequent disappearance of federal stimulus aid. However, it is also true that for at least a decade New York has had a chronic and growing structural budget imbalance. That is, spending growth has exceeded the underlying growth in recurring revenues, even in periods of relative prosperity.

For State Fiscal Year 2010-11, the Executive Budget stated a deficit of \$8.2 billion. This number would have been even larger without almost \$10 billion in temporary revenue items such as tax increases and federal stimulus money. With these items removed, the gap totaled around \$18 billion. After the budget was submitted, the projected gap widened by an additional \$1 billion. Economist Carol O'Cleireacain estimated that somewhere between \$5 billion and \$5.5 billion of the gap represented recession-related revenue declines and spending increases. These factors could be expected to abate with economic recovery. But the remaining gap—the amount that would remain even with a recovery—amounted to more than \$13 billion. This was the size of the state's structural budget imbalance.

The structural imbalance would lead to growing future deficits. The Division of the Budget projected these gaps at \$5.4 billion in 2011-12, \$10.7 billion in 2012-13, and \$12.4 billion in 2013-14. Robert Ward of the Rockefeller Institute calculated that closing gaps of this size would entail tax and fee increases of 15 to 25 percent, or spending cuts of an unprecedented 15 percent.

Just as disturbing as the size of the gaps was what I gradually discovered about the ways in which the state's budgeting practices had enabled it to avoid facing the gaps.

New York, like most states in varying degrees, uses cash budgeting. This means that it can balance its budget in a technical sense by not paying expenses in the year in which they arise or by accelerating future revenues into the present year. In addition, though state law requires the enactment of a balanced budget for the General Fund, it does not require budget balance for other state funds—which account more fully a third of the state's expenditures. Cash budgeting allows the state to balance the General Fund budget in part by shifting cash into the General Fund and moving spending obligations into other state funds.

Cash budgeting has also allowed the state to make heavy use of "one-shots"—non-recurring revenues or expenditure cuts that may show up in one year or a few years only to disappear in future years. In the eight years prior to 2010, the state used more than \$20 billion in non-recurring revenues to make its budget numbers balance.

The State Comptroller would later call this combination of devices and strategies the "Deficit Shuffle."

It was clear by the time I took office, however, that the state is coming to the end of its ability to avoid the consequences of its structural budget imbalance. The pressures on state spending are accelerating, reflecting aging infrastructure, labor contracts, rising pension and health benefit obligations to state employees, and rising Medicaid costs, which are projected to increase twice as fast as gross domestic product over the next 10 years.

At the same time, New York's overall economic future is uncertain. In 1950, we had 10 percent of the nation's population; we are now at barely more than six percent. In the years preceding the recent recession, from 2000 to 2008, New York's population grew much more slowly than the national average; we ranked only 41st among the states in population growth rate. During the same years, New York was the state with the single highest amount of out-migration. A million and a half New Yorkers left for other states; Florida gained about a third of the out-migrants.

The structure of New York's economy, largely the downstate economy, has kept the state's per capita income relatively high. But our income growth, as the recent recession demonstrated, is subject to a great deal of volatility.

The Five-Year Plan to Address the New York State Budget Deficit

I concluded that New York could not solve its structural budget gap in a single year without unacceptably hurtful dislocations. Therefore, the plan that I submitted called for a multi-year planning process under which the state could achieve structural balance within five years. It began with a requirement that the governor submit to the legislature not just an annual budget, as is now required, but also a five-year plan to be adopted by the legislature.

The plan would project recurring state revenues and expenditures over five years, under current laws and explicit economic assumptions, and would identify the structural gaps that these numbers would produce. The initial plan would lay out options for policy initiatives to close the structural gaps over the course of the five years, calculating each year's savings net of any up-front costs needed to achieve the savings. The plan would allow one-shots and a limited amount of borrowing, but only to meet temporary costs and only as part of the process that would bring the budget into eventual balance on the basis of genuinely recurring revenues. The plan would be adjusted periodically within the year to take account of the inevitable intervening changes.

The planning process would differ from current budgeting practices in two major ways. First, it would aim at balance not just for the General Fund but for all non-federal-source state spending.

Second, the planning process would require the state to balance its budget according to Generally Accepted Accounting Principles (GAAP) as these principles are applied to governments by the Governmental Accounting Standards Board. In contrast with the state's current practices, which recognize "receipts" when funds are received and "disbursements" when funds are paid out, GAAP would require revenues to be recognized when they are actually earned and would require expenditures to be recognized when the associated liabilities are actually incurred.

Governments that use versions of GAAP, like New York City, make adjustments—such as special rules for the treatment of surpluses—to take account of their particular circumstances. GAAP is not a panacea; no accounting system, GAAP included, is immune to manipulation. But it is no accident that GAAP has become the standard for accurate financial reporting in both the private and public sectors. It can reasonably be expected that GAAP budgeting would improve the quality of financial data on which budget decisions are based and provide more accountability than the state's current system allows.

Ensuring Compliance with the Plan

The state's budgeting history gave little reason for confidence that a plan like the one I proposed would be self-enforcing. Therefore, the plan included mechanisms for producing compliance. One such mechanism was a Financial Review Board. Its members would be appointed by the governor and the legislature but would not be officers or employees of the state and would not have business with the state. Board members would be required to have general knowledge of the state's economic and financial conditions and expertise in fields such as budgeting, accounting, or finance.

The Board would *not* be a "control board" and would have no direct budgetary power. Instead, its function would be to receive the financial plan, as updated throughout the year, and issue a finding as to whether the plan was projected to achieve structural budget balance by the end of the fifth year or—after the fifth year—whether the plan was in structural balance.

If the Board found that the submitted plan was not projected to achieve or maintain balance, the Board would be required to inform the governor and the state legislature. If the governor and legislature did not agree on corrective action within 15 days, the governor would be empowered to make across-the-board reductions to the extent necessary to achieve or maintain balance.

The five-year plan provided an additional mechanism to ensure budgeting compliance. It allowed the state to engage in a limited amount of deficit borrowing in order to ease the five-year transition to structural budget balance—just as the Municipal Assistance Corporation, in the 1970s, was authorized to do transitional borrowing to give New York City time to bring its budgeting into compliance with GAAP. The state's transitional borrowing would be subject to restrictions. The term of the borrowing would be the shortest period practicable. The borrowing could not exceed $2 billion in any year. There would be no borrowing after the third year of the five-year plan. The borrowing would amount to no more than 10 percent of the state's five-year cumulative deficit (then projected at approximately $60 billion); the remaining 90 percent of the deficit-closing measures to reduce the structural gap would have to consist of spending reductions. No borrowing other than the transition borrowing could be used for the purpose of financing state operating deficits during the plan's first five years.

In addition, the transition bonds, and all other state-supported debt issued during the plan's first five years, would include a special covenant: The state would issue future state-supported debt only when the Board found that the state's most recently updated financial plan was projected to achieve or maintain budget balance.

Reforms Needed to Make the Plan Work

In addition to cash budgeting and the exclusive focus on General Fund budget balance, I concluded that other features of the state budgeting process were major obstacles to sustainable budget balance. One of them was the inadequate size of the state's reserve funds; our reserves fall far short of what experts on state finance generally recommend, which is 10 to 15 percent of revenues.

If the state were to move to GAAP accounting, reserves would be especially important. In fiscal terms, the state is largely a pass-through entity; it collects and redistributes revenues and reimbursements. Under GAAP, the state would have less room to put off paying its obligations; therefore, it would need reserves of a size that was to ensure against volatility in its revenues and reimbursements. In our present climate of budget constraint, it is not realistic to expect the state to make large additional contributions to its reserves; but, for the longer run, the state must determine an adequate level of reserves and the rules for their use and replenishment.

Another overarching issue is the state's peculiar fiscal year. Forty-six of the nation's 50 states currently budget on a fiscal year that begins on July 1. Changing the beginning of New York's fiscal year from its present April 1 to July 1 would address a number of problems in the current process. The state must currently engage in complex operations to manage the task of forecasting and budgeting for a fiscal year that begins on April 1 while the state's highly volatile income tax receipts do not appear until after April 15. If the state were to move to budgeting under GAAP as applied to governments, the problem would become still more pressing, because the state would be required to set aside adequate reserves to protect against possible inaccuracies in its revenue forecasts. Changing to a July 1 fiscal year would mitigate this problem by enabling the state to have its April 15 personal income tax receipts in hand when forecasting revenues for the coming year.

It is no small matter to change the starting date of a state fiscal year. Many localities and others that do business with the state are accustomed to the present state calendar. Further, changing to July 1 would require at least one fiscal year that does not consist of 12 months. In making my recommendation, however, I knew that New York State has professionals in the Division of the Budget and the Office of the State Comptroller who are more than competent to effect the change.

The last of the major reforms that I considered necessary to the five-year plan dealt with the deeper "crisis of governance." For years, prospects for rational budgeting in New York have been harmed by the mutual suspicion between the governor and the legislature over their respective budgeting powers.

New York governors have strong authority in the passage of budget legislation; in recent years, the legislature has complained about governors' taking advantage of this authority to insert substantive legislation into budget bills. On the other hand, New York Governors are unusually weak in their ability to make budgetary adjustments over the course of the year to keep the budget in balance. These features make co-operation between the two branches a matter of critical importance.

My plan gave the governor additional power, in the form of authority to make spending cuts if the governor and the legislature were unable to agree on corrective action in response to a finding by the Financial Review Board. I also recommended an accommodation to the legislature, by which the governor would agree not to insert language into executive branch appropriations bills that was more than incidentally legislative, while the legislature would be able to strike—though not amend or replace—language that was more than incidentally legislative.

The Five-Year Plan and 2010 Politics

The state's politics in 2010 were not hospitable to the five-year plan and its various attempts at balance.

Both the Office of Governor's Counsel and the New York Assembly began drafting bills based on the five-year plan. But Governor Paterson chose not to submit a bill or to negotiate with the legislature concerning any of the drafts.

Instead, the enacted 2010-11 budget relied on techniques similar to those the state had employed in the past.

The Division of the Budget estimated that the enacted budget had made use of only $600 million in non-recurring revenues; but the Budget Division arrived at that relatively low figure by counting any revenue as recurring if it promised to be available for more than one year. By contrast, the Office of the State Comptroller, counting revenues as non-recurring unless they are permanent, estimated that the 2010-11 budget includes several billion dollars in non-recurring revenues.

The state also used borrowing—but borrowing without the rules and accountability that constrained the borrowing in the five-year plan. For example, the state and its localities were allowed to spread their statutorily required contributions to the state pension plan over a longer period than was previously required. In effect, they were allowed to borrow from the pension plan in order to make the contributions to the pension plan that they were statutorily required to make. Similarly, the budget claimed a deficit reduction in the form of a reduction of certain corporate income tax credits—but committed the state to repay these amounts in three years.

But, underneath the conventional politics, the larger features of budget politics were changing, not only in New York but across the country. As the Center on Budget and Policy Priorities reports, 2012 is expected to be the states' most difficult budget year on record; so far, the states are projecting budget shortfalls of $125 billion. At the same time, federal stimulus money, which played a major role in propping up state budgets during the recession, is ending. The proposed state budgets that have been released for the next fiscal year include deep cuts to state services, on top of the cuts already made since the start of the recession.

New York politics has reflected this trend; the budget that Governor Cuomo has outlined for New York State recognizes the severity of the budget problem, rejecting formula-based spending increases and proposing substantial cuts in spending.

As of the date of this writing, we do not know what the budget will look like when enacted. In particular, we do not know how the budget's strategy of across-the-board cuts will affect the state's capacity to invest in its future.

A year ago, I wrote a piece for the *Albany Law Review* titled "Eating Your Seed Corn." It took its theme from the fact that farmers, after they harvest a year's crop of corn and before they sell or consume any of it, set aside part of it for the next year's planting. If a farmer fails to do so, he is, as the phrase goes, "eating his seed corn"—getting by in the short run, gambling on an upturn in his fortunes, and risking his long-term survival.

The seed corn of New York State and the United States as a whole is our physical and human infrastructure—our roads, bridges, mass transit, and water, as well as the system of higher education that maintains our human capital. The governor's current budget addresses part of the "seed corn" problem by finally facing the need to rein in unrestrained spending growth. But to deal with the issue of investment in the future, we will need a more searching examination of the balance between revenues and expenditures. The objectives of eliminating deficits, instituting a sensible budgeting process, and investing for the future will give rise to conflicts. The political system's responsibility to address these conflicts is compelling.

Richard Ravitch was appointed Lieutenant Governor by Governor David A. Paterson on July 8, 2009. Prior to his appointment, Lieutenant Governor Ravitch was a Partner in the law firm Ravitch, Rice & Co. and served as Chairman of the Commission on MTA Financing, which Governor Paterson formed to examine financing options for the MTA.

New York's Economy: From Stagnation to Decline

By Abraham M. Lackman

> *"He not busy being born is busy dying."*
>
> *—Bob Dylan, 1965*

Introduction

For at least the last decade, New York State's budget has been in a state of perpetual crisis. Revenues continually fall short of expectations and out-year deficits consistently total billions of dollars. The basic premise of this article is that these chronic deficits are the result of a state economy that continues to weaken compared to the economies of the nation and of key competitor states, particularly Texas.[1]

Since 2000, New York's economy—as measured by growth in private sector employment—has actually been in a state of **decline**. In aggregate, New York did not add a single new private sector job between 2000 and 2010; in fact, during this period, the state experienced a net decline of approximately 150,800 jobs. By comparison, the state of Texas' economy has been unusually vibrant; between 2000 and 2010, Texas added more than 600,000 new private sector jobs to its economy.

The contrast in job growth between New York and Texas over the past 60 years is stark. In 1950, New York's private sector employment accounted for nearly 14 percent of the national total; today the comparable figure is 6.5 percent. Chart 1 traces private sector job growth in New York and Texas over the past 60 years.

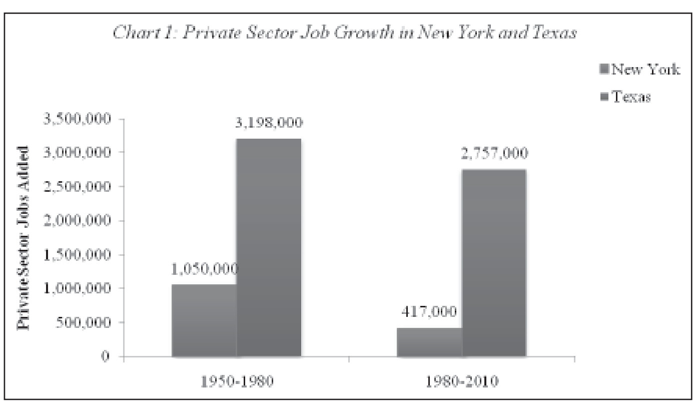

Chart 1: Private Sector Job Growth in New York and Texas

Population is another indicator of economic health. New York looks only slightly better by this light. While it lost population in the 1970s, since then it has added some—mostly foreign immigrants. However, on a relative basis, New York has shrunk—it now harbors six percent of the nation's population, compared with 10 percent in 1950.

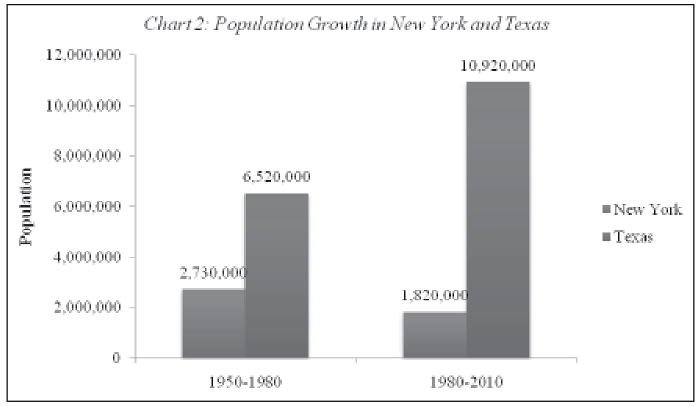

Chart 2: Population Growth in New York and Texas

A third key economic indicator is personal income growth. Again, the pattern over a 60-year span was one of relative decline. In 1950, New York accounted for approximately 12 percent of the nation's total personal income; by 2010, this figure had dropped to 7.6 percent. Chart 3 compares New York's personal income growth to that of Texas—a key competitor state. From 1950-1980, New York and Texas ran neck and neck; however, during the most recent 30-year period (1980-2010), Texas easily surpassed New York.

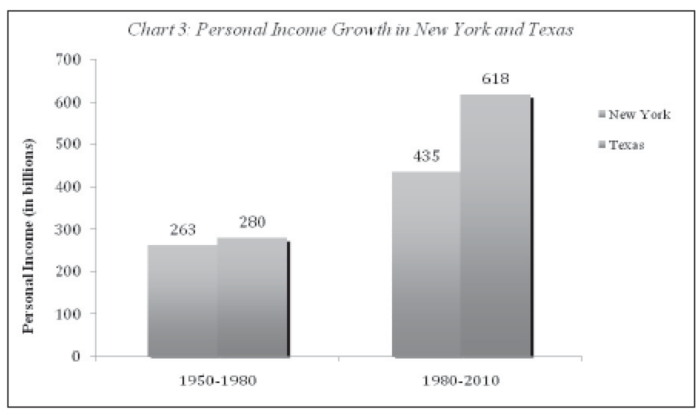

Chart 3: Personal Income Growth in New York and Texas

This article uses population, private sector employment, and personal income growth as the three key measures of New York's economic health. In addition, it compares New York's economic performance to the performances by both the United States and Texas. By any reasonable criteria, it concludes, New York's economy over the past 60 years can be described as anemic at best. New York's spending structure, which remains out of step with the nation's, amplifies the negative budgetary effects of the state's weak economy.[2]

Population and Migration Trends: 1950 to 2010

According to the U.S. Census, New York's population grew from 14.8 million in 1950 to 19.4 million in 2010—this represents an increase of 4.6 million, or 31 percent. These figures, which appear moderately healthy on the surface, mask a number of disturbing trends. When compared to the aggregate growth of the United States and of the state of Texas, New York's population growth is fairly weak.

Chart 4: Aggregate Population (millions)[3]

	United States	New York	Texas
1950	150.7	14.8	7.7
1980	226.5	17.6	14.2
2010	308.7	19.4	25.1

Between 1950 and 2010, the populations of the United States and Texas grew by 104 percent and 226 percent respectively, while New York's population increased by 31 percent. Chart 5, which breaks out the aggregate increase in population into two 30-year cycles, demonstrates the extent to which New York's population growth has slowed over the past 30 years.

Chart 5: Aggregate Growth in Population (millions)

	United States	New York	Texas
1950-1980	+75.2	+2.7	+6.5
1980-2010	+82.2	+1.8	+10.9
1950-2010	+157.4	+4.6	+17.4

As Chart 5 indicates, Texas added more than twice as many people as New York between 1950 and 1980. It added **six times** as many people as New York between 1980 and 2010. Closer examination of the data reveals that while New York is growing, it experiences significant out-migration of its citizens to other states.

Net Migration: 1970 to 2009

As many articles in this journal make clear, New York faces enormous economic and budgetary challenges. Their severity is indicated by the state's astonishingly negative "domestic migration"—how many people it acquires from other states, minus the number it loses. It is also valuable to look at net foreign migration, which measures the number of foreign immigrants arriving in the United States from countries abroad. Chart 6 captures this estimated movement from 1970 to 2009 for both New York and Texas. The results are startling.

Chart 6: Net Domestic and Foreign Migration, 1970-2009

	New York		Texas	
	Net Domestic Migration	**Net Foreign Migration**	**Net Domestic Migration**	**Net Foreign Migration**
1970-80[4]	-2,484,000	+942,000	+1,509,000	+271,000
1980-90[5]	-1,364,886	+914,907	+343,195	+598,454
1990-2000[6]	-1,888,936	+1,107,814	+569,957	+715,420
2000-2009[7]	-1,649,644	+839,590	+838,126	+933,083
Totals	-7,387,466	+3,804,311	+3,260,278	+2,517,957

Between 1970 and 2009, as many as 7.4 million New Yorkers "voted with their feet" by moving out of state. This loss of wealth and talent has been devastating. High foreign immigration to New York offset this loss, but only by half.[8]

By contrast, Texas between 1970 and 2009 had positive inflows of both domestic and foreign migrants. As indicated by Chart 6, Texas had an estimated gain of 5.8 million people, while New York suffered an estimated aggregate loss of 3.6 million people.

Another fascinating element of these trends is that Texas, for the first time in recent memory, is attracting more foreign immigrants than New York. In the period from 2000 to 2009, 933,000 immigrants arrived in Texas, while 840,000 entered New York. This represents a substantial shift from previous decades, when (on average) New York drew nearly twice as many foreign immigrants as Texas.

The ongoing value of foreign immigrants to the state's economy is a hotly debated topic. While the author believes that the effects of foreign immigration, on balance, are positive, other commentators focus on the fiscal stress that low-income and poorly educated immigrants have on a state's social and physical infrastructure.[9]

Returning to domestic migration, not only is New York losing people, but the citizens it loses are wealthier and earn more than the people who arrive to (partially) replace them. While this effect is difficult to quantify, a recent study by Wendell Cox and E.J. McMahon estimates that in 2007 alone, the domestic migration cost New York $4.3 billion in taxpayer income.[10] From 2001 to 2007, they calculate, New York lost $30 billion in household income.[10]

Private Sector Employment: 1950 to 2010

Arguably the single best measure of a state economy's health is its number of private sector jobs. "Government can't create all the jobs we need," as President Obama recently stated. What it can do is "promote a strong, dynamic private sector—the true engine of job creation in our economy."[11]

Unfortunately, New York's private sector is not robust. Indeed it has been at a relative standstill over the past 30 years.

Chart 7: Private Sector Employment (millions)

	United States[12]	New York[13]	Texas[14]
1950	40,541,000	5,553,000	2,552,000
1960	45,146,000	6,098,000	3,025,000
1970	58,317,417	6,417,000	3,734,000
1980	74,150,667	6,603,000	5,750,000
1990	91,075,667	6,740,900	5,837,900
2000	111,003,167	7,170,800	7,869,700
2010[15]	107,338,000	7,020,000	8,507,000

In 1950, New York's private sector workers accounted for 14 percent of the national private sector workforce; in 2010, the comparable percentage was 6.5 percent—a decline of over 50 percent in New York's share of private sector jobs.

Chart 8: Aggregate Growth in Private Sector Employment

	United States	New York	Texas
1950-1980	+33,609,667	+1,050,000	+3,198,000
1980-2010	+33,187,333	+417,000	+2,757,000
1950-2010	+66,797,000	+1,467,000	+5,955,000

While nearly 1.1 million jobs were created in New York between 1950 and 1980, only 417,000 were created between 1980 and 2010; this also represents a relative decline of over 50 percent in private sector job growth. In fact, this slowdown has actually turned negative in the last decade, with an absolute decline of 150,800 jobs between 2000 and 2010. It is significant that the decade-long decline in private sector employment has also occurred nationally, but not in Texas.[16]

Finally, it should be noted that the enduring strength of Texas' economy does not mean that the state has completely avoided all budget problems. The relative size of these fiscal problems, however, is also the subject of debate.[17] What distinguishes New York's budget problems from Texas', in this author's view, is that the former are chronic while the latter are tied to the ebbs and flows of the business cycle. For example, Texas entered the most recent recession with nearly $14 billion in fiscal reserves, while New York's comparable total was less than $2.3 billion.[18]

Personal Income Growth: 1950-2010

The final economic index examined is personal income growth. While New York's personal income growth rate is not as grim as its rates of population and private sector employment growth, the news is still not good. Between 1950 and 2010, personal income in the nation and in Texas grew by 506 percent and 941 respectively, while personal income in New York grew by only 280 percent. Not surprisingly, New York's relative national share declined from 12 percent in 1950 to 7.6 percent in 2010.

As another point of comparison, in 1950 New York's aggregate personal income was nearly three times Texas'. Today, Texas' aggregate personal income **exceeds** New York's. Chart 9 traces the aggregate growth in personal income for both New York and Texas over the past 60 years.

Chart 9: Aggregate Personal Income (Billions)[19]

	New York	Texas	Ratio[20]
1950	248.7	95.4	2.61
1960	349.7	138.5	2.52
1970	499.0	228.7	2.18
1980	511.4	375.0	1.36
1990	713.5	491.7	1.45
2000	835.5	758.2	1.10
2010	946.1	993.1	.95

While for the first time, Texas' aggregate personal income exceeds New York's, it should be noted that New York still has a higher per capita income than Texas does—$48,821 versus $39,493 in 2010. This positive margin, however, is driven in part by the financial sector, which is located primarily in New York City.

The securities industry, which accounts for approximately three percent of total private sector employment in New York, generates nearly 20 percent of New York's tax collections.[21] In 2007, for example, the average salary on Wall Street (including cash bonus) was $403,358, while per capita personal income for the state as a whole was $47,188.[22]

Unfortunately, New York's securities industry is in jeopardy. The events of the past 10 years—most notably the Sept. 11 attacks and the recent economic recession—have hit this industry hard. Employment in the securities industry declined by 12.4 percent in 2002 and by 5.3 percent in 2003. While the following five years saw modest growth, the recent recession triggered sharp employment declines of 9.7 percent in 2009 and 3.7 percent in 2010.[23]

Concluding Observations

The past decade has not been kind to New York. The state has seen a continual expansion of costly entitlement programs, primarily Medicaid. While the pressure to spend on programs and benefits in education, health, the environment, and public employment has continued to accelerate, the state's private sector—its economic backbone—has withered; the aggregate number of private sector jobs in New York today is lower than it was 10 years ago. It is not surprising that this pattern of an anemic economy coupled with the substantial out-migration of New Yorkers has led to a per capita state and tax burden that is significantly higher than the national average.

This dynamic—of spending going up and the state economy's going down—is not sustainable and is the primary cause of the chronic budget deficits of both the state and local governments. If New York does not find a way to control costs, stabilize taxes, and, more importantly, to restart the private sector economy, the State and its remaining citizens will continue to suffer the painful consequences.

Endnotes

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New York State Tax Structure

By Robert D. Plattner[1]

I. Introduction

Under the American system of dual sovereignty, the states maintain primary responsibility for many core governmental services, including public safety, public education, and the public infrastructure. Commensurate with these responsibilities, the states generally have the power of a sovereign entity to levy taxes, limited only by the federal Constitution and acts of Congress.

New York State not only imposes its own taxes, but also authorizes its local governments, creations of the state, to impose certain taxes. New York has chosen to delegate significant duties for the delivery of services to its local governments, as well as the responsibility to raise much of the revenue needed to pay for those services. New York City is unique among local governments, possessing the authority to impose a broad array of taxes more typical of a state than a local government.

The state's personal income tax, corporate franchise taxes, and sales tax have been the three main components of the state's tax structure since 1965, when the sales tax was added.[2] Local governments other than New York City rely heavily on real property taxes, along with local sales taxes administered by the state. In fiscal year 2008, New York was one of only a few states in which local governments raised more tax revenues than the state.[3] In that year, combined New York State and local tax revenues were approximately $138 billion, of which $73 billion, or 53%, was raised by local governments.[4] The state also imposes taxes that provide dedicated revenues for the Metropolitan Transit Authority, which serves New York City and its surrounding suburban counties.

II. State Revenue Sources

New York, as most states, relies upon a broad mix of taxes and fees to raise revenues. The Department of Taxation and Finance, the state's principal revenue collector, is charged with the administration of more than 40 different state taxes. These taxes yielded some $55 billion for the state in 2009-10.[5] A list of these taxes, and the revenues they generated, is set out in Table 1 of this article. Nearly $35 billion of the $55 billion, or 63%, is collected from the personal income tax, with another $10 billion from the sales tax.

It should be noted that this $55 billion in tax revenues accounts for less than half of the state's total receipts, which also include some $45 billion in federal funds and another $23 billion in miscellaneous receipts, including Health Care Reform Act (HCRA) assessments,[6] motor vehicle fees, Lottery receipts, SUNY tuition and dormitory fees, and public utility assessments.[7]

Table 1

Tax	Collections (in millions)
Personal Income	$43,751
Business Taxes	
Corporate Franchise	2,130
Foreign Corp. Licenses (sec. 181)	25
Transport & Transmission (sec. 183)	29
Additional Tax (sec. 184)	69
Ag. Co-ops (sec. 185)	0
Light, Water, Power (sec. 186)	27
Utilities (sec. 186-a)	150
Telecommunications (186-e)	517
Wireless Surcharge (186-f)	193
Unrelated Business Income	15
Bank Franchise	1,173
Insurance Franchise	1,259
Direct Writings	12
Petroleum Business	1,104
Sales (State only)	9,904
Excise Taxes	
Motor Fuel	507
Petroleum Testing Fees	3
Cigarettes	1,288
Cigarette License Fees & Stickers	13
Tobacco Products	64
Alcoholic Beverages	226
Truck Mileage	99
Vehicle Permits	10
Fuel Use	29
Auto Rental	56
Property Transfer Taxes	
Estate Tax	864
Real Estate Transfer	493
Miscellaneous Taxes & Fees	
Pari-Mutuel (Flat Racing)	7
Pari-Mutuel (Harness Racing)	1
Off-Track Betting	14
Racing Admissions	.50
Boxing & Wrestling	.50
Tax	
Hazardous Waste	2
Waste Tires	22
Returnable Bottle Deposits	48
Tax Return Preparer Registration Fees	1
State Total	**$55,106**

Note: Numbers may not add due to rounding.

Source: New York State Department of Taxation and Finance, Office of Tax Policy Analysis, *2009-10 New York State Tax Collections.*

III. History

The beginnings of the state's current tax structure date back to the late 1800s. During this period, New York established a corporate franchise tax (1880) and a tax on the organization of corporations (1886). It began to tax inheritances in 1885. A stock transfer tax was added in 1905 and a mortgage recording tax in 1906. The first net income-based corporate franchise tax was imposed beginning in 1917 and the first personal income tax in 1919.[8] By 1921, the State Tax Department, created in 1915[9] (renamed the Department of Taxation and Finance in 1927[10]), had assumed most of the state's tax collection responsibilities. Meanwhile, real property taxes, which had served as the primary source of both state and local revenue in the second half of the 19th century and into the 20th, continued to decline as a source of revenue for the state government, and were abandoned entirely for this purpose by 1929.

Over the next three decades, the state added taxes on motor fuel (1929), alcoholic beverages (1933), the income of unincorporated businesses (1935), cigarette sales (1939), a pari-mutuel tax on horse-race wagering (1940), and a truck mileage tax (1952). A restructured income-based corporate franchise tax replaced the earlier tax in 1944.[11] The taxation of personal property was abolished by statute in 1934, and the taxation of intangible personal property was prohibited by constitutional amendment in 1938. Over this period, the personal income tax emerged as the single largest source of state revenues.

In 1960, the state enacted its current personal income tax (Article 22). In 1965, it adopted a statewide sales and use tax of 2%, which immediately became the second leading source of state revenue.[12] New York's top personal income tax rate reached its peak in 1972 under Governor Nelson A. Rockefeller: 15% on taxable income over $23,000, plus a 2-1/2% surcharge, making the top effective marginal rate 15.375%. Corporate franchise tax rates peaked in 1976 at 10%, with a 20% surcharge—an effective rate of 12%.

Table 2
State and Local Taxes Per $1,000 Personal Income
Fiscal Year 2008

Rank	State	State and Local Taxes		Rank	State	State and Local Taxes
	U.S. Average	$111.99		26	Indiana	$107.33
1	Alaska	347.31		27	Kentucky	107.09
2	Wyoming	151.03		28	Mississippi	106.74
3	*New York*	*149.49*		29	Montana	106.17
4	North Dakota	135.60		30	Washington	105.49
5	Hawaii	128.93		31	Massachusetts	105.37
6	Maine	128.58		32	Arizona	105.16
7	Vermont	125.38		33	North Carolina	105.08
8	New Jersey	123.67		34	Arkansas	105.00
9	New Mexico	122.61		35	Maryland	104.59
10	Connecticut	119.11		36	Florida	102.81
11	California	118.31		37	Georgia	101.92
12	West Virginia	117.83		38	Nevada	100.74
13	Wisconsin	117.63		39	Idaho	100.34
14	Louisiana	116.07		40	Oklahoma	99.40
15	Ohio	115.14		41	Texas	98.37
16	Rhode Island	115.07		42	Virginia	98.17
17	Kansas	114.38		43	Missouri	95.75
18	Minnesota	114.23		44	Colorado	95.53
19	Nebraska	111.93		45	Oregon	93.94
20	Pennsylvania	111.54		46	South Carolina	93.19
21	Utah	110.63		47	Alabama	92.29
22	Michigan	109.58		48	Tennessee	90.11
23	Illinois	108.47		49	New Hampshire	88.30
24	Iowa	108.36		50	South Dakota	86.10
25	Delaware	107.49				

Source: "2008 Census of Government Finance," U.S. Department of Commerce, Bureau of the Census.

In the late 1970s, the state began a series of substantial reductions in its top personal income tax rates and, by 1982, had eliminated its stock transfer and unincorporated business taxes.[13] The top personal income tax rate was reduced to 6.85% in 1997. By 2007, the corporate tax rate (Article 9-A) had been reduced to 7.1% for most businesses and 6.5% for manufacturers and qualified emerging technology companies.

In addition, the state significantly accelerated the use of targeted business tax incentives intended to encourage business activity within its borders. In 1994, New York offered five distinct business tax credits. There are now over 40 business credits.[14] Many of these are structured as refundable credits, providing direct cash payments to individuals and business taxpayers outside the appropriation process.

IV. Comparative Tax Burden

While there is a good deal of debate regarding the strengths and weaknesses of the various methods used to compare state tax burdens, it is safe to say that by any measure New York is a high tax state. In particular, the state's local tax burden, driven by New York City's taxes and by real property taxes outside the city, stands out in comparisons with other states. Measured per $1,000 of personal income, New York's local tax burden for 2008 was $78.82, far higher than the national average of $46.19. Because of its huge, daily influx of commuters and tourists, New York City has service responsibilities that are disproportionate to its residential population.

Table 2 of this article provides a ranking of the states based on their *combined* state and local tax burden per $1,000 of income. New York's burden of $149.49 is significantly higher than the national average of $111.99. It is worth noting that those states identified in Table 2 as having the lowest overall tax burdens—South Carolina, Alabama, Tennessee, New Hampshire and South Dakota—are not necessarily thought of as better places to do business than many of the states with higher tax burdens. Not surprisingly, the level of taxation is only one factor among many that together determine a state's "business climate."[15]

V. State Taxes

A. Personal Income Tax

New York imposes a personal income tax on the income from all sources of resident individuals, estates and trusts. Nonresident individuals, estates and trusts are subject to tax on income derived from or connected with New York sources. Taxes paid by nonresidents account for a substantial fraction of total collections, approximately 15% in 2008.[16] The tax incorporates many of the features of the federal income tax. Federal adjusted gross income (FAGI) is the starting point for the calculation of the tax, which is then subject to modifications that may increase or decrease the amount of income subject to tax. Taxpayers' federal filing status (e.g., married filing joint) generally dictates their state filing status. However, as a result of New York's new Marriage Equality Act, effective for tax year 2011, same-sex married couples will be able to file a joint New York return even though they cannot file jointly for federal tax purposes.

The most recent major structural changes in the personal income tax occurred in 1987. In addition to reducing rates, the 1987 Act[17] eliminated the distinction between earned and unearned income, made joint returns standard for federal joint filers, simplified the tax base by eliminating certain New York modifications, altered the delivery of low-income relief, and revamped the taxation of nonresidents and part-year residents.

The highest rate in the current permanent rate structure is 6.85%, imposed on single individuals on taxable income in excess of $20,000, and on married joint filers on taxable income in excess of $40,000. For tax years 2009 through 2011, New York has temporarily added two new income tax brackets for high-income taxpayers. A rate of 7.85% is imposed on married joint filers on taxable income in excess of $300,000, on single filers on taxable income in excess of $200,000, and on heads of household on taxable income in excess of $250,000. A rate of 8.97% is imposed on taxable income in excess of $500,000, regardless of filing status.[18]

B. Business Taxes

1. Overview[19]

As a general rule, business corporations pay tax under the Article 9-A corporate franchise tax. Separate taxes apply to banks (Article 32)[20] and insurance companies (Article 33).[21] Gross receipts and other non-income based taxes imposed under Article 9 apply to certain transportation and transmission corporations, utility companies, telecommunications services, and agricultural cooperatives.

A Metropolitan Transportation Authority (MTA) surcharge applies to business taxes on income allocable to the Metropolitan Commuter Transportation District.

2. Article 9-A[22]

New York's general business corporation tax (Article 9-A) imposes an annual franchise tax on domestic and foreign corporations for the privilege of exercising their corporate franchise, doing business, employing capital, owning or leasing property, or maintaining an office in the state. The determination of the tax requires the computation of tax under four alternative bases.

The four bases include: 1) a tax on allocated entire net income (ENI) with rates that vary; 2) a tax of 0.15% on business and investment capital allocated to New York after deduction for short- and long-term liabilities (the maximum tax on this alternative is $350,000 for manufacturers and $10 million ($1 million beginning in tax year 2011) for all others); 3) a 1.5% tax on an alternative minimum taxable base; or 4) a minimum tax at fixed dollar amounts. A separate tax of .09% is imposed on allocated subsidiary capital.

The entire net income (ENI) base equals federal taxable income (FTI), modified for income and deduction items that New York treats differently. For example, New York's tax base excludes subsidiary income and does not allow deductions directly or indirectly attributable to subsidiary capital.

The tax rate on allocated ENI varies depending upon the taxpayer's particular characteristics. Most taxpayers are subject to a rate of 7.1%. Small business taxpayers with ENI of $290,000 or less are subject to a rate of 6.5%, which rises in stages to 7.1% as ENI increases to $390,000. Qualified New York manufacturers and qualified emerging technology companies (QETCs) are subject to a 6.5% rate.

The fixed dollar minimum tax is based on a taxpayer's New York receipts. The tax ranges from $25 to $5,000 for C corporations, and from $25 to $4,500 for S corporations.

ENI can be viewed as consisting of three types of income: subsidiary income, investment income, and business income. Subsidiary income and investment income are specifically defined in statute. The remainder is business income.

As noted above, taxable ENI excludes income from subsidiary capital. Investment income is allocated to New York using a formula that reflects the New York presence of the issuers of the financial instruments generating such investment income. Business income is allocated using a single factor—receipts. Allocated investment income plus allocated business income constitute the ENI base.

The alternative minimum taxable income base equals ENI plus certain federal items of tax preference and adjustments. In addition, most of the tax credits available may not be utilized. The tax rate is 1.5%.

General business corporations that file as S corporations for federal tax purposes may also elect S status for New York State franchise tax purposes. This election requires the shareholders to report their proportionate share of S corporation income, gain, or loss and deductions on their personal income tax returns. At the entity level, S corporations are subject only to the fixed dollar minimum tax.

Article 9-A offers many business tax incentives, most often in the form of tax credits. These incentives are primarily intended to encourage business investment and job creation within the state. Significant incentives include the Excelsior Jobs Program Tax Credits, the Empire Zone Program Tax Credits, the Qualified Emerging Technology Company Credits, the Brownfield Redevelopment Tax Credit, the Investment Tax Credit, and the Empire State Film Production Credit.

For tax years 2010 through 2012, the aggregate amount of certain tax credits that may be used by a taxpayer in a year is limited to $2 million. In 2013, taxpayers may begin to reclaim credits earned but not used because of this temporary limitation.

3. Bank Tax (Article 32)[23]

The state imposes a separate corporate franchise tax on banks (Article 32), which differs in significant ways from Article 9-A. The continuing presence of a separate tax article for banks is an indication of the failure of the tax structure to reflect changes in the financial services sector following federal legislation enacted in 1999, known as Gramm-Leach-Bliley (GLB),[24] that blurred the distinctions among banks and other financial industry firms. New York's response to GLB has been a series of "transitional" provisions extending over more than a decade, which allow corporations to retain their pre-GLB status as Article 9-A or Article 32 taxpayers.

4. Insurance Company Taxes (Article 33)[25]

Article 33 imposes a tax on insurance corporations. Life insurers are subject to a franchise tax that includes an income tax component as well as a tax on premiums. Non-life insurers are subject only to a premiums tax.

5. Article 9 Taxes

Article 9 imposes a variety of taxes on corporations including:

- an organization tax on domestic corporations;[26]
- licensing and maintenance fees on corporations doing business in New York;[27]
- a franchise tax under § 183 on the capital stock of corporations principally engaged in a transportation, telephone, or other transmission business (not including the transmission of gas, electricity, or steam);[28]
- a franchise tax on gross receipts that applies to the same entities subject to § 183 of the Tax Law above, except long distance telephone carriers;[29]
- a franchise tax on the capital stock of farmers' or other agricultural cooperatives;[30]
- a tax on gross income or gross operating income that applies to entities furnishing water, gas, electricity or steam, whether or not it is their principal business, and to local telephone companies subject to the supervision of the Public Service Commission;[31]
- an excise tax on telecommunications services that applies to all companies engaged in the furnishing of telecommunication services;[32] and
- a Public Safety Communication Surcharge that applies to wireless communication devices.[33]

6. Petroleum Business Tax (PBT)

The state imposes a set of component taxes under Article 13-A,[34] known as the Petroleum Business Tax (PBT), on a variety of petroleum products and aviation fuel imported into or produced in New York. Though formally structured as a tax on the privilege of doing business in New York, the tax functions as an excise tax imposed on various products on a cents-per-gallon basis at differing rates and indexed annually. By statute, the tax must be passed through to the final consumer.

C. Sales and Use Tax

New York has imposed a statewide sales tax since 1965 that is modeled on the New York City sales tax first adopted in 1934.[35] The state tax is imposed at the rate of 4%. The tax is imposed on retail sales of tangible personal property and statutorily enumerated services.

Local governments may piggyback their own sales and use taxes on the state tax. These are administered by the state. Combined rates run as high as 8.875% in New York City when the state rate, city rate, and the 0.375% rate for the Metropolitan Commuter Transportation District are added together. With the exception of New York City, the local tax base is similar but not identical to the state base. The city tax base differs from the state's more significantly, with the city taxing a broader range of services than the state. A use tax designed to prevent avoidance of the sales tax is imposed to complement the sales tax.

The legal imposition of the tax is on the purchaser, but vendors are obligated to assist in the collection of the tax, and both parties face liability if the proper tax is not collected and remitted. The tax is riddled with exclusions, exemptions and exceptions to almost every general rule. Compliance by even the most diligent of taxpayers is difficult when dealing with murky areas of the law.

Originally intended as a broad-based consumption tax, the sales tax base has not kept up with changes in the marketplace. When enacted in 1965, approximately 45% of household income was spent on purchases subject to tax. That percentage has since fallen to 28%.[36]

D. Excise Taxes

The state imposes excise taxes on alcohol, cigarettes and other tobacco products, and on motor fuel and diesel motor fuel. In addition, it levies a highway use tax, a fuel use tax, a waste tire management fee, pari-mutuel taxes, and a boxing and wrestling exhibition tax. Together these taxes raise over $2 billion annually.[37] The tax on cigarettes has been increased dramatically over the past decade, both to encourage smokers to quit and to fund growing health care expenditures. At $4.35 a pack, it is currently the highest in the nation.[38]

E. Estate Tax

New York's estate tax does not conform automatically to changes in the federal estate tax. Rather, the legislature must affirmatively act to incorporate federal changes into state law. The current New York estate tax is based on the federal estate tax as it existed on July 22, 1998, including an exemption capped at $1 million.

Because of this limited conformity, the recent reinstatement of the federal estate tax, which now provides a $5 million exemption level, does not directly impact the New York estate tax. However, the increase in the federal gift tax exemption from $1 million to $5 million will encourage taxpayers to increase their gifting. This gifting will reduce the size of New York taxable estates, and New York has no gift tax. The result for the state will be a loss of estate tax revenue.

Approximately 4,500 estates were subject to the New York estate tax in state fiscal year 2009-10, generating approximately $900 million in revenue.[39]

F. Real Estate Transfer Tax

The state imposes a real estate transfer tax (Article 31),[40] which is levied on every conveyance of real property in New York where the consideration exceeds five hundred dollars. The basic rate is two dollars for every five hundred dollars of consideration or fractional part thereof. The tax is imposed on the seller. In the event the seller fails to pay in a timely fashion, seller and purchaser become jointly and severally liable for the tax. New York City and many other local jurisdictions have separate, additional transfer taxes that apply to real property located within their jurisdictions.

G. Mortgage Recording Tax

New York imposes a tax on the privilege of recording mortgages on real property located in the state (Article 11).[41] Although imposed pursuant to state Tax Law, revenues from the tax are collected locally and benefit local governments and transportation agencies. The recording tax essentially applies to all mortgages on real property. Instruments subject to the tax include almost every type of mortgage and all deeds of trust that impose a lien on or affect the title to real property, as well as executor contracts for the sale of real property under which the purchaser has or is entitled to possession of the property. A contract or agreement by which the debt secured by a mortgage is increased is also deemed a taxable mortgage. Local governments, including New York City and numerous counties, impose similar taxes.

VI. Metropolitan Transportation Authority (MTA) Taxes

A. Overview

The state also imposes taxes whose revenues are fully dedicated to the MTA.

B. Mobility Tax (Tax Law Article 23)[42]

A tax is imposed on employers and self-employed individuals engaged in business within the Metropolitan Commuter Transportation District (MCTD).

The tax on employers equals 0.34% of the payroll expense for employees stationed within the MCTD. The employer's payroll expense must be greater than $2,500 in a calendar quarter before the tax applies. The same tax rate applies to individuals, including partners in partnerships and members of limited liability companies that are treated as partnerships, on their net earnings from self-employment allocated to the MCTD. The tax does not apply if an individual's allocated net earnings from self-employment are $10,000 or less for the tax year.

C. Medallion Taxicab Ride Tax (Article 29-A)[43]

The Tax Law imposes a 50 cent tax for every taxicab ride that originates in New York City and terminates anywhere in the Metropolitan Commuter Transportation District. The tax is paid by medallion owners authorized by the New York City Taxi and Limousine Commission to operate a yellow taxicab.

VII. Tax Adjudication and Administration

The administration of the state tax system is largely the responsibility of the Department of Taxation and Finance (DTF). The adjudication of contested tax matters is set out in Article 40 of the New York Tax Law which establishes the Division of Tax Appeals and Tax Appeals Tribunal and governs the formal administrative process for contesting proposed assessments and other actions of the DTF.

The administrative procedures applicable to the various taxes imposed by the Tax Law often differ. The principal administrative procedures applicable to the corporate franchise taxes imposed under Article 9, Article 9-A, Article 32, and Article 33 are generally uniform, as set out in Article 27. The personal income tax and sales and use tax have their own administrative rules that differ in significant respects from the Article 27 rules, as well as from each other.

The most notable change in the "nuts and bolts" of tax administration is the move away from paper to electronic filing.[44]

DTF provides assistance to taxpayers in various ways to support voluntary compliance with the tax laws. Voluntary compliance accounts for over 95% of the revenue collected by the DTF. Assistance includes written guidance, both formal and informal, outreach, and a Taxpayer Rights Advocate. Over time, the DTF's web site has taken on increasing significance as the means by which the Department communicates with taxpayers, a trend that is certain to continue.

VIII. Local Taxes

A. Real Property Tax

The New York State property tax system has been shaped over many decades by the state and hundreds of local taxing jurisdictions with varying approaches to property taxation that operate within the broad framework of state law. In 1958, the State Legislature passed the Real Property Tax Law (RPTL), which codified into a single consolidated law all laws relating to the assessment and taxation of real property. The RPTL established basic standards of taxation, collection, and administration throughout the state. The RPTL did not so much displace earlier local laws as codify them. Real property taxation remains largely a function of local governments, with the state role limited to that of broad oversight.

The revenues derived from property taxes are expended by local communities for education, health and welfare, the maintenance of streets and roads, police and fire protection, and other local government functions. While augmented by the sales and use tax, and in New York City by personal and corporate income taxes, the property tax remains a critical revenue source for local governments and school districts. Total property tax revenues collected in 2010 were $48 billion, significantly more than the $34.7 billion collected from the state personal income tax.[45]

The Office of Real Property Tax Services, now part of the Department of Taxation and Finance, is the state office assigned to assist localities in the taxation of real property. It exercises general supervision of the assessment process throughout the state, assesses special franchises, sets equalization rates for localities, and approves assessments of state lands.

The state's School Tax Relief Program,[46] known as "STAR," administered by local assessors, provides over $2.5 billion in property tax relief to approximately 3.4 million households.[47]

The real property tax burden on homeowners is an issue that has taken center stage in New York. Governor Cuomo made enactment of a property tax cap one of his highest priorities, and a cap on annual growth of the tax levies of all local governments other than New York City was recently enacted. Levy growth is limited to 2% or the rate of inflation, whichever is less, and adjustments are made for certain local government expenditures.

B. Local Sales Taxes

Local governments are authorized to impose sales and compensating use taxes. These taxes are generally levied by counties and are closely linked to the state sales tax base and administered by the DTF, which distributes the local portion to local governments. Cities and counties may choose to impose a selective sales tax on certain items instead of conforming with the overall state sales tax base. These include utility services, "restaurant" food and drink, hotel room occupancy, and certain amusement charges.

School districts that are partly or wholly within cities with populations under 125,000 may impose sales tax on utility services at a rate up to 3%.

C. Local Utility Taxes

Cities other than New York City and villages may impose selective gross receipts taxes on sales of utility services. These are in addition to sales taxes, and are locally administered. The maximum rate is 1% of the gross income of utilities operating in their jurisdiction, although Buffalo, Rochester, and Yonkers are authorized to impose a rate of up to 3%.

D. Hotel Occupancy Taxes

Most counties, as well as some cities, towns, and villages, impose locally administered hotel occupancy taxes.

IX. New York City Taxes

A. Overview

New York City imposes many of the same taxes imposed at the state level. Some of them, such as the personal income and sales taxes, are closely linked to state law and require approval by the State Legislature to be amended. These taxes are administered by the DTF. Almost all other taxes, such as the real property tax and various business and excise taxes, are administered by the New York City Finance Department.

B. Personal Income Tax

A tax is imposed on residents and part-year residents of the city. Using the same filing statuses as the state income tax, the starting point is state taxable income, with rates for tax year 2010 ranging from 2.907% to 3.876%.[48]

C. Business Taxes

New York City imposes several of the same types of taxes on businesses that the state imposes. Unlike the state, however, it also imposes an unincorporated business tax. The New York City Department of Finance administers the city's business taxes.

A tax is imposed on unincorporated businesses, such as sole proprietorships and partnerships, at the rate of 4%. The rate is generally based on the business's federal gross income, after allowance of a $10,000 exemption. Compensation paid to a proprietor or partner for services or the use of capital in excess of $10,000 per partner is not deductible. A credit eliminates the tax for businesses with taxable incomes of up to $85,000 and reduces the tax for businesses with taxable incomes of less than $135,000.

The city also imposes a general corporation tax (GCT) and bank tax similar to those imposed by the state, though significant differences exist. One key difference is that unlike federal and state law, New York City does not allow for the S corporation election, with the result that all S corporations are subject to the GCT.

D. Excise and Miscellaneous Taxes

New York City also imposes and administers many of the same types of excise and other taxes imposed at the state level, including levies on cigarettes, hotel occupancy, alcoholic beverages, real property transfers, insurance companies, and utilities.

E. Tax Administration

Administration and adjudication of the city's various taxes are divided. Several of the city's taxes are administered by the state—the sales tax and related taxes on parking and hotel room occupancy, the resident personal income tax, the mortgage recording tax, and the beer and liquor excise tax. With respect to those taxes administered by the state, tax protests and adjudication are also conducted within the state system. The remaining city taxes are administered by the city's Department of Finance, and tax adjudication involving these taxes is the responsibility of the city's Tax Appeals Tribunal.

X. Issues

A. Modernization and Simplification

1. Overview

As noted earlier, the basic structures of the key components of the state's current tax system—its personal income tax (1960), sales and use tax (1965), and corporate income tax (circa 1944) date back to the middle of the 20th century. Because the personal income tax is tied closely to the federal tax, and because of 1987 reform legislation, the personal income tax, while certainly ripe for improvements, is structurally sound.

The same cannot be said for either the sales and use tax or the corporate franchise taxes on general corporations (Article 9-A) and banks (Article 32), which are badly outdated and structurally flawed in the context of today's economy. State and local taxes on communications services, where the tax laws lag far behind dramatic changes in the industry, also cry out for modernization.

2. The Sales and Use Tax

The state and local sales tax, which raises over $22 billion annually,[49] is a key component of New York's revenue structure. But its vitality is waning for a variety of reasons—shifts in consumer spending from goods to services, rapid changes in technology, and a base narrowed by a long list of exemptions enacted over several decades. The 2011 Annual Report on New York State Tax Expenditures now lists 146 sales tax exemptions and credits.

Between 1965 and 2009, the shift away from spending on taxable goods and services by consumers was dramatic. In 1965, 52% of consumer spending was for goods (mostly taxable) and 48% for services (mostly nontaxable). In the same year, consumers also spent an average of 45% of their personal income on taxable goods and services. In 2009, the percentage of consumer spending devoted to services had risen to 68% and the share of personal income spent on taxable goods and services had dropped to 28%.[50] If the share of personal income spent on taxable goods and services were still 45%, as in the mid-1960s, state sales tax revenues would be $6.5 billion greater than now collected.[51]

In addition, the sales tax law has not kept pace with technology. A wide variety of products that were previously available only in tangible form are now available as digital products, including music, movies, books, and photographs, and these products are rapidly displacing their tangible counterparts. Because the tax is generally imposed on sales of tangible goods, no sales tax is due on purchases of these digital products.

Furthermore, the power of the state to require sales tax collection by remote vendors remains limited by outdated but controlling federal constitutional case law. While New York has aggressively sought to extend its reach within the constitutional limits, lost revenues from Internet sales by remote vendors on which the tax goes uncollected are substantial.

In addition, legislation enacted over the past four decades has exempted numerous products and services. Setting aside the merits of each individual exemption, the combined result of these and other exemptions is a narrower tax base that runs contrary to the preferred structure of the sales tax as a broad-based tax on consumption. One unwelcome consequence of this narrower base, as evidenced in recent years, is that sales tax revenues have become more vulnerable to downturns in the economy. A second adverse consequence is that the law is now exceedingly complex, imposing undue burdens on vendors obligated to collect the tax and additional costs on the state to administer it.

Exemptions for products including grocery food, residential energy, drugs and medicines, and clothing are often justified as helping to make the sales tax less regressive. It is accurate that the sales tax is inherently regressive—that is, the percentage of a household's income devoted to paying sales tax decreases as household income increases. However, sales tax exemptions are a highly inefficient mechanism to provide benefits to lower-income households because every household, regardless of income, receives the benefit of the exemption. As noted in the 2010 Annual Tax Expenditure Report, almost one-half of the benefits from the exemptions noted above go to households with annual incomes of $70,000 or more, while only 20% of the benefits accrue to households making $30,000 or less. As an alternative strategy, some states impose a broad-based sales tax coupled with a refundable personal income tax credit designed to provide targeted low-income relief.[52]

3. Corporate Franchise Taxes

There has been widespread recognition for a decade or more within the business community and state government that the state's current corporate franchise tax structure is out-of-date and in need of reform. As a result of the failure to modernize, the current system is unduly complex, offers tax planning opportunities, invites aggressive filing positions, taxes similarly situated taxpayers differently, and in some instances creates disincentives to increase a corporation's activities in New York.

After a number of false starts over the last decade, a reform effort begun by the DTF in 2008 has made substantial progress, resulting in a study bill widely disseminated in 2010. The bill would make the most significant changes in New York's corporate taxation since 1944. These changes would:

- Merge the bank tax (Article 32) into general corporate franchise tax (Article 9-A).
- Allocate income based on a single receipts factor using customer sourcing.
- Adopt full water's edge unitary combined reporting with an ownership requirement of more than 50%.
- Do away with the separate treatment of subsidiary capital and income and narrow the current definition of investment capital and income.
- Maintain an alternative tax on capital to serve as a backstop to the entire net income base.
- Couple base broadening with rate reduction to maintain revenue neutrality.

4. Telecommunications Taxes

Taxes from the telecommunications industry are a significant revenue source for the state and its localities—$2.6 billion in 2008.[53] New York's telecommunications tax structure, however, has not kept pace with the rapidly evolving technology that has radically transformed the industry, and a large share of current revenue is dependent on the most outdated and increasingly irrelevant segment of the industry—traditional landline phone service. As the industry evolves, the cost of providing traditional phone service is becoming an incidental cost of a larger telecommunications package, much of which is currently not subject to taxation. A major reform effort is required to provide a level playing field for competitors in the industry and to ensure an ongoing, relatively stable revenue stream.

B. Targeted Business Tax Incentives

The use of targeted business tax incentives to promote economic development in general and job creation in particular has proliferated in recent decades in New York (and many other states). The proliferation of these credits reflects the choice of the states to use these credits as the primary weapon in their fierce competition for business activity. In 1994, New York offered five business tax credits, at an approximate cost of $150 million. By 2009, the state offered more than 40 such credits, and the cost had grown to $1.5 billion.[54]

Further, many of the new credits are refundable. That means that if the amount of the credit exceeds a taxpayer's liability, the state will return the difference as a cash payment. Experience has shown that for the most significant refundable credits, an overwhelming percentage is in fact paid to the taxpayer as a cash subsidy rather than used by the taxpayer to reduce its tax liability. For example, 85% of the qualified Empire Zone enterprise property tax credit is refunded, 96% of the Brownfield redevelopment credit is refunded, and 98% of the qualified emerging technology company credits are refunded.[55]

Uncapped, "as of right" credits, which include the state's Empire Zone, Brownfield, and QETC credits, suffer from serious flaws as economic development policy tools. More carefully drafted tax incentive programs are able to address some, but not all, of these flaws:

- They often reward the bulk of their benefits to taxpayers for activity that would have been undertaken without the tax incentive.
- Even though they are in essence spending programs, they require no initial appropriation, and therefore are often enacted without appropriate scrutiny of their likely benefits and costs.
- Because they require no annual appropriation, they tend to remain on the books indefinitely with little or no evaluation of their success or lack thereof.
- They may be vulnerable to aggressive tax planning techniques that increase their cost without commensurate economic benefits to the state.
- They often hide credit beneficiaries behind the veil of taxpayer secrecy.
- Multi-year credits impose future spending obligations on the state that are viewed by many as the equivalent of contractual obligations, with the result that they may be seen as "untouchable" even while spending on education and Medicaid, for example, is reduced.
- Refundable credits potentially expose the state to huge, unanticipated costs since the amount of the credit earned can far exceed a taxpayer's liability.
- They undermine basic tax principles, including fairness.
- They add complexity to the tax system and require substantial additional DTF resources to administer and audit.

The Empire Zone program provides a textbook example of what can go wrong. Widely viewed in hindsight as a costly, largely ineffectual program, it was allowed to "expire" in 2010.[56] Nonetheless, even though no additional businesses will enter the program, because it offered a multi-year stream of refundable credits, the state will continue to honor these credits in the form of cash payments to taxpayers for a decade or more.

C. Fiscal Federalism Under Attack

Over the recent past, Congress has shown an increased willingness to limit (preempt) state taxing powers without sufficient justification. The most notable example is the Internet Tax Freedom Act, which tightly circumscribes the states' powers to tax Internet access and certain Internet content.[57] As a result of that success, a number of industry-specific preemption bills are introduced each year, as well as bills that would more broadly curtail states' taxing authority, such as the Business Activity Tax Simplification Act.[58] For the foreseeable future, New York and its sister states will be required to defend themselves against continuing attempts by Congress, acting on behalf of business constituencies, to diminish their taxing powers.

Endnotes

1. The views expressed are those of the author only, and do not represent New York State Department of Taxation and Finance policy.
2. N.Y. State Dep't of Taxation and Finance, 2009-2010 New York State Tax Collections: Statistical Summaries and Historical Tables 52 (2010) [hereinafter NYS Tax Collections], *available at* http://www.tax.ny.gov/pdf/stats/stat_fy/2009_10_annual_statistical_report_of_ny_state_tax_ collections.pdf.
3. Throughout this report, data is for the most recent year available, which may vary by tax types.
4. U.S. Dep't of Commerce, 2008 Census of Government Finance (2008), http://www.census.gov/govs/estimate/.
5. NYS Tax Collections, *supra* note 2, at 1.
6. 1996 N.Y. Laws Ch. 639.
7. N.Y. State Governor Andrew M. Cuomo, 2011-12 Executive Budget, Five-Year Capital Program and Financing Plan 23-40 (2011), *available at* http://publications.budget.state.ny.us/eBudget1112/capitalPlan/CapPlan.pdf.
8. NYS Tax Collections, *supra* note 2, at 71.
9. 1915 N.Y. Laws Ch. 317.
10. 1926 N.Y. Laws Ch. 553.
11. N.Y. State Dep't of Taxation and Finance, New York State Tax Sourcebook 91 (2004), *available at* http://www.tax.ny.gov/pdf/stats/policy_special/sourcebook02/new_york_state_tax_sourcebook_april_2005.pdf.
12. NYS Tax Collections, *supra* note 2, at 1.
13. Although the stock transfer tax still remains in statute, a rebate program was enacted in 1979 and phased in over succeeding years so that the entire tax is now rebated.
14. N.Y. State Dep't of Taxation and Finance, Annual Reports on New York State Tax Expenditures 2011–12 State Fiscal Year 22–23 (2011) [hereinafter Annual Reports], *available at* http://publications.budget.state.ny.us/eBudget1112/fy1112ter/TaxExpenditure11-12.pdf.
15. *See* Donald J. Boyd, Citizens Budget Comm'n, A Simulation of Business Taxes in New York City and Other Locations: Final Technical Report (2007), *available at* http://www.cbcny.org/BoydCBCBusinessTaxModeFinalMemorandumReport_June2007.pdf (presenting the findings of a well-designed study that measures the impact of state and local business taxes on business profits in nine locations, including New York City, Westchester County and Albany County).
16. N.Y. State Dep't of Taxation and Finance, Analysis of Personal Income Tax Returns (2008), http://www.tax.ny.gov/research/stats/stat_pit/county_of_residence/analysis_of_2008_state_personal_income_tax_returns_by_place_of_residence.htm.
17. 1987 N.Y. Laws Ch. 28, 333.

18. New York also imposes a supplemental income tax that serves to recapture the benefit conferred to taxpayers from tax brackets with rates lower than the maximum rate.
19. Unless otherwise provided, all references to "Articles" come from the New York State Tax Law. *See* N.Y. Tax Law §§ 1–3038 (McKinney 2005).
20. *See id.* §§ 1450–68.
21. *See id.* §§ 1500–20.
22. *See id.* §§ 180–207-b.
23. *See id* §§ 1450–68.
24. Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338.
25. *See* N.Y. Tax Law §§ 1501–20.
26. *Id.* § 180.
27. *Id.* § 181.
28. *Id.* § 183.
29. *Id.* § 184.
30. *Id.* § 185.
31. *Id.* § 186.
32. *Id.* § 186-e.
33. *Id.* § 186-f.
34. *Id.* §§ 300–15.
35. 1934 N.Y. Laws Ch. 873.
36. N.Y. State Dep't of Taxation and Finance, Annual Report on New York State Tax Expenditures 16-22 (2011), *available at* http://www.budget.state.ny.us/pubs/archive/fy1011archive/eBudget1011/fy1011ter/TaxExpenditure10-11.pdf.
37. NYS Tax Collections, *supra* note 2, at 29.
38. *Id.* at 28.
39. *Id.* at 34.
40. *See* N.Y. Tax Law §§ 1400–21.
41. *Id.* §§ 250–67.
42. *See id.* §§ 800–06.
43. *See id.* §§ 1280–90.
44. 2011 N.Y. Laws Ch. 60.
45. *See* N.Y. State Comptroller, Overlapping Real Property Tax Levies (2010), *available at* http://www.osc.state.ny.us/localgov/orptbook/narrative10.pdf.
46. N.Y. Real Prop. Tax Law § 425 (McKinney 2008).
47. *See STAR School Tax Relief*, N.Y. State Office of Real Property Servs., http://www.orps.state.ny.us/star/index.cfm (last visited April 6, 2011).
48. *See* N.Y. Tax Law §§ 1–3038 (McKinney 2005); New York City, N.Y. Admin. Code § 11-101–11-4022 (2009).
49. NYS Tax Collections, *supra* note 2, at 47.
50. *Id.* at 29.
51. To the extent a modernization of the sales tax base resulted in increased revenues, these revenues could be used to offset tax reductions in other taxes, for example, the revenue "spent" in the personal income tax on a real property tax circuit breaker credit.
52. *See, e.g.*, N.M. Stat. Ann. § 7-2-14 (2010).
53. N.Y. State Dep't of Taxation and Finance, Report on the Taxation of the Telecommunications Industry in New York 21 (2009), *available at* http://www.tax.ny.gov/pdf/stats/policy_special/telecommunications/2009/taxation_of_the_telecommunications_industry_in_ny_state_october_2009.pdf.
54. Annual Reports, *supra* note 14.
55. NYS Tax Collections, *supra* note 2, at 29.
56. From 2001 through 2007, the latest year for which complete data is available, the Empire Zone Program awarded over $2 billion in tax credits.
57. Internet Tax Freedom Act of 1998, Pub. L. No. 105-277, 112 Stat. 2681.
58. Business Activity Tax Simplification Act, H.R. 5267, 110th Cong. (2009).

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New York's Spending: A State Like No Other

By Charles Brecher and Tammy P. Gamerman

I. Introduction

Among the 50 states New York has a distinctive pattern of spending. Its expenditures are high; they are decentralized among multiple local governments due in large part to state established mandates, and the spending priorities favor social services, education and mass transit more heavily than most other states. Each of these traits is long-standing and the prospects for change are not strong.

II. A Full Perspective—The State and Its Localities

From a fiscal perspective, it is important to consider a state in the context of the combined system of state and local governments. Legally, local entities are "creatures of the state"; their powers are set and limited by the state, and local jurisdictions are subject to multiple mandates imposed at the state level. These mandates include requirements for spending for a variety of purposes including education, health, welfare and employee pensions. Given the state's overarching role, local governments are appropriately viewed as instruments of the state for implementing its spending policies on a decentralized basis.

This perspective leads to two important conclusions about New York. First, it is a large system in both an absolute and relative sense. Second, it is a relatively decentralized system, relying more heavily on localities than do most other states.

A. New York's High Spending

In 2008, the latest year for which comparative data are available, the total spending of the state and local governments in New York exceeded $237 billion—well below the figure for the highest ranking state, California (nearly $371 billion), but well above the third largest state, Texas ($177 billion).[1] Because these totals reflect the states' population size, it is preferable to assess the scale of state and local government spending on a per capita basis. In these terms, New York ranks third with per capita spending of $12,207. (See Table 1). The states with larger spending per capita are Alaska and Wyoming. Alaska is unique because it imposes a severance tax on oil and other minerals exported from the state; those taxes, representing more than half the state's total revenue, are largely used to make annual payments to residents. Wyoming also imposes relatively high mineral severance taxes, which comprise about half its total revenues, most of which are allocated to a special reserve fund.

Table 1: State and Local Direct Expenditure per Capita by Function, New York, Fiscal Year 2008

	New York	National Median	Percent Above/ (Below) Median
Social Services	$3,208	$1,964	63%
K-12 Education	$2,635	$1,775	48%
Public Safety	$920	$602	53%
Environment and Housing	$760	$565	35%
Mass Transit	$733	$61	1097%
Higher Education	$595	$793	(25%)
Administration	$567	$404	40%
Interest on General Debt	$507	$303	67%
Highway Transportation	$499	$539	(7%)
Electric Utility	$410	$148	176%
Other Education	$149	$161	(8%)
Water and Gas Utility	$129	$172	(25%)
Air Transportation	$107	$52	107%
All Other	$987	$359	175%
Total Direct Expenditure	**$12,207**	**$8,010**	**52%**

Note: Per capita figures calculated using population as of July 1, 2007. Direct expenditures exclude intergovernmental expenditures and expenditures for insurance benefits and repayments (e.g. unemployment insurance and workers compensation).

Sources: U.S. Department of Commerce, U.S. Census Bureau, Division of Governments, *Survey of State and Local Finances,* 2008. U.S. Department of Commerce, U.S. Census Bureau, Population Division, *Population Estimates.*

Excluding Alaska and Wyoming, the state with total per capita spending closest to New York is California ($10,246); New York's is about 19 percent higher.[2] New York's per capita spending is 52 percent above the national median ($8,010) and is nearly double that for Arkansas ($6,628), the lowest ranking state.[3]

Three categories of spending contribute the most to New York's comparatively high spending—(1) social services, (2) K-12 education and (3) mass transit.

Accounting for the largest dollar amount disparity, New York's spending on social services, which include Medicaid, public assistance and public health, is 63 percent above the national median. (See Table 1). In the area of K-12 education, New York spends 48 percent more per person than the national median, $2,635 versus $1,775. Lastly, due to the state's extensive system of public transit, especially in the New York City region, New York spends $733 per person for these services, compared to a national median of only $61.

Table 2: State and Local Direct Expenditure per Capita, New York, Fiscal Years 1980, 1990, 2000 and 2008

	50-State Rank	New York	National Median
1980	4	$2,397	$1,744
1990	2	$5,539	$3,415
2000	2	$8,526	$5,707
2008	3	$12,207	$8,010

Note: Per capita figures calculated using population as of July 1 of the previous year. Direct expenditures exclude intergovernmental expenditures and expenditures for insurance benefits and repayments (e.g. unemployment insurance and workers compensation).

Sources: Data for 1980, 1990 and 2000 from the Urban Institute-Brookings Institution Tax Policy Center, *State & Local Government Finance Data Query System.* <http://www.taxpolicycenter.org/slf-dqs/pages.cfm>. U.S. Department of Commerce, U.S. Census Bureau, *Annual Survey of State and Local Government Finances,* 2008. U.S. Department of Commerce, U.S. Census Bureau, Population Division, *Population Estimates.*

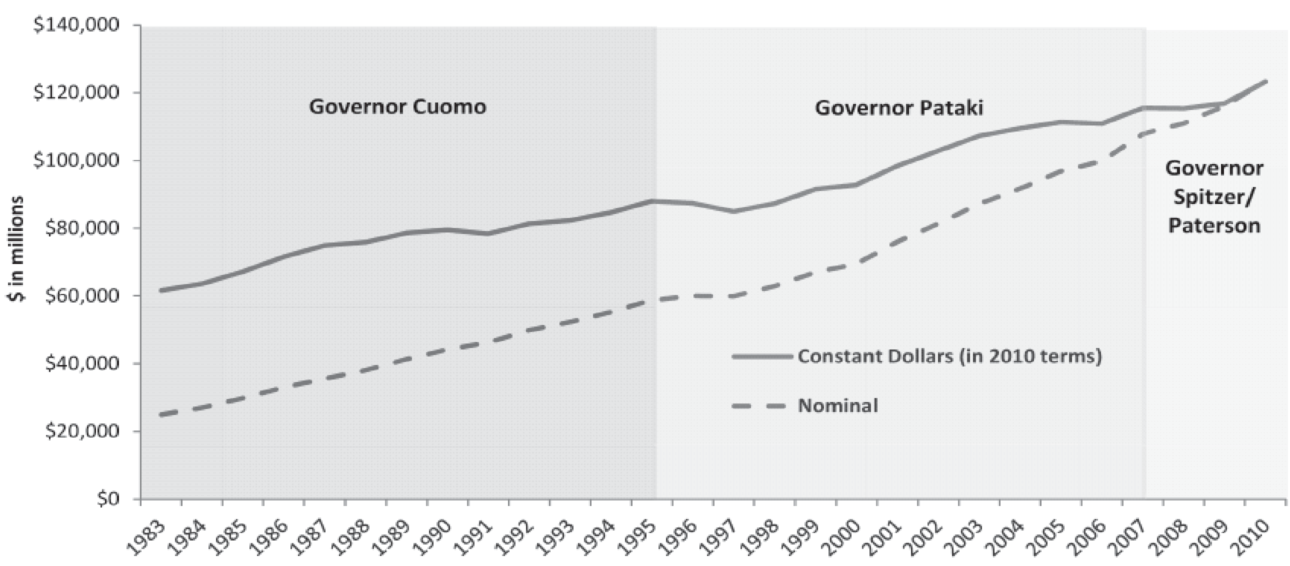
As shown in Table 2, the state has been a high spender for most of recent history. In the years since 1980, New York has typically ranked second or third in state and local spending per capita; in 1980 New York's per capita state and local expenditures were 39 percent above the national median compared to 52 percent in 2008.

New York's sustained high ranking as a big spender is related to continued rapid growth in state appropriations. Through Democratic and Republican administrations, the New York State budget has consistently expanded at a rate above the consumer price index. (See Figure 1). From 1983 through 1995, under Democratic Governor Mario Cuomo, constant dollar state spending grew on average per year 3.0 percent. During the next administration, under Republican George Pataki, annual growth slowed only slightly to an average of 2.3 percent above inflation. From 2007 to 2010, buoyed by federal stimulus assistance during one of the worst national recessions, total state spending adjusted for inflation grew 2.2 percent on average. Over the past 28 years, state spending grew less rapidly than the rate of inflation only five times.

New York's high spending reflects a willingness to impose a heavy tax burden. The state ranks second in per capita combined state and local tax revenues (behind Alaska) with a burden ($7,120) that is 76 percent above the national median. As discussed below, much of this tax burden is levied indirectly by the state, through mandates that require localities to fund key government activities.

Figure 1

New York State Spending, Nominal and Constant Dollars, Fiscal Years 1983-2010



Note: Spending excludes capital projects. Fiscal year 2010 adjusted for delayed school aid payments.

Sources: State of New York Office of the Comptroller, *Annual Report to the Legislature on State Funds Cash Basis of Accounting,* Multiple Years. U.S. Department of Labor, Bureau of Labor Statistics, *Consumer Price Index for All Urban Consumers, New York-Northern New Jersey-Long Island Area, All Items.*

B. New York's Decentralized Spending

The decentralized character of New York's public spending is evident in the share of combined state and local spending funded by the state. (See Table 3). In New York the state government's share of total direct spending (37 percent) is below the national median for states (44 percent). This places New York 42nd among the 50 states. Moreover, this figure is distorted—the state number for New York is disproportionately increased by the inclusion of utility expenditures. New York ranks first in the state share of electric utility expenditures because of the large role that New York's power authorities play in generating energy for the state. Excluding the state's electric utility expenditures moves New York to a lower 35 percent of combined state and local expenditures appropriated by the state, moving its ranking to number 46. Using this measure, the states ranking below New York (in order from number 47 to 50) are Colorado, Florida, California and Nevada.

Table 3: State Share of State and Local Direct Expenditure by Function, New York, Fiscal Year 2008

	50-State Rank	New York	National Median
Social Services	45	65%	81%
Higher Education	40	76%	97%
Administration	17	52%	46%
Mass Transit	9	37%	0%
Public Safety	47	25%	34%
Highway Transportation	45	45%	62%
Interest on General Debt	39	38%	53%
Other Education	49	4%	7%
Environment and Housing	49	10%	24%
All Other	37	18%	24%
Subtotal	**46**	**35%**	**46%**
Electric Utility	1	98%	0%
Total Direct Expenditure	**42**	**37%**	**44%**

Note: Direct expenditures exclude intergovernmental expenditures and expenditures for insurance benefits and repayments (e.g. unemployment insurance and workers compensation).

Source: U.S. Department of Commerce, U.S. Census Bureau, Division of Governments, *Survey of State and Local Finances,* 2008.

In the social welfare arena, New York relies on the city of New York and its 57 counties to administer public assistance, Medicaid and child welfare, and mandates that these localities pay an unusually large proportion of the cost of these programs. Particularly unusual is the high share of Medicaid costs imposed on localities. For fiscal year 2010–11, local governments' share of statewide Medicaid expenditures is estimated to be about $7.3 billion, or 13.8 percent of the total.[4] No other state requires a proportional contribution this large; most states require no local funding of Medicaid. As a result, in New York the state funds 65 percent of all social services, compared to a national median of 81 percent. (See Table 3). New York's funding level ranks it 45th among the 50 states.

Table 4: K-12 Education Expenditure per Capita, New York, Fiscal Year 2008

	New York	National Median
Local Direct Expenditure	**$2,635**	**$1,743**
State Intergovernmental Aid to Localities	**$1,382**	**$963**
State Direct Expenditure	**$0**	**$0**
Total State-Funded Expenditure	**$1,382**	**$991**
Local and State Direct Expenditure	**$2,635**	**$1,775**
State Share of Direct Expenditure	52%	57%
50-State Rank of State Share	30	NAP

NAP = Not Applicable.

Note: Per capita figures calculated using population as of July 1, 2007. The national median figure for each subcategory cannot be added to calculate the median figure for the larger category.

Sources: U.S. Department of Commerce, U.S. Census Bureau, Division of Governments, *Survey of State and Local Finances,* 2008. U.S. Department of Commerce, U.S. Census Bureau, Population Division, *Population Estimates.*

It is important to note that the data in Table 3 does not count as state spending the state's intergovernmental transfers, notably state aid to localities, which play a significant role in funding certain local services. The netting out of state aid to localities in Table 3 has the largest impact on the state share of education funding. Like all other states, except Hawaii, New York relies on local school districts to run its public schools, but the state provides local districts with aid to support education. In New York, however, the state plays a lesser role in financing those districts with state aid, leaving more financial responsibility to local districts. Using available data it is possible to calculate the state-funded portion of K-12 education spending. In 2008 among the 50 states the median state-funded share was 57 percent; in New York the figure was 52 percent, placing it 30th among the states.[5] (See Table 4).

With respect to decentralization, New York has consistently ranked low in the state share of total expenditures. (See Table 5). In past years New York was actually more decentralized than it is today. In 1980, the state accounted for only 30 percent of total state and local expenditures. As of 1990 this figure had increased to 35 percent, and it rose slightly higher by 2000 to 36 percent.

Table 5: State Share of State and Local Direct Expenditure, New York, Fiscal Years 1980, 1990, 2000 and 2008

	50-State Rank	New York	National Median
1980	46	29.7%	40.8%
1990	41	34.9%	41.6%
2000	45	35.9%	44.0%
2008	42	37.3%	44.4%

Note: Direct expenditures exclude intergovernmental expenditures and expenditures for insurance benefits and repayments (e.g. unemployment insurance and workers compensation).

Sources: Data for 1980, 1990, and 2000 from the Urban Institute-Brookings Institution Tax Policy Center, *State & Local Government Finance Data Query System.* <http://www.taxpolicycenter.org/slf-dqs/pages.cfm>. U.S. Department of Commerce, U.S. Census Bureau, Division of Governments, *Survey of State and Local Government Finances,* 2008.

The decentralization of public services is also evident in the provision of public employee retirement benefits. Employees of the state and of local governments other than the city of New York are enrolled in one of three defined benefit pension funds—one for teachers,[6] one for police and firefighters, and one for all others. These three funds are managed by the state Comptroller. Employees of the city of New York are enrolled in one of five funds—one each for police and firefighters, one for teachers, one for other education workers, and one for all others. The city funds are managed by joint labor-management boards. All eight of these funds are subject to control by the state legislature, which sets the eligibility requirements, employee payments, and benefit levels. That is, the state controls the cost to local governments of the pension benefits for their employees.

The separation of control over costs from responsibility for financing the benefits leads to a system that likely is far more expensive than if the pension benefits were controlled directly by local governments. As a Citizens Budget Commission report observed, “Legislators have incentives to support union demands, but need not face the taxpayers in raising the money to pay for them.”[7] In 2008 the state and local governments in New York spent an average of $1,104 per capita from their public employee retirement benefit funds.[8] This figure is more than double the national median of $480, causing New York to rank number two among the 50 states, behind only Alaska. The third highest ranking state, Illinois, distributed $827 per capita from its retirement benefit funds.

III. The State’s Spending Policies

New York spends its money in ways that differ from most other states. Four features distinguish New York’s state spending policies—greater provision of intergovernmental aid to localities, a high priority for social services, support for a unique transportation system, and relatively little support for public higher education.

Given its decentralized system of state and local governments, it should not be surprising that New York State allocates a disproportionately large share of its funds to aid to localities rather than to direct state operations. More than one-third (37 percent) of New York’s state spending takes the form of intergovernmental aid, a figure well above the national median of 28 percent. (See Table 6).

Table 6: State Expenditure per Capita by Function, New York, Fiscal Year 2008

	50-State Rank	New York	Percent of Total Spending	National Median
Intergovernmental to Localities	**2**	**$2,687**	**36.9%**	**$1,377**
K-12 Education	5	$1,382	19.0%	$963
Social Services	2	$807	11.1%	$60
Mass Transit	1	$186	2.6%	$0
Other Education	3	$113	1.6%	$9
Administration	26	$75	1.0%	$76
Environment & Housing	2	$68	0.9%	$16
Public Safety	14	$15	0.2%	$9
Highway Transportation	45	$1	0.0%	$43
Other	20	$41	0.6%	$36
Intergovernmental to Federal	**2**	**$32**	**0.4%**	**$0**
Direct Expenditure	**13**	**$4,555**	**62.6%**	**$3,574**
Social Services	9	$2,097	28.8%	$1,563
Higher Education	49	$455	6.3%	$710
Electric Utility	2	$400	5.5%	$0
Administration	8	$297	4.1%	$189
Mass Transit	2	$273	3.8%	$0
Public Safety	17	$227	3.1%	$214
Highway Transportation	43	$225	3.1%	$319
Interest on General Debt	16	$195	2.7%	$147
Other Education	40	$105	1.4%	$133
Environment and Housing	43	$79	1.1%	$122
All Other	18	$201	2.8%	$121
Total Expenditure	**7**	**$7,275**	**100.0%**	**$5,022**

Note: Per capita figures calculated using population as of July 1, 2007. All data excludes expenditures for insurance benefits and repayments (e.g. unemployment insurance and workers compensation). The national median figure for each subcategory cannot be added to calculate the median figure for the larger category.

Sources: U.S. Department of Commerce, U.S. Census Bureau, Division of Governments, *Survey of State and Local Finances,* 2008. U.S. Department of Commerce, U.S. Census Bureau, Population Division, *Population Estimates.*

As in most other states, the lion’s share of intergovernmental expenditures is state aid to local school districts. But New York’s school aid is a less dominant element than in other states, accounting for about 51 percent of total aid compared to a national median of 67 percent. Much more of New York's aid goes toward other functions carried out by localities, notably social services—30 percent versus a national median of 5 percent.

Although state funds account for a relatively low share of total education spending, the amount of per capita state aid to school districts in New York ($1,382) ranks fifth in the nation and is 43 percent above the national median ($963). (See Table 6). The dollar amount is high while the state share of the total is low because local spending for education in New York is extremely high, especially in wealthier districts. In the 2007–08 school year, New York spent $17,173 for each elementary and secondary school pupil, 67 percent higher than the national average of $10,259.[9]

New York's high priority for social services is reflected in its high ranking among the states for both direct expenditures (9th) and intergovernmental aid (2nd). The combined per capita state spending for social services is $2,904, more than every other state. This is even more remarkable given the unusual requirement in New York for local governments to fund a major share of social service spending; combined state and local direct spending per capita for social services in New York is $3,208, the second highest in the nation behind Wyoming.

The three major elements of social services spending are child welfare, public assistance and medical assistance. The last and largest category, funded in part through the federal Medicaid program, is the major factor accounting for the state's exceptionally high social service spending. New York has the highest Medicaid spending among the states, accounting for 14.1 percent of the national total in fiscal year 2008 while covering only 8.5 percent of the beneficiaries.[10] New York's spending per beneficiary in fiscal year 2007, $8,450 annually, was the highest in the nation and 64 percent above the national average.[11]

A recent study identified three characteristics of New York's Medicaid program that make it unusually expensive.[12]

a. New York extends eligibility to the non-poor or middle class for long-term care services such as nursing homes and at-home personal care. Eligibility rules, which some might characterize as "loopholes," permit individuals to qualify for these services while protecting their assets through transfers to other family members and through a process of "spousal refusal" enabling spouses to keep assets and income while the individual receives Medicaid funded care. As a result New York accounts for fully one-quarter of the nation's Medicaid beneficiaries who are receiving long-term care services while not qualifying for cash assistance.

b. New York pays institutional providers, notably hospitals and nursing homes, at rates above competitive costs. After adjusting for local cost of living and for the medical needs of patients (known as casemix), the rates paid to hospitals in New York were still 15 percent above the national average; the rates for nursing homes were 33 percent above the national average.[13]

c. New York allows excessive use of some services, specifically hospital inpatient care and personal care. Among elderly and disabled residents, New York has higher rates of hospital inpatient use than many states, and among individuals enrolled in New York's personal care program the average number of hours of care is nearly triple the national average.

As a result, New York's Medicaid spending per enrollee is higher than national norms across all categories of eligibility, with spending per enrollee for the elderly and disabled nearly double the national average.[14] In fiscal year 2007 spending for the elderly and disabled in New York was 77 and 95 percent higher than the national average, respectively. For elderly enrollees New York spends $22,159 per beneficiary compared to a national average of $12,499. For the disabled the figures are $28,223 in New York and $14,481 nationally.

A similar relative generosity characterizes New York State's public assistance benefits. Using the benefit provided to a family of three in the state's largest urban area as a gauge, New York's monthly benefit of $721 ranks second behind Alaska ($923).[15]

With respect to transportation, New York's per capita spending ranks fifth.[16] This figure, however, masks an important difference between New York and most other states. Fully 65 percent of New York's transportation spending supports public transit, more than any other state and well above second place New Jersey (50 percent). New York's Metropolitan Transportation Authority, providing mass transit services in the downstate region, accounts for about 32 percent of all public transit ridership in the nation.[17] The state's combined high support for public transit, with relatively modest support for highways, thus reflects the nature of its transportation system.

In contrast, New York state's support from its own funds for higher education ($455 per capita) ranks 49th among the states, about 36 percent below the national median and just ahead of last-ranking Florida. In most states, state support for higher education takes the form of appropriations for a state run university system. However, only about 56 percent of freshman students from New York attend a public institution within the state, ranking it 41st on this indicator.[18] The state's low higher education spending thus reflects the relatively low share of state youth who attend New York's state university system.

New York's modest per capita level of support for public higher education nevertheless yields a higher than average level of funding per student, $7,924 versus a national median of $6,922. Because New York charges relatively low tuition and fees, $3,588 per student versus the national median of $4,198, New York has a relatively low overall $14,708 expenditure per student, compared to the national median of $16,748.[19]

Finally, New York allocates a larger share (5 percent) of its public support to private colleges and universities than all but one other state—Pennsylvania with 11 percent.

IV. Thoughts on the Future

In summary, three distinguishing features of New York State spending, all long-standing, are: (1) a large state and local public sector; (2) a decentralized state and local sector with large shares of spending a local responsibility; and (3) state spending that gives high priority to social services (including Medicaid) and mass transit.

Given the enduring nature of these characteristics, the most likely outlook is for their continuation. Is there any change in the political or economic landscape that might suggest fundamental changes in New York's fiscal policy?

Two commonly discussed factors are (1) the recent, severe economic recession originating in the financial services sector, which has undermined a key portion of New York's revenue base; and (2) a new governor and recent changes in the party control over the state senate, which in 2011 switched back to Republican control after a brief two-year period of Democratic control.

The national recession that began in early 2008 is turning into the worst economic period since the Great Depression of the 1930s. It has eroded tax revenues for all states, causing base tax revenues to decline for two consecutive years in New York. Initially state leaders did not alter the basic features of New York's fiscal policies. The budget adopted in the spring of 2009 for the 2009-10 fiscal year increased spending 8.5 percent from the previous year, financing this increase with federal stimulus aid plus $8.1 billion in new revenue measures.[20] The largest of these revenue measures was a three-year increase in the personal income tax for high-income residents, which yielded $3.5 billion in its first year. The temporary surcharge will expire at the end of calendar year 2011. Other new or added taxes were levied on insurance companies and utilities. In addition, after adoption of the budget, the state established a new payroll tax in the 12 counties served by the Metropolitan Transportation Authority, with the revenue dedicated to that agency. The 0.3 percent tax yielded over $1 billion in fiscal year 2009–10.[21]

Passage of the fiscal year 2011 budget involved a protracted battle between Governor David Paterson and the legislative leaders with final budget legislation passed in August 2010, more than four months after the start of the fiscal year. The "lame duck" Governor used his budgetary powers to fight for moderation in the growth of spending and was partly successful. Spending from all governmental funds increased 6.3 percent, but the figure drops to 3.0 percent when adjustment is made for items delayed from the previous fiscal year.[22] This was still a significant increase given the high base in the previous year and the weak economic conditions. Even more troubling was the use of an estimated $16.7 billion in non-recurring resources including federal stimulus aid to finance the spending, leaving future budget gaps that rise to $17.2 billion in fiscal year 2014.[23] While the budget powers used by Paterson suggest future governors with the inclination might be effective in controlling spending, the general outlook indicates the recession has not altered the basic political dynamic.

The change in party control of the senate also is unlikely to alter basic fiscal patterns. Republicans in other states are typically identified with more fiscally conservative policies, such as lower overall spending and a lower priority for social services. But New York followed the opposite policies for years under a Republican senate, and the switch back to Republican control is likely to mean continued support for these same priorities. However, the state's new governor, Andrew Cuomo, signaled throughout the campaign that his administration will control the growth of spending. During the campaign Governor Cuomo issued a policy agenda which advocated for a state spending cap, freezing state employee salaries, and no tax increases, among other fiscally conservative proposals.[24] His first budget was challenging, as his administration struggles to find savings amidst the expiration of federal stimulus, large baseline expense increases (particularly for Medicaid) and a stagnant economy. Remarkably, the enacted budget reduces spending from all government funding by 1.3 percent, the first year over year reduction since 1997.

One area which may see accelerated change under the new regime is a move toward greater centralization at the state level. The impetus for shifting more responsibility for school finance to the state came from New York City through court action, and the favorable court decisions have been applied to other urban districts. In 2007 newly elected Governor Eliot Spitzer proposed and had enacted a program to substantially increase aid to needy urban school districts over several years. The move to more generous and better targeted school aid was slowed by the recession, but this policy is likely to be revived as economic conditions improve.

With respect to Medicaid and public assistance, the city of New York and virtually all counties favor increased state financing. Shifting to state funding would move the burden of financing services for the indigent to wealthier individuals, an arrangement that public finance experts consider more equitable. Early steps in this direction were taken under Governor Mario Cuomo, a Democrat, when the state assumed a larger share of the financing for long-term care under Medicaid. In 2005, under Governor George Pataki, a Republican, the state capped the growth in the local share of Medicaid funding at 3 percent annually, and took full responsibility for an expanded portion of the Medicaid program known as Family Health Plus. In 2010, the state enacted legislation requiring a full state assumption of Medicaid administration costs by 2016.[25] Similar efforts are likely to gain greater support in coming legislative sessions, depending of course on the renewed availability of state revenues. Thus, the area with the greatest potential for change is the heavy decentralization of New York's public fisc.

Endnotes

1. Data for this comparative analysis is from the U.S. Dep't of Commerce, U.S. Census Bureau, Div. of Gov'ts, 2008 Annual Surveys of State and Local Government Finance [hereinafter State and Local Survey], *available at* http://www.census.gov/govs/estimate/ and the U.S. Dep't of Commerce, U.S. Census Bureau, Populations Division, Preliminary Annual Estimates of the Resident Population for the United States, Regions, States, and Puerto Rico: April 1, 2000 to July 1, 2010 [hereinafter Population Estimates], *available at* http://www.census.gov/popest/eval-estimates/eval-est2010.html. At the time of this writing, the most recent year for which state and local data are available is fiscal year 2008. Some figures were derived from micro data from the individual unit file, which contains individual amounts for each finance code and unit of government. Total spending used in this article excludes the category "Insurance Benefits and Repayments," which includes unemployment insurance and workers' compensation, and "Intergovernmental Expenditures." Intergovernmental expenditures are excluded to avoid double counting of local direct spending that is funded by state aid. The documentation for the Census data notes that there is not a consistent basis of accounting used across all government units. For each government, the Census adopts whatever accounting basis is used by that government, as long as it is consistent for that government over time.
2. *Id.*
3. *Id.*
4. N.Y. State, Div. of the Budget, 2010–11 Enacted Budget Financial Plan 66 (2010), *available at* http://publications.budget.state.ny.us/budgetFP/2010-11FinancialPlanReport.pdf.
5. State share of K-12 education calculated as state direct and intergovernmental expenditures divided by state and local direct expenditures.
6. The faculty at the state and city university systems have an option to enroll in TIAA/CREF.
7. Citizens Budget Comm'n, Old Assumptions, New Realities: The Truth about Wages and Retirement Benefits for Government Employees 9 (2005), http://www.cbcny.org/Pension_Web.pdf.
8. State and Local Survey; Population Estimates, *supra* note 1.
9. U.S. Dep't of Commerce, U.S. Census Bureau, Division of Governments, Public Education Finances: 2008 xiii (2010), *available at* http://www2.census.gov/govs/school/08f33pub.pdf.
10. Kaiser Family Found., *State Health Facts*, http://www.statehealthfacts.org (last visited Mar. 30, 2011). Data for Medicaid enrollees are based on fiscal year 2007.
11. Kaiser Family Found., *State Medicaid Fact Sheets: New York & United States*, http://www.statehealthfacts.org/mfs.jsp?rgn=34&rgn=1 (last visited Mar. 30, 2011).
12. *See* Citizens Budget Comm'n, Medicaid in New York: Why New York's Program is the Most Expensive in the Nation and What to do About It (2006), http://www.cbcny.org/MedicaidREV4Web.pdf.
13. Citizens Budget Comm'n, Paying More But Not Getting Better Care: The Case for a New Payment System for Nursing Homes in New York's Medicaid Program 2 (2008), http://www.cbcny.org/Nursing_Home_FINAL.pdf.
14. The Lewin Group, Analysis of the New York State Medicaid Program and Identification of Potential Cost-Containment Opportunities (2010), http://www.nysaaaa.org/News%20Headlines/2010/Reports/CitizensBudgetCommissionRpt%20-%20Lewin%20Group%20-%202010.pdf. This report was prepared for the Citizens Budget Commission.
15. The Urban Inst., Welfare Rules Databook: State TANF Policies as of July 2009 184–5 (2010), *available at* http://www.urban.org/uploadedpdf/412252-Welfare-Rules-Databook.pdf.
16. The ranking combines intergovernmental expenditures and direct state expenditures for mass transit, highway transportation and other forms of transportation.
17. American Pub. Trans. Assoc., Transit Ridership Report, First Quarter 2009 (2009), http://www.apta.com/resources/statistics/Documents/Ridership/2009_q1_ridership_APTA.pdf.
18. Nat'l Ctr. for Educ. Statistics, *Integrated Postsecondary Education Data System, Data Analysis System*, http://nces.ed.gov/ipeds/ (last visited Mar. 30, 2011).
19. *Id.*
20. Citizens Budget Comm'n, Review of the New York State Fiscal Year 2009–10 Budget (2009), *available at* http://www.cbcny.org/Review%20of%20New%20York%20State%20Fiscal%20Year%202009-2010%20Budget.pdf.
21. Office of the N.Y. State Comptroller, Annual Report to the Legislature on State Funds Cash Basis of Accounting, Fiscal Year Ended March 31, 2010 61 (2010), *available at* http://www.osc.state.ny.us/finance/cashrpt/annual2010.pdf.
22. New York State Div. of Budget, 2011–12 Financial Plan, Enacted Budget 2011, http://publications.budget.ny.gov/budget FP/2011-2012EnactedBudget.pdf.
23. *Id.;* Office of the N.Y. State Comptroller, Report on the State Fiscal Year 2010–11 Enacted Budget 1–3 (2010), *available at* http://www.osc.state.ny.us/reports/budget/2011/2010-11enactedbudgetreport.pdf.
24. *See* Cuomo 2010, The New NY Agenda, Chapter 2: Get Our Fiscal House in Order (2010), *available at* http://www.andrewcuomo.com/issues_and_agenda. (last visited Mar. 3, 2011).
25. 2010 N.Y. Laws Ch. 58, Part B, § 47-b.

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Unions, Collective Bargaining, and the State Budget

By E.J. McMahon

New York's Taylor Law, enacted in 1967, granted state and local workers the right to form unions to collectively bargain with their employers. Union contracts now cover at least seventy-three percent of New York's government employees, more than twice the national average.[1] Members of public employee unions account for more than half of all unionized workers in the state. Union contracts cover the vast majority of the state's 232,000 full-time equivalent employees (FTEs).[2]

"While the Taylor Law has succeeded in creating a comprehensive framework for orderly resolution of labor-management disputes in state and local government, it also has narrowed the options available to state officials seeking to control spending in times of great fiscal stress."

Widespread public-sector unionization has played an important role in shaping the size, composition and compensation levels of the state government's workforce. While the Taylor Law has succeeded in creating a comprehensive framework for orderly resolution of labor-management disputes in state and local government, it also has narrowed the options available to state officials seeking to control spending in times of great fiscal stress. The budgetary impact of collective bargaining is not limited to the state payroll. Unions representing local government employees, especially teachers, also have come to wield significant influence on the state budget process.

Background

The Executive Budget provisions of New York State's constitution had been in effect for less than a decade when workers in New York were granted the right to organize and collectively bargain under Article 1, Section 17 of the State Constitution, adopted in 1938. At that point, however, the state government and other public sector employers were under no reciprocal obligation to negotiate with their worker organizations.

It would be almost twenty years before New York City municipal employees became the first large group of government workers in the state to be granted full collective bargaining privileges. Continuing labor unrest in the city, and the perceived ineffectiveness of the state's draconian law barring public sector strikes, led Governor Nelson Rockefeller to push for a statewide solution. The result was the Public Employees Fair Employment Act, better known as the Taylor Law,[3] which granted collective bargaining privileges for every level of government in New York while outlawing strikes by government workers.

Soon after the Taylor Law's enactment in 1967, the Civil Service Employees Association (CSEA) was certified as the union representing most administrative and institutional employees in state government. State corrections officers, state troopers, and other employees would form their own unions, while some of CSEA's better-paid professional and technical members ultimately would spin off into the Public Employees Federation (PEF). By the 1970s, the vast majority of classified positions in state and local government were covered by collective bargaining agreements.

It should be noted that government workers in New York were hardly bereft of rights and protections before the Taylor Law. The Association of State Civil Service Employees, predecessor of CSEA, had successfully lobbied for a uniform salary classification structure and for a reduction in work hours for institutional employees in the 1930s. By 1941, civil service employees had won the right to a hearing if faced with disciplinary charges. In 1955, all competitive class employees were granted tenure.[4]

But the formal collective bargaining mandate represented a new paradigm with significant implications for the state budget. It meant that salaries and benefits for state employees, already statutory, would now be treated as a binding *contractual* commitment. Any proposed change in employee compensation, or in other terms and conditions subject to bargaining under the Taylor Law, is subject to negotiation with unions.[5]

Subsequent amendments to the Taylor Law also required agencies to collect union dues through paycheck deductions from employees on a non-voluntary "agency shop" basis. This gave public employee unions access to a large new pool of income, which they could use to expand their lobbying staffs and political activities. As a result, they became more significant players in elections at both the state and local level.

Timing Is Everything

The state government's union contracts typically run for four-year periods, timed to expire with the last fiscal year of each gubernatorial term. This gives the unions a fresh start with every newly elected or re-elected governor. It also gives governors one opportunity per term to negotiate contract changes that can have a major bearing on state expenditures.

Governor Mario Cuomo had been elected with the strong support of unions (especially CSEA) in 1982, and he significantly expanded the number of state workers during his first two terms, adding 31,000 full-time equivalent (FTE) position to the payroll. (*See* chart from the Office of the State Comptroller below). But when a major fiscal crisis developed in 1990-91, Cuomo reversed course—sharply reducing the state headcount through a combination of layoffs and attrition. He also froze base salaries for state employees in the first two years of union contracts negotiated during his final term.[6]

Cuomo's successor, George Pataki, was elected on a fiscally conservative platform, committed to restraining spending growth and cutting taxes. Faced with a $5 billion gap upon taking office as governor in 1995, Pataki persuaded unions to accept non-recurring bonus payments in lieu of base pay increases during his first two years in office. He also moved aggressively to reduce the state payroll through attrition, while pursuing his goal of outsourcing more work to private contractors.[7] During Pataki's first two years in office, the FTE headcount was reduced by more than 20,000 positions, declining to its lowest level since 1983.

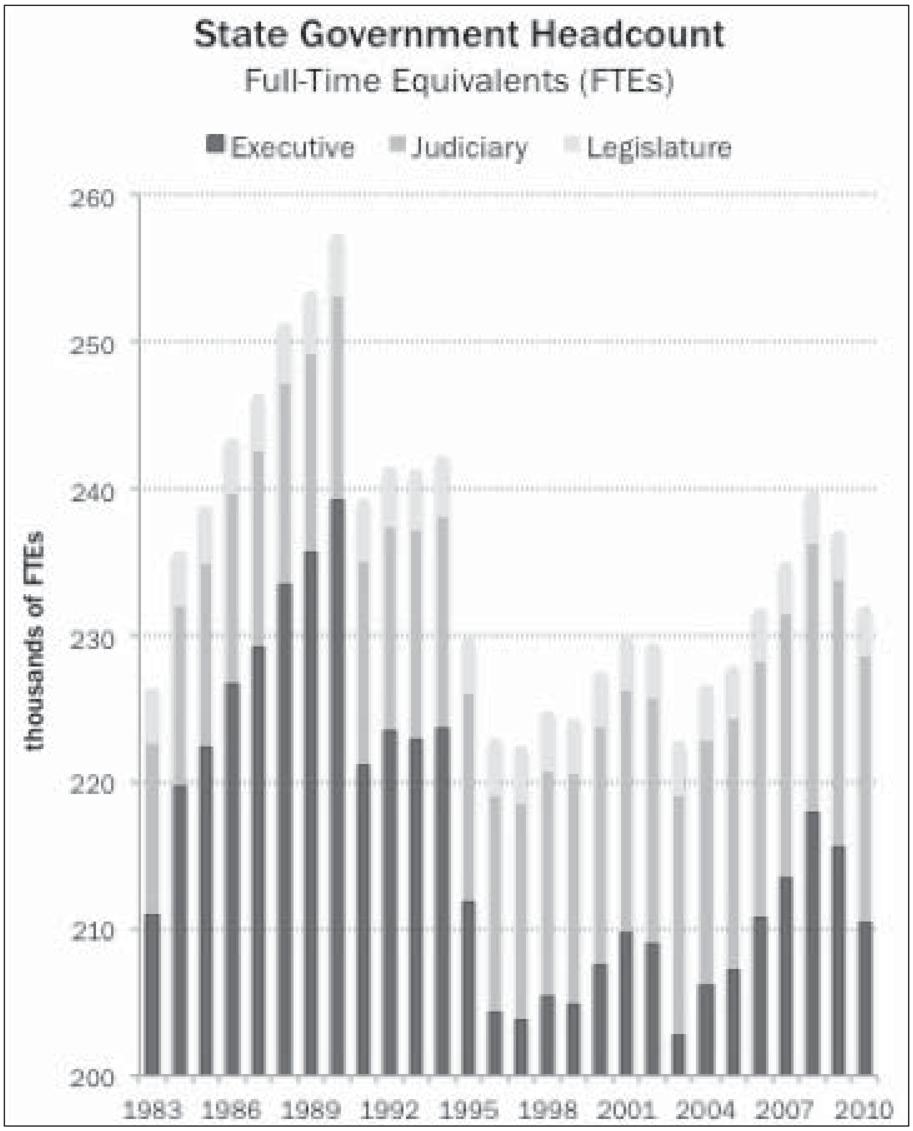
The second contract cycle of the Pataki era began in the midst of an economic and financial boom—which was reflected in the terms of the ultimate settlement. In 2000, the governor and state unions agreed to contracts featuring a total base salary increase of nearly fourteen percent. As a bonus, Pataki agreed to seek legislative approval for a series of pension benefit enhancements, including the elimination of employee pension contributions for all workers with at least ten years in the system. For eligible workers, this amounted to an additional three percent pay increase.

Just three years later, the Wall Street bubble had burst and the state's fiscal condition had been radically altered—for the worse. In the wake of a national recession, stock market downturn and the 9/11 attacks, Pataki began his third term faced with a record $9 billion budget gap. Once again, union contracts were up for renewal. Repeating the pattern of the early 1990s, Pataki's final contract cycle produced modest pay increases, beginning with a lump sum bonus instead of a raise in base salaries.

The timing of New York's most recent fiscal cycle, however, has been much more favorable to state unions. The expiration of state contracts in early 2007 coincided with the peak of a national economic expansion and the arrival of a new governor, Eliot Spitzer, who had run with the support of public employee unions. The new governor added 8,000 jobs back to the payroll, reflecting in part his agreement with the unions' goal of reversing Pataki's outsourcing policies.

Spitzer's October 2007 deal with CSEA set the pattern for subsequent contracts with other unions: a four-year base pay increase of nearly fourteen percent, plus increases in base pay differentials for employees working downstate. Paterson reached similar agreements with PEF and the State Police Benevolent Association soon after taking office in the spring of 2008.

The financial crises and Wall Street crash in the fall of 2008 was followed by an immediate, sickening drop in state revenues. Scrambling to close what was estimated at one point to be an $11 billion budget gap, Paterson repeatedly sought concessions from the state's unions, which refused to reopen their contracts.[8] While taxes were being raised and other areas of spending were tightly



constrained or even cut, state employees ended up receiving their scheduled raises of three percent on April 1, 2009 and four percent on April 1, 2010. The 2007-2011 labor agreements added a total of well over $1 billion to state spending during what turned out to be the worst and most prolonged fiscal crisis in decades.

Frustrated in his attempts to win voluntary union concessions, Paterson attempted to force the issue by including a one-day payless furlough for 100,000 workers in a May 2010 temporary budget extender bill. However, that move was overturned by a federal court injunction.[9] One of Paterson's last acts as governor was to announce the layoffs of about 900 workers—effective his final day in office.

Governor Andrew Cuomo took office committed to seeking at least a one-year freeze in state employee salaries—which averaged $66,600, with fringes bringing total average compensation to $98,854.[10] His 2011-12 Executive Budget assumed $450 million in savings would flow from union concessions or up to 9,800 layoffs. By July 2011, Cuomo had negotiated tentative five-year contracts with CSEA and PEF on relatively austere terms, pledging no layoffs in exchange for a three-year freeze in base pay, unpaid furloughs in 2011-12 and 2012-13, and an increase in the employee share of health insurance premiums.

Of course, the budgetary impact of labor concerns is not limited to contractual compensation issues. For example, the union representing correctional officers has been the main obstacle to proposals to close upstate prisons, even though the inmate population is dropping. And as then-Governor-elect Cuomo discovered on a tour of state facilities in November 2010, a state law requiring one-year's notice of facility closures required an upstate juvenile justice center to be kept open and fully staffed, even though it no longer had any residents.

Structural Issues

In addition to setting forth the terms and conditions subject to negotiation with unions, the Taylor Law has been amended over the years in ways that further strengthen the labor side of the bargaining table. Two provisions are especially noteworthy:

The ***Triborough Amendment*** ("Triborough"), adopted in 1982,[11] provides that all terms and conditions of an expired contract remain in effect until a new contract is negotiated. Among other things, Triborough preserves the automatic annual longevity "step" increments provided to employees on civil service salary schedules. Local governments and school districts have long argued that Triborough makes it easier for unions to resist changes in existing contracts, since many employees (and most teachers, whose contracts feature the most steps) can continue receiving raises during a contract impasse. The state government is also affected; for example, the state will be required to dole out $100 million in incremental raises in 2010-11, despite Governor Andrew Cuomo's professed intention to "freeze" state salaries.

Binding Arbitration of contract impasses can be sought by unions representing public safety employees in New York State. Municipal officials have argued that arbitration has enabled police, in particular, to build a significant edge in salaries over other state and local government employees. Nonetheless, Governor Pataki further expanded arbitration rights to State Police and state corrections officers during his tenure.

Both the Triborough Amendment and arbitration provisions of the Taylor Law could be changed by the Legislature without recourse to union negotiations. However, while repeal or modification of both provisions is a high priority of local government officials, it has yet to surface as an issue in Albany.

Public pension benefits, while technically non-negotiable with unions, are another key budget issue influenced by public employee unions. As noted above, Pataki agreed as part of his 2000 union contract negotiations to seek a series of pension sweeteners for state and local workers; in addition to eliminating contributions for many employees, these included the addition of a partial annual cost-of-living increase in pension benefits. Retirement ages, pension vesting periods and other benefit levels all had been enhanced under previous legislation in the 1980s and 1990s. These changes, promoted as virtually cost-free at the time of their adoption, would later compound the financial impact of pension fund losses in the 2001-02 and 2007-09 stock market downturns.

Responding to public alarm over rising pension costs, Governor David Paterson sought in 2009 to curb future state and local retirement benefits. In exchange for an agreement by CSEA and PEF not to lobby against his proposed pension changes, Paterson made an unprecedented promise not to lay off workers through the rest of his term—effectively giving up the only leverage he had to seek further concessions from the unions.

The result, in December 2009, was the enactment of a fifth pension "tier" for newly hired state and local employees. For civilian employees, Tier 5 essentially restored the pension benefit structure in effect under Tier 4 as originally enacted in 1983. The most significant Tier 5 changes affected police and firefighters, who will now be required to contribute to their pension plans. The state comptroller's office estimates that tax-funded pension costs for employees in the new plan will be about 20 percent lower, but those savings will not become apparent for years to come.

Influence of Local Unions

Salaries and benefits for state workers will come to $17.7 billion, or 20 percent of the State Funds budget (net of federal grants), under Governor Cuomo's proposal for 2011-12. But the largest portion of the budget is aid to K-12 public schools, which will consume nearly $23 billion in state funds.[12] While school boards, administrators and parent groups have their own well-established statewide associations, the most powerful source of lobbying pressure for more school aid has been New York State United Teachers (NYSUT) and its New York City affiliate, the United Federation of Teachers (UFT). Teacher compensation, after all, is the biggest category of school spending.

NYSUT and UFT played an important role in supporting and promoting the Campaign for Fiscal Equity lawsuit, which led to Court of Appeals decision encouraging the state to significantly increase its aid to New York City schools.[13] The CFE ruling, in turn, became the rationale for Governor Spitzer's promise of record aid for all schools expansion starting in 2007. During the budget battles of 2009, the teacher unions spearheaded a successful campaign to raise taxes on high-income New Yorkers as an alternative to cutting school aid, and they were pushing an extended "millionaire tax" to finance school aid restorations in 2011.

Conclusion

The Taylor Law made public employee unions a powerful force to be reckoned with—perhaps the most powerful force in the state budget process. The travails of Governor Paterson demonstrated the extent to which collective bargaining can limit the ability of elected executives and legislators to respond to fiscal emergencies. Once a contract is in effect, a governor confronted with a fiscal emergency has little recourse but to freeze hiring and lay off employees if unions are unwilling (as, historically, they have generally proven to be) to make other concessions.

Even when a contract is up for negotiation, governors acting on their own have limited ability to reshape the parameters of employee compensation or work rules. And—so far, at least—governors and lawmakers have been unwilling to seek changes in provisions of the Taylor Law that protect the *status quo* for unions.

Endnotes

1. Based on federal data for the State of New York. *See* Barry T. Hirsch & David A. Macpherson, Union Membership, Coverage, Density and Employment by State, 2009 (2010), http://www.unionstats.com/.
2. Office of the N.Y. State Comptroller, Div. of State Gov't Accountability, New York State Housing Finance Agency and State of New York Mortgage Agency: Eligibility for Health Insurance Coverage 3 (2008).
3. *See* N.Y. Civ. Serv. Law §§ 200–214 (McKinney 2011). The law is named after George Taylor, a prominent labor law expert who chaired the committee that Governor Rockefeller appointed to recommend provisions for a New York collective bargaining statute.
4. Terry O'Neill & E.J. McMahon, Empire Ctr. for N.Y. State Policy, Taylor Made: The Cost and Consequences of New York's Public-Sector Labor Laws 3 (2007), *available at* http://www.empirecenter.org/Special-Reports/2007/10/TaylorMadeReport.cfm; *see also Preller Bill Makes 165 Changes in Civil Service Law; Allows Right of Hearing with Counsel; Extends Transfers; Ends Budget Director's Veto*, 16 Civil Service Leader 21 (1955), *in* Civil Serv. Employees Assoc. Inc., Records 1918-Ongoing, Archives of Public Affairs and Policy, http://library.albany.edu/speccoll/findaids/ apap015.htm (last visited April 6, 2011).
5. The sole major exception: pension benefits—which are guaranteed by the 1938 state Constitution. Collective bargaining of pension changes was prohibited in 1971, although this has not prevented elected officials and unions from agreeing informally to seek legislation increasing benefits.
6. The unions also agreed to drop their legal challenges to a five-day "lag" payroll instituted by Cuomo and the Legislature without their initial consent in December 1990. The courts had been siding with the unions in that dispute; *see, e.g.*, Condell v. Bress, 983 F.2d 415, 416 (2d Cir. 1993).
7. Ironically, although the concept was most closely identified with his Republican successor, the largest single outsourcing of state work in New York's recent history was Governor Mario Cuomo's 1994 shift of income tax processing from seasonal state employees to a private vendor (initially Fleet Bank) in 1994.
8. Although it was widely overlooked at the time, a bill submitted with Paterson's 2009-10 budget would have eliminated all scheduled pay increases starting in 2009 without the unions' consent—a power the Legislature arguably possesses, as legal consultants to the Empire Center explained. *See* Memorandum from Terry O'Neil & Howard Miller, Bond, Schoeneck & King PLLC to E.J. McMahon, Director, The Empire Center for New York State Policy (May 3, 2010), *available at* http://www.empirecenter.org/Documents/PDF/Legislative%20Wage%20Freeze%20Memo.pdf.
9. *See* Donohue v. Paterson, 715 F. Supp.2d 306 (N.D.N.Y. 2010).
10. N.Y. State Governor Andrew M. Cuomo, 2011-12 Executive Budget Briefing Book 81 (2011), *available at* http://publications.budget.state.ny.us/eBudget1112/fy1112littlebook/BriefingBook.pdf.
11. 1982 N.Y. Laws Ch. 868, 921.
12. Editorial, *Gov Cuomo's Budget*, N.Y. Times, Apr. 1, 2011, at A18. The new budget includes aid for subsidized property tax homestead exemptions under the School Tax Relief (STAR) program.
13. Campaign for Fiscal Equity, Inc. v. State, 861 N.E.2d 50, 51 (N.Y. 2006).

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Medicaid in New York: A Half-Century of Care, Cost and Controversy

By John F. Cape

As New York State grapples with a yawning structural budget deficit, it has become clear that the current cost profile of Medicaid is fundamentally unsustainable. Moreover, unlike the past, a similar reality now confronts the federal government. As calls for fundamental entitlement reform, albeit belatedly, gain real traction, New York finds itself at a crossroads. As we look ahead to the implementation of federal healthcare reform and the Hobson's choices imposed on us by a new economic reality, we should pause to reflect on how we got here.

In his companion piece to this monograph, Eugene Laks, an architect of many of the Medicaid laws for over a quarter century, traces the evolution of the Medicaid program through its major benchmarks. To place that illuminating article in context, I will revisit the birth of state and federally funded healthcare in New York and what lessons we might derive as we look to the implementation of a redesigned Medicaid program going forward.

It was a time that fewer and fewer of us remember. John Kennedy was in the White House, and after a tragedy that rocked the country to its core, he was followed by Lyndon Johnson with his commitment to a "Great Society." In New York, Governor Nelson Rockefeller presided over the most progressive approach to state government in decades. In this golden age of liberalism, New York converted and transformed its patchwork system of charity and welfare-driven healthcare for the poor and elderly into a system of Medicaid and Medicare that Governor Rockefeller saw as a new national model.

Today, Governor Rockefeller's legacy pervades the State Capitol, which is framed by the striking original South Mall complex that now bears his name and looks down on the elegant headquarters of the Delaware and Hudson Railroad—which now house his most striking achievement: the State University of New York. But despite these monuments, nowhere does Rocky's legacy dominate the business of New York State government more than in the Medicaid program's impact on its balance sheet. Today, New York's Medicaid program, by far the nation's most expensive, consumes a staggering $53 billion.[1]

As with many public policy issues, the root causes of the current condition can be traced to choices made at the program's inception. In this case, those choices can be found in the 1960s.

The federal government was acutely aware of the need to gain cooperation and inclusion from the healthcare industry. Accordingly, in creating Medicare Part A, the former federal Department of Health, Education, and Welfare (HEW)[2] allowed hospitals to create buffers between themselves and the federal bureaucracy. Most hospitals elected to nominate Blue Cross agencies as "fiscal intermediaries" to deal with the federal Social Security Administration. Similarly, under Part B, the Secretary of HEW chose regional insurance entities, called "carriers," to be the intermediary in geographic regions. Most carriers turned out to be Blue Shield entities. As such, the Medicare program, at its inception, was largely a federally funded creature of the insurance industry, a single-payor insurance model that remains today.

Moreover, underlying the financing structure of Medicare was a policy of using this federal program to expand and enhance the nation's healthcare infrastructure. Following the practice used by Blue Cross, the federal government opted for a cost-based system of reimbursement, rather than a common, or negotiated, schedule of fees for services. In designing the reimbursement system, the government agreed to include depreciation in the cost base, a position very favorable to hospitals. Essentially, by paying depreciation to a not-for-profit hospital, the federal government shifted the burden for institutions built with community and charitable funds to be rebuilt and expanded with public funds.

In contrast, Medicaid programs were left to be largely a creature of the states. In New York, the original design was built on the history of welfare medicine supported by counties and a series of state programs. Accordingly, the original Medicaid program included a significant role for counties in both the administration and financing of the program. In 1965, the State re-imposed a sales tax at the rate of 2 percent, and authorized a like amount for counties.[3] In the next six years the State raised the rate twice—first to three and then to four percent.[4] Counties were allowed to follow suit to support the cost of half of the rapidly rising non-federal share of Medicaid.

The decision to provide capital reimbursement in both Medicare and Medicaid, in addition to the federal Hill-Burton program, created a huge incentive for hospital expansion, even as there was a growing movement toward ambulatory care in the medical community. These financing streams allowed hospitals to gain their own access to financing for capital investment, thereby frustrating fledgling efforts at coordinating healthcare investment.

One of the earliest efforts at planning for a rational allocation of healthcare resources was the creation of the Hospital Planning Council of Greater New York in the late 1930s. Over the next thirty years, community efforts, largely to coordinate philanthropy, sprung up across the country. In 1966, the federal government authorized partial funding for Comprehensive Health Planning agencies, but stopped short of giving them authority over Medicare capital reimbursement.[5]

By the 1970s the twin stresses of the Vietnam War and runaway inflation changed the national mood toward healthcare from redistributive to regulatory. Similarly, the 1970s in New York ushered out the high-flying Rockefeller era, and brought in Governor Carey to confront the State and New York City fiscal crises. That experience ushered in the first of a series of attempts to control the cost of Medicaid in New York. Furthermore, the 1980s brought the nation Ronald Reagan to do the same on the national level. But, the healthcare economic genie was out of the bottle and, as Gene Laks describes, the state has spent the last thirty years trying—with limited success—to rein in the seemingly insatiable costs of the perpetual motion machine that is the New York Medicaid program.

During his administration, Governor Pataki took the first major step to restructure the supply-side of healthcare in New York, when he created the Berger Commission to develop a plan to reduce excess capacity in the hospital system.[6] As the recommendations from that Commission reach full implementation, and the five-year Federal-State Healthcare Reform Partnership (FSHRP) funding that accompanied it reaches conclusion, the State and cash-strapped counties find themselves, once again, hemorrhaging cash as they face the prospect of the most significant restructuring of public healthcare in half a century and the uncertain prospect of future federal funding.

Against this backdrop, Governor Cuomo has called for a major "re-design" of the Medicaid program.[7] The question is: will healthcare entitlement go the way of public pensions? Will "defined benefit" healthcare, where all recipients have access to a more-or-less limitless market basket of goods and services, be replaced by a "defined contribution" of a limited dollar amount of healthcare available through an ersatz insurance model?

Only time will tell.

With this background, and mindful of the old aphorism: "Those who do not learn from history are bound to repeat it," Gene Laks' excellent review of the road we have traveled follows.

Endnotes

1. *See* Thomas Kaplan, *For Medicaid Cost-Cutter from Wisconsin, A More Complicated Job in New York*, N.Y. Times, Jan. 25, 2011, at A21.
2. This federal agency was split in 1979 into the Department of Health and Human Services and the Department of Education.
3. N.Y. State Dep't of Taxation and Finance, Enactment and Effective Dates of Sales and Use Tax Rates 2 (2010), *available at* http://www.tax.ny.gov/pdf/publications/sales/pub718a.pdf.
4. *Id.*
5. HHS.gov: U.S. Dep't of Health and Hum. Servs., Historical Highlights, http://www.hhs.gov/about/hhshist.html (last visited Mar. 30, 2011).
6. *See generally* N.Y. State Comm'n on Health Care Facilities in the 21st Century, Final Report : A Plan to Stabilize and Strengthen New York's Health Care System (2006), *available at* http://www.nyhealthcarecommission.org/docs/final/commissionfinalreport.pdf (proposing major reforms to New York's health care facilities).
7. See Exec. Order No. 5, 9 NYCRR 8.5 (Jan. 5, 2011) (establishing the New York Medicaid Redesign Team).

John F. Cape is considered a national expert on state budgets and public policy, with over 30 years of experience in the public sector. Since 2007, Mr. Cape has served as a Managing Director at Public Financial Management, Inc. (PFM) where he heads the State Strategic Consulting Practice where he advises states across the county on budget and programmatic strategies. He is also a Senior Fellow at the Rockefeller Institute of Government, and a member of the Advisory Board of the New York City Independent Budget Office.

Prior to joining PFM, Mr. Cape served as the Director of the Budget for New York State. Mr. Cape began his State career in 1973, working as a Municipal Management Consultant and federal program manager before joining New York State's Division of the Budget in 1980. During the following 26 years, he had the opportunity to oversee funding for virtually every State program area, including heading the Division's Federal Relations office, working with organizations including the National Governors Association advocating for changes and enhancements to federal programs including Medicaid. He also served as Chairman of the State's Public Authority Control Board and a Director of the Local Government Assistance Corporation.

Mr. Cape received his Bachelor of Arts degree from the State University of New York Empire State College and pursued graduate study at the Rockefeller College of Public Affairs.

The Complex History of Medicaid Reimbursement in New York State

By Eugene M. Laks

The 2011-2012 enacted state budget for the first time places fixed dollar caps on Medicaid expenditures for this and the 2012-2013 state fiscal years. The Commissioner of Health is authorized to adjust Medicaid rates and fees to assure that expenditures remain within the authorized caps. The N.Y. Constitution Article VII Medicaid budget legislation imposes numerous cost-containment provisions on reimbursement methodologies to achieve billions in savings over projected growth. While the magnitude of the reductions to be borne by the Medicaid program is high, Medicaid has since its inception been subject to tension between program costs and state revenues. Costs of the Medicaid program have been a continuing concern of every budget session, with cost containment provisions periodically added to the various reimbursement methodologies in N.Y. Constitution Article VII bills accompanying and implementing the budget. State Medicaid cost-containment initiatives to restrain the rate of growth in Medicaid expenditures have been balanced against the needs of urban safety net institutions that rely on government funding and the needs of rural communities to maintain viable local health care services.

Balancing the state budget through Medicaid cost-containment initiatives has the multiplier effect on health care providers of concomitant loss not only of the state share but also of the fifty percent federal share of Medicaid expenditures. An alternative has been the imposition of provider taxes on segments of the health care system, which raises revenue for the state without the loss of federal funds for health care providers. The expansion of Medicaid managed care in the state reduces the fiscal impact of cost control proposals that address fee-for-service reimbursement methodologies, other than nursing home services that generally are not covered by most managed care arrangements.

Governor Cuomo has appointed a Medicaid Redesign Team to develop recommendations for program areas where reduced Medicaid costs and increased quality and efficiencies may be realized.[1] An initial list of 274 areas to be considered and ranking of favored recommendations has been issued.

This article will provide a brief history and overview of the Medicaid program, selected salient reimbursement issues, and a policy concern that should be considered regarding all reimbursement proposals.

I. Program Background

In 1964, prior to the Medicaid program, Governor Nelson Rockefeller appointed the Governor's Committee on Hospital Costs to address concerns over the State's costs of care for public assistance recipients under reimbursement negotiated by the Department of Social Services with health care providers. This led to the vesting of responsibility in the Department of Health under Article 28 of the N.Y. Public Health Law for health facility regulation and establishment of reimbursement rates under the new Medicaid program enacted by Congress in 1965.[2]

Medicaid is a joint federal-state partnership under Title XIX of the federal Social Security Act in which the federal government shares a percentage of a state's expenditures in providing medical assistance to eligible needy individuals.[3] For each state, covered health care items and services, Medicaid eligibility criteria, and state reimbursement methodologies for participating providers, practitioners and suppliers are set forth in a State Medicaid Plan.[4]

Each state must provide certain mandatory services under its State Medicaid Plan and may provide various optional services. New York State provides a broad array of health care services to over four million persons enrolled in Medicaid. Some federal program requirements may be waived and additional services provided upon application of a state for a waiver and federal approval. The Secretary of the Federal Department of Health and Human Services must approve the State Medicaid Plan and proposed plan amendments to assure compliance with federal requirements. State Medicaid payment rates must be consistent with efficiency, economy and quality of care and must be sufficient to enlist enough providers so that Medicaid services are available to recipients at least to the same extent that comparable services are available to the general public.[5]

The Medicaid program oversight by the federal government is administered by the Centers for Medicare and Medicaid Services (CMS), formerly known as the Health Care Financing Administration, within the Federal Department of Health and Human Services. A State Medicaid Plan Amendment may be approved by CMS retroactive to the beginning of the quarter in which the proposed amendment is submitted.[6] A state must publish a public notice of a proposed amendment. In New York, such notices are published in the *New York State Register*.

The N.Y. Social Services Law provided for jurisdiction by the Department of Social Services over various aspects of the Medicaid program.[7] The Department of Social Services, however, was reorganized in 1996. General supervision and authority over the Medicaid program was transferred[8] and all references in the law to the state Department of Social Services and to the state Commissioner of Social Services are now deemed to refer to the state Department of Health and to the state Commissioner of Health, respectively.[9] The Department of Health now is the "single State agency" authorized under the Federal Social Security Act to supervise the state's Medicaid program.[10] Under statutes[11] and memoranda of understanding,[12] various functions are transferred from the Department of Health to other state and local governmental agencies.[13]

II. Federal Medical Assistance Percentage

The federal share of Medicaid expenditures by a state for health care services, called the federal medical assistance percentage (FMAP), varies from state to state depending on a complex formula that measures state levels of need and wealth compared to the national average.[14] For New York State, the FMAP has been generally 50 percent.[15]

FMAP enhancements for all states were provided for the twenty-seven month period, October 2008 through December 2010, under the recent federal economic stimulus legislation, based in part on unemployment within the state.[16] New York qualified for FMAPs increasing to over sixty percent.[17] The increase in the FMAP was extended for six months through June 2011, phasing down each quarter over the six-month extension period.

III. Local Share

In New York, medical assistance had been a local county or city of New York responsibility with reimbursement from federal funds and from state funds.[18] The state provided reimbursement for the non-federal component of Medicaid expenditures in varying percentages depending upon the particular item or service.[19]

The escalating cost of the Medicaid program placed an increasing burden on local government revenue. Under 2005 legislation, local governments' shares of Medicaid expenditures are limited to a capped amount. For 2006, each local government's share of Medicaid expenditures is capped at a 3.5% increase over base year 2005 expenditures with additional cumulative non-compounded increases over base year expenditures of: 3.25% for 2007 and a further additional 3.0% per year for 2008 and each year thereafter.[20] Various Medicaid payments for the benefit of county operated facilities or public benefit corporations for which the county is responsible for the non-federal share of the payment are excluded from the cap.

The calculated Medicaid expenditure cap for each county and the city of New York is paid to the Department of Health in equal weekly installments as their maximum responsibility for Medicaid expenditures. The Commissioner of Health maintains an accounting of what would have been each local government's share without the cap, and applies that amount if lower. To encourage innovations, the savings from any local government Medicaid demonstration program approved by the Department of Health will be shared equally by the state and such local government.[21]

For the Family Health Plus program, the state assumed the full county share cost for services provided on and after October 1, 2005. For New York City, the state assumed the full local share on January 1, 2006.[22]

The Commissioner of Health has developed a plan for assumption by the state of the administrative services performed by counties and the city of New York under the Medicaid program.[23] The plan provides a five-year implementation period beginning April 2011.

IV. Rate Methodologies

Formula-based Medicaid rates of payment are established by the Commissioner of Health for hospitals, nursing homes, diagnostic and treatment centers, home health care providers, and hospices. Formula-based rates of payment are established by the Commissioner of Mental Health for inpatient and outpatient mental health services providers, by the Commissioner of Developmental Disabilities for inpatient and outpatient developmental disabilities services providers, and by the Commissioner of Alcoholism and Substance Abuse Services for inpatient chemical abuse services providers. For providers dually licensed by the Department of Health and another agency, the rates are established by the Department of Health except for certain outpatient mental health services. All Medicaid reimbursement rates are subject to approval by the Director of the Budget.

Medicaid cost-based rate-setting begins with a comprehensive cost report submitted by a provider. From the cost report, allowable operating and capital costs for rate setting purposes are determined in accordance with federal Medicare reimbursement principles and specific costs disallowed in state regulations.

The state then applies complex rate-setting methodologies to convert provider allowable costs into Medicaid reimbursement rates. The methodologies vary among different types of service providers and may include such factors as ceilings on certain costs, peer group efficiency comparisons, group average costs, and adjustments to reflect regional or provider differences in wage levels and other costs. Rates are established for a prospective rate period.[24] If a provider fails to file required financial and statistical reports and data, Medicaid payment rates may be reduced.[25] Provider cost reports are subject to audit and rates may be adjusted based on audit findings.[26]

Following an initial rate setting effort and an attempt to freeze hospital rates, cost control legislation was enacted in 1969[27] to require the Department of Health to consider in the reimbursement methodology not only provider incurred costs but to relate such costs to the efficient production of service and the general economy in the area. A prospective rate setting methodology based on historical costs, subject to peer group ceilings on costs, projected to the rate period to reflect inflation, was adopted and approved by the federal government.

The next major methodology change followed a study by the Council on Health Care Financing and introduced the New York Prospective Hospital Reimbursement Methodology (NYPHRM).[28] NYPHRM initially applied to the period 1983 through 1985 as an "all-payer" system, using 1981 reported hospital operating costs trended to the rate period.[29] For capital costs, including interest on indebtedness and depreciation or amortization, actual rate period data for the provider was used. A state-set *per diem* rate-setting and charge control methodology was applied. NYPHRM instituted a system of percentage surcharges on payer payments for inpatient care, to be paid into state-operated pools and distributed to hospitals under a formula methodology to defray part of the costs of uncompensated care, including care for the uninsured.[30] This NYPHRM system was continued in 1986 and 1987, except for Medicare payments that were no longer subject to the state rate-setting methodology.[31]

In 1988, the system became a comprehensive state-set generally per-case payment methodology applicable to all third-party payers except Medicare, based on assignment of each patient upon discharge to a weighted diagnosis-related group (DRG) for payment purposes, reflecting the intensity of care for each patient.[32] The 1981 hospital cost base for operating costs trended to the rate period and actual provider rate period capital costs were applied to calculate the per discharge rate for a hospital. The state-operated pools were expanded to encompass various other state policy goals, in addition to defraying part of the cost to hospitals of uncompensated care. This system was continued, with various cost containment adjustments and enhancements, through 1996.[33]

Beginning with 1997, under the New York Health Care Reform Act (HCRA) of 1996,[34] reimbursement rates for Blue Cross, commercial insurers, HMOs, and self-insured funds and hospital charges were deregulated. Such payers have since 1997 been permitted to negotiate payment rates with hospitals. For Medicaid, the state-set per case rate-setting system was continued and periodically modified.[35]

The Health Care Improvement Act of 2009[36] provides the statutory structure for a new methodology, the All-Patient-Refined Diagnosis-Related Group (APR DRG) methodology, initiating major revisions in hospital inpatient reimbursement, including: utilizing a more sophisticated DRG taxonomy to account for severity of illness, updating the base year utilized for hospital operating costs from 1981 to 2005, establishing a Medicaid-only cost base, eliminating previous rate add-ons, and providing for a new more sophisticated DRG taxonomy.[37] Hospital 2005 operating costs trended to the rate period and rate period capital costs are applied to establish the per discharge rate. Medicaid rates must be designed to result in a reduction in inpatient hospital reimbursement in the aggregate of $225 million annually.

Budget initiatives over the various methodologies to contain the growth in Medicaid spending have included such factors as: annual limits on case mix increases, elimination or reduction of the annual inflation factors, reductions in funding for graduate medical education, addition of efficiency adjustments, percentage and fixed dollar reductions in various components of the rate structure, applying peer group averages for reimbursement of common services, selective contracting for certain services, and elimination of payments for preventable hospital readmissions or hospital-acquired conditions (referred to as "never events").

Hospital emergency room and outpatient services, freestanding clinic services and ambulatory surgical services have been reimbursed under various fee methodologies. Reflecting a shift in Medicaid reimbursement resources from hospital inpatient services to ambulatory care services, Medicaid payment rates for such services were implemented in 2008 and 2009 to reflect the utilization of an ambulatory patient groups classification system reimbursement methodology (APG), rather than the per-threshold-visit fixed-rate methodologies.[38] Under the new payment methodology, ambulatory care reimbursement is based on the complexity of the case and intensity of services provided for a patient visit. This is intended to foster the delivery of comprehensive outpatient care and promote the migration of inpatient services to less costly outpatient venues.

For clinic services licensed by the Office of Mental Health, transition to an APG methodology begins retroactive to October 2010; for Office of Alcoholism and Substance Abuse Services clinics and Office for Persons with Developmental Disabilities clinics, transition begins retroactive to July 2011. Implementation of APGs for such clinics is contingent on federal approval.

Nursing homes, home health care, and inpatient and outpatient providers under the Mental Hygiene Law also have complex histories under diverse Medicaid rate and fee setting methodologies. These programs were also subject to numerous methodology revisions to reflect state Medicaid cost control initiatives.[39]

From 1986 through 2006, nursing home reimbursement was based on 1983 reported nursing home costs with costs containment features periodically added during the budget processes, including base price reductions, elimination of or reductions in the annual inflation factors, applying administrative and fiscal costs limits, adding a productivity adjustment, and applying adjustments to encourage providers to pursue Medicare reimbursement for dual-eligible patients. Transition to a new methodology rebased to 2002 reported costs was adopted and deferred and then instituted with specific limits on the overall growth in nursing home reimbursement.

For home health care services, rates are calculated based upon rolling base year reported costs, with cost containment features including administrative and general costs limits, factors to promote Medicare utilization for dual-eligible patients and elimination of or reductions in annual trend factor adjustments. For providers regulated under the N.Y. Mental Hygiene Law reimbursement methodologies, cost containment initiatives have included cost limits on various rate components, productivity adjustments and elimination of or reductions in annual trend factor adjustments.

V. Fee Schedules

Reimbursement for services provided by health care practitioners and suppliers enrolled in the Medicaid program are made by the state in accordance with state fee schedules. Billing instructions are published in the New York State Department of Health MMIS (Medicaid Management Information Systems) *Provider Manuals*. *Provider Manuals* are issued by Computer Sciences Corporation, the state's contracted fiscal agent[40] and are available online.[41] State fee schedules, policies and billing instructions are updated and revised in *Medicaid Update*, a monthly publication of the New York State Department of Health, Office of Medicaid Management, available online.[42] Provider fee schedules are established by the Department of Health and approved by the Director of the Budget. Fee schedules for certain services provided by facilities licensed by their respective agencies also may be established by the Commissioner of Health, Commissioner of Mental Health, Commissioner of Developmental Disabilities, and Commissioner of Alcoholism and Substance Abuse Services, subject to approval by the Director of the Budget.

VI. Provider Taxes

A provider-specific tax is defined under federal law and regulations as a tax or assessment imposed by a state on a class of health care providers, or on the payment for health care services, or the tax is related to health care items or services and at least eighty-five percent of the burden of the tax falls on health care providers. States may raise funds through provider-specific taxes if such taxes are either broad-based and uniform, as defined in the federal regulations, or the state receives a federal waiver for its tax program. Waivers may only be granted under very narrow parameters in which a tax, under a statistical analysis, must be "generally redistributive" in its effect on health care providers. A statistical regression analysis is applied to measure whether the burden of the assessment falls disproportionately on providers with higher Medicaid revenue. State revenue from taxes that do not meet these tests and do not receive a waiver would be offset against state Medicaid expenditures, thus reducing federal financial participation under the Medicaid program.[43]

In addition, a state may not provide, directly or indirectly, for any payment, offset or waiver that guarantees to hold the provider harmless for any portion of the costs of the tax.[44] The "indirect" guarantee test has not applied to a provider-specific tax that was not more than six percent of the revenues received by the provider for periods through 2007, reduced to 5.5% beginning January 2008.

New York's assessments on hospital services did not qualify as broad-based and uniform in part because under the federal rules the assessment had to be applied equally to acute care hospitals and to psychiatric hospitals and had to include all revenue. New York's program did not apply to psychiatric hospitals. In addition, various provider-specific taxes did not apply to all revenue. Federal waivers therefore would have been required. There was a dispute, however, between the state and the federal government over the proper methodology to calculate whether New York was eligible for a waiver.

To resolve the waiver issues, Congress passed legislation in 1997 as part of the federal budget process that allowed New York's then existing provider-specific tax programs.[45] However, a new law had given to the President the authority to exercise a line-item veto over Congressional additions to the federal budget. This provision for New York's provider-specific tax programs was subject to a line-item veto by President William Clinton. The authority of the President to exercise a line-item veto was subsequently declared unconstitutional by the U.S. Supreme Court in a suit relating in part to the provider-specific tax legislation.[46]

VII. Partnership Plan and Federal-State Health Reform Partnership

New York's application under Section 1115 of the Social Security Act for a waiver of State Medicaid Plan requirements to implement a statewide comprehensive Medicaid managed care program, called the Partnership Plan, was approved by the Health Care Financing Administration (now CMS) for the five-year period July 15, 1997 through March 31, 2003, renewed through March 31, 2006, and further renewed through September 30, 2011. The program provides for the mandatory enrollment of various categories of Medicaid beneficiaries at various times. In 2006, an additional Section 1115 waiver program was approved for five years as the Federal-State Health Reform Partnership (F-SHRP) through September 30, 2011.[47]

Under a budget neutrality condition of the approval of the Partnership Plan, federal financial participation in payments by the state for Medicaid services covered by the Partnership Plan is subject to an overall expenditure limit.

The cap is calculated on an aggregate basis over the term of the waiver. The overall payment limit is based upon an estimate of what aggregate Medicaid expenditures would have been for the period under the fee-for-service system on a *per capita* cost basis. Thus, the state is not at risk for increased program costs that result from a negative change in the overall economy resulting in more persons becoming eligible for the Medicaid program.

The Partnership Plan established a Community Health Care Conversion Demonstration Project, a $1.25 billion fund ($250 million per year for five years in federal funds) out of federal savings under the original 1997 waiver. Distributions were made to assist voluntary and public hospitals that serve a large number of Medicaid and uninsured persons in the transition to a managed care environment. The funds also assisted in restructuring the hospital delivery systems to promote primary care and retraining the hospital workforce.

The F-SHRP waiver provides for federal reinvestment in New York of $1.5 billion over five years ($300 million per year) of federal funds limited to fifty percent of the federal savings (anticipated to be over three billion dollars) during this period from Medicaid managed care Partnership Program and F-SHRP savings under the waivers, and savings from implementation of health care system reforms. The F-SHRP waiver funds are available as a federal Medicaid match to state expenditures for certain designated state health programs that would not otherwise be Medicaid eligible programs. The federal funds free up state funds for New York to invest in the reform initiatives. As a condition of receiving the additional funds under the waiver, the state must expend at least $600 million each year in various Medicaid reform initiatives. The state also must meet performance milestones, including: increasing Medicaid fraud and abuse recoveries to meet annual targets reaching $644 million in 2011.

VIII. State Medicaid Inspector General

During the summer of 2005, a series of articles in *The New York Times* focused on an exposé of Medicaid fraud and abuse that had gone undetected by regulators.[48] In response to these disclosures, Governor Pataki appointed, by Executive Order,[49] a Medicaid Inspector General of the State of New York to coordinate the investigation of waste, fraud and abuse in the Medicaid program. In 2006, an independent Medicaid Inspector General and Office of Medicaid Inspector General (OMIG) were established by law in the Department of Health, and their authority, duties and responsibilities delineated.[50] The responsibilities of the various state agencies regarding fraud and abuse were consolidated in the new Office, including the audit functions. Under federal regulations[51] and a Memorandum of Understanding, where the OMIG suspects fraud or abuse the case must be referred to the Attorney General's Medicaid Fraud Control Unit for criminal or civil prosecution.

IX. On Our Own Petard

New York State health care regulatory agencies have adopted complex detailed regulatory structures governing the program operation of health care providers within their respective jurisdictions. The regulatory strictures, however, may not have been intended as absolute compliance requirements as a prerequisite to entitle a provider to Medicaid reimbursement. Furthermore, overly zealous auditors from the Federal Office of Inspector General and from the State Office of Medicaid Inspector General have been applying such regulations as absolute requirements. The Federal Office of Inspector General, for example, in two audits of the personal care program and an audit of rehabilitative services by community residence providers has demanded repayment by New York of Federal Medicaid funds exceeding $500 million.[52]

The New York State Department of Health stated in response, for example, to the community residence rehabilitative services audit that the audit findings are "punitive," based upon "technical violation of New York State program regulations," that there were "no findings or allegations that the services provided were not medically necessary, were not in fact provided" and were "for alleged violations having nothing to do with the quality or appropriateness of care, recipient eligibility or provider fraud or abuse."[53]

X. Conclusion

Medicaid reimbursement methodologies are complex and regulatory compliance requirements are very broad. In considering Medicaid cost containment initiatives to maintain a balanced state budget, program regulations should be revised to afford greater flexibility to health care providers to allow them to reduce their operating costs. Standards that exceed minimum federal requirements, and for which adequate Medicaid reimbursement may not be provided under state cost containment initiatives, should not be a basis for future audit adjustments.

Endnotes

1. N.Y. Exec. Order No. 5, 9 NYCRR 8.5 (Jan. 5, 2011) (establishing the New York Medicaid Redesign Team).
2. For additional information, see N.Y. State Council on Health Care Financing, Recommendations for Financing Hospital Inpatient Care (1980) [hereinafter Recommendations for Financing Hospital Inpatient Care].
3. *See* Social Security Act of 1965, Pub. L. No. 89–97, §§ 1901–36, 79 Stat. 366, *amended by* 42 U.S.C. §§ 1396–96v (2010). The new amendments to the Social Security Act were recently held unconstitutional as not severable by a Florida federal court. *See* Florida ex rel. Bondi v. U.S. Dep't of Health & Human Servs., 2011 WL 285683 (N.D. Fla. Jan 31, 2011).
4. *See* New York State Medicaid Plan, http://www.health.state.ny.us/nysdoh/phforum/foil/foil.htm (last visited March 30, 2011).
5. *See* Social Security Act, Pub. L. No. 89–97, § 1902(a)(30)(A), 79 Stat. 366, *amended by* 42 U.S.C. § 1396a(a)(30)(A) (2010).

6. *See* 42 C.F.R. § 447.205 (1983).
7. *See* N.Y. Soc. Serv. Law §§ 363–69 (McKinney 2010).
8. *See* 1996 N.Y. Laws Ch. 474 §§ 233–48.
9. *See* N.Y. Soc. Serv. Law §§ 2(1), (6) (McKinney 2009).
10. *See* N.Y. Pub. Health Law § 201(1)(v) (McKinney 2010).
11. *See, e.g.*, N.Y. Soc. Serv. Law § 364, *amended by* 2010 N.Y. Laws Ch. 58; N.Y. Mental Hyg. Law § 43.02 (McKinney 2010).
12. *See* N.Y. Soc. Serv. Law § 364-a (McKinney 1996).
13. *See* Medicaid Inst., United Hosp. Fund, Administration of Medicaid in New York State: Key Players and Their Roles (2006), *available at* http://www.medicaidinstitute.org/publications/434595 (last visited Mar. 30, 2011).
14. *See* Social Security Act of 1965, Pub. L. No. 89–97, § 1905(b), 79 Stat. 366, *amended by* 42 U.S.C. § 1396d(b) (2010).
15. *See, e.g.*, 74 Fed. Reg. 227, 62315–17 (2009), *available at* http://aspe.hhs.gov/health/fmap11.htm.
16. *See* The American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 5001, 123 Stat. 115, 496.
17. *See* Daniel R. Levinson, Review of New York State's Compliance With the Prompt Pay Requirements for the Increased Federal Medical Assistance Percentage Under the American Recovery and Reinvestment Act of 2009 (A-02-09-01037) (2010), *available at* http://docs.google.com/viewer?a=v&q=cache:CDmcDrf4A4J:oig.hhs.gov/oas/reports/region2/20901037.pdf.
18. *See* Toia v. Regan, 387 N.Y.S.2d 309 (App. Div. 1976).
19. *See, e.g.*, N.Y. Soc. Serv. Law § 365 (McKinney 1996).
20. *See* 2005 N.Y. Laws Ch. 58, Part C, §§ 1–4, 6 (the several amendments to this legislation are scattered through the Consolidated Laws of New York as well as the Session Laws of New York).
21. *See* 2005 N.Y. Laws Ch. 58, Part C, § 5.
22. *See* N.Y. Soc. Serv. Law § 368-a(1)(t) (McKinney 2010).
23. *See* 2010 N.Y. Laws Ch. 58, Part B, § 47-b; N.Y. State Dep't of Health, New York State Medicaid Administration November 2010 Report (2010), *available at* www.health.state.ny.us/health_care/docs/ 2010-11_medicaid_admin_report.pdf.
24. *See* N.Y. Pub. Health Law §§ 2807(7), (7-a) (McKinney 2010), *amended by* 2010 N.Y. Laws Ch. 58; Anthony L. Jordan Health Corp. v. Axelrod, 493 N.E.2d 941 (N.Y. 1986).
25. *See* N.Y. Pub. Health Law § 12-d (McKinney 2010); N.Y. Comp. Codes R. & Regs. tit. 14, §§ 578.5, 635-4.4, 841.5 (1992–2006).
26. *See* N.Y. Comp. Codes R. & Regs. tit. 18, § 517 (1988).
27. *See* 1969 N.Y. Laws Ch. 957.
28. *See* Recommendations for Financing Hospital Inpatient Care, *supra* note 2.
29. *See* N.Y. Pub. Health Law § 2808-c (McKinney 1985).
30. *See id.* §§ 2808-c(4), (9).
31. *See* N.Y. Pub. Health Law § 2807-a (McKinney 1988); 1985 N.Y. Laws Ch. 807.
32. *See* N.Y. Pub. Health Law § 2807-c (McKinney 2010), *amended by* 2010 N.Y. Laws Ch. 58. This law was preempted by two federal decisions. *See* Travelers Ins. Co. v. Cuomo, 14 F.3d 708, 710 (2nd Cir. 1993); U.S. v. West Virginia, 238 F.Supp.2d 751, 753 (S.D.W.Va. 2002).
33. *See* 1990 N.Y. Laws Ch. 922; 1993 N.Y. Laws Ch. 731.
34. *See* 1996 N.Y. Laws Ch. 639, *amended by* 2009 N.Y. Laws Ch. 58, Part B, § 21.
35. *See* 1996 N.Y. Laws Ch. 639, § 168(5); 1999 N.Y. Laws Ch. 1, § 138(1), *amended by* 2008 N.Y. Laws Ch. 58, Part B, §§ 1, 1-a.
36. *See* 2009 N.Y. Laws Ch. 58, Part C, § 1-a.
37. *See* N.Y. Pub. Health Law § 2807-c(35)(h) (McKinney 2010).
38. *See id.* § 2807(2-a)(a), *amended by* 2010 N.Y. Laws Ch. 58.
39. For additional information concerning Medicaid rate and fee setting methodologies, see Eugene M. Laks, 2011–2012 New York Medicaid Reimbursement Guide (2010).
40. *See* N.Y. Soc. Serv. Law § 367-b(8) (McKinney 2008).
41. *See* eMedNY, http://www.emedny.org.
42. *See* N.Y. State Dep't of Health, *Medicaid Update*, http://www.health.state.ny.us/nysdoh/mancare/ omm/main.htm (last visited Mar. 30, 2011).
43. *See* Social Security Act of 1965, Pub. L. No. 89–97, § 1903(w), 79 Stat. 366, *amended by* 42 U.S.C. § 1396b(w) (2010).
44. *See* Social Security Act of 1965, Pub. L. No. 89–97, § 1903(w), 79 Stat. 366 *amended by* 42 U.S.C. § 1395b(w)(4)(C).
45. *See* Balanced Budget Act of 1997, Pub. L. No. 105-33, § 4722(c), 111 Stat. 251, 515 (1997).
46. *See* Clinton v. City of New York, 524 U.S. 417 (1998).
47. *See* Mark R. Ustin, *F-SHRP: A Strong Note for Reform*, 12 N.Y. St. B.A. Health L.J. 23 (2007); N.Y. State Dep't of Health, Ctrs. for Medicare & Medicaid Servs., Federal-State Health Reform Partnership Medicaid Section 1115 Demonstration, Number 11-W-00234/2 (2006–2011), *available at* http://www.health.state.ny.us/health_care/managed_care/appextension/health_reform_partnership/docs /special_terms_and_conditions.pdf.
48. *See* Michael Luo & Clifford J. Levy, *New York Medicaid Fraud May Reach Into Billions*, N.Y. Times, July 18, 2005, at A1; Michael Luo & Clifford J. Levy, *As Medicaid Balloons, Watchdog Force Shrinks*, N.Y. Times, July 19, 2005, at A1.
49. *See* N.Y. Exec. Order No. 140-1 (Feb. 2, 2006), *available at* http://www.omig.state.ny.us/data/content/ view/38/36/ (last visited Mar. 30, 2011) (establishing the Office of the Medicaid Inspector General and revoking N.Y Exec. Order No. 140 (Aug. 5, 2005)); N.Y. Comp. Codes R. & Regs. tit. 9, §§ 140.0, 140.1 (1969).
50. *See* N.Y. Pub. Health Law §§ 30–36 (McKinney 2006–2007).
51. *See* 42 C.F.R. 455.15 (1986).
52. *See* Daniel R. Levinson, Review of Medicaid Personal Care Services Claims Made by Providers in New York City (A-02-07-01054) (2009); Daniel R. Levinson, Review of Medicaid Personal Care Services Claims Made by Providers in New York State (A-02-08-01005) (2010); Daniel R. Levinson, Review of New York's Medicaid Rehabilitative Services Claims Submitted by Community Residence Providers (A-02-08-01006) (2011).
53. *See* N.Y. Dep't. of Health, *comments*, August 23, 2010, *to* Report of the Office of Inspector General, Review of New York's Medicaid Rehabilitative Services Claims Submitted by Community Residence Providers, A-02-08-01006, (2011).

Mr. Laks focuses his practice on matters pertaining to health care reimbursement, health care networks and affiliations, managed care law, federal and state statutory and regulatory compliance, health care facility licensure and delivery of quality health care. Mr. Laks has published a comprehensive treatise on New York's Medicaid reimbursement system. Mr. Laks previously worked for the New York State Department of Health and was the principal draftsman of the State's Medicaid reimbursement legislation from 1984 to 1996.

How Does the State Respond to a True Fiscal Crisis? The Legacy of Governor Hugh L. Carey

By Dr. Seymour P. Lachman

Only once between the Great Depression of 1929, which lasted through the 1930s, and today has New York ever experienced a fiscal crisis the dimensions of which are similar to the current one. That was the great fiscal crisis of 1975. It also took several years to be resolved, and the man who is credited by most people, including Governor Andrew Cuomo, with saving New York was then newly elected Democratic Governor Hugh L. Carey.

Carey brought to the office of Governor broad experience in private and public life. He was both a supervisor and lawyer for his brother's petroleum firm and helped his father in attempting to maintain his petroleum firm during the Great Depression. In World War II, he entered the army as a private and four years later was a Major. It was during this time that he saw the horrors of warfare, including the death of some of his best friends fighting alongside of him as the allied troops and his unit pressed into Germany, where his unit crossed the hard fought-over Remagen Bridge as well as liberating the infamous Nordhausen Concentration Camp. These events made him believe that no one person had the right to take someone else's life. This led to his opposition to the death penalty. In the army, he developed leadership skills in administration, quick thinking, as well as direct action when needed. After the war he ran for the U.S. House of Representatives in a safe Republican congressional district. He received the nomination because no other Democrat wanted to waste their time and money running against the strong Republican incumbent, Francis Dorn. He campaigned with his hero, Democratic Presidential Candidate John F. Kennedy; the pundits said that John F. Kennedy could possibly win in this congressional district, but that Hugh Carey would run far behind the head of the ticket and definitely lose. The reality was that Hugh Carey surprisingly defeated Congressman Dorn in the district and John F. Kennedy, soon to be the nation's first and only Roman Catholic President, lost in the district to then-Vice President Richard Nixon. Carey went on to serve seven terms (fourteen years) and even won the seat after the redistricting of New York State during the Rockefeller administration, which made the seat even more solidly Republican than it was before. In his years in the House of Representatives he achieved the reputation as a bright man with an analytical mind and a keen sense of humor. Representative Carey was also a key player in the passage of the historic Elementary and Secondary Education Act that brought about an invitation to fly with President Lyndon Baines Johnson on Air Force One, after a compromise had been worked out by the President and Carey on the issue of aid to public and non-public schools. He achieved a key position on the House Ways and Means Committee and cultivated friendships with people on both sides of the aisle, Democrats and Republicans. Some of these people were to be of major help to him in saving New York in its future economic crisis. These individuals included Republican Representative and minority leader Gerald Ford, who would become the future President, as well as Republican Representative Melvin Laird, the future Secretary of Defense.

"[T]he man who is credited by most people, including Governor Andrew Cuomo, with saving New York [in 1975] was…Governor Hugh L. Carey."

When Congressman Carey first ran for Governor in 1974, he defeated Howard Samuels for the Democratic nomination and then Malcolm Wilson who, as Lieutenant Governor, succeeded to the Governorship after Nelson Rockefeller resigned in 1973 to become Gerald Ford's Vice President. Neither Rockefeller, nor Wilson, nor the then-Mayor of New York, Abe Beame, had given him any information that New York City was close to bankruptcy. Slowly between the election and the inauguration in January he began to receive diverse but not as yet completely substantiated news that New York City faced a major fiscal crisis.

When it came to picking his staff, political obligations were of little or no concern to him since he owed almost nothing to the major county leaders in New York City and New York State. The overwhelming number of these leaders openly and directly supported his opponent Howard Samuels and a couple even threatened him if he wouldn't drop out of the race. He began with only a 6% statewide voter recognition rate and barely went over the 25% number at the 1974 State Democratic Convention that permitted him to be a candidate for the September primary which he went on to win handedly. He then defeated Governor Malcolm Wilson. It was therefore easier for him to hire whomever he wanted since he didn't have to "pay back" any of the major politicians in the city or state of New York. He, not surprisingly, decided that he would select, for the most important positions in his administration, the best, brightest, and most competent of people regardless of political affiliation or where they came from. He didn't care who they supported in the election, or who they had worked for before joining his administration. That is how people such as Peter Goldmark, Felix Rohatyn, Stephen Berger, David Burke, John Dyson, Bob Morgado, Richard Ravitch, and Judah Gribetz, among others, came to work for him.

An example of his independence in hiring the most outstanding people he could was his early relationship with Richard Ravitch. Congressman Carey, before the September primary, decided to call Richard Ravitch to introduce himself, tell him he was running for Governor, and ask for a contribution. Ravitch candidly told him that he was not usually involved in politics but he did make a contribution to the campaign of his tennis partner, Howard Samuels, who was Carey's opponent. He also mentioned to the then-Congressman that he did not believe in giving campaign contributions to two people running for the same office. After winning the election, Carey consulted with his inner circle of leading New Yorkers, and Ravitch's name was mentioned as a possible candidate for a major position in Carey's cabinet because of his vast knowledge of business, finance, and housing. Richard Ravitch was then surprised to receive a phone call from Hugh Carey offering him a most important position in his new administration. After trying to talk Carey out of the suggestion, he finally relented and accepted the job. How many executive administrators, then or today, would have the courage to do this?

When his staff people succeeded, especially in achieving positive results in very difficult situations, he gave each of them credit for success. Unlike most politicians in executive positions, who claimed staff success as their own, he would not take credit for what they had achieved, but rather basked in their accomplishments and they in turn became increasingly impressed with his growing leadership.

As budget director Peter Goldmark once remarked, "the greater the pressure, the bigger he got," and he did even though he probably realized the more he became involved in saving New York from bankruptcy, the less his chance of becoming a future Democratic nominee for President or even Vice President, which New York Governors invariably seek.

When Governor Carey shortly thereafter convinced banker and later U.S. Ambassador to France, Felix Rohatyn, to become "Felix the savior" by joining his administration, it became increasingly obvious that New York City could not come through on its short term debt payments at any time, since its monthly payments to bond holders were hundreds of millions of dollars. It became self evident that, as Carey said in his January Inaugural address, "the days of wine and roses, are over," and within two months the state's Urban Development Corporation became the first large government agency to default since the 1930s.

Stephen Berger was as familiar as anyone in the new Carey administration with the precarious condition of New York City's budget, because he had served as director of the Scott Commission set up in 1971 by Rockefeller to examine "the management, structure, organization, fiscal and governance practices of the city of New York and its agencies," that in 1973, telegraphed the city's approaching fiscal crisis (which very few believed at the time). Shortly after Carey defeated Howard Samuels in the primary, Berger shared with Carey his view that the city was headed down a dangerous path. Though the city's tax base was eroding, the costs of salaries, labor contracts, and social services were growing, so at some point soon, Berger believed, something was liable to collapse.

"Arthur Levitt says there's plenty of money," Carey told Berger, referring to Levitt, the New York State Comptroller.

"Arthur is wrong," Berger replied, and he summarized the Scott Commission's findings. The room became quiet. Soon the suspender-clad thirty-eight-year-old budget hard-liner, a favorite of Carey's Campaign Manager, David Garth, who was new to the Carey cabinet, got up and left. "I'm sure that was the first time anyone suggested to him that we were heading toward a fiscal mess," said Berger, who soon became the state's social services commissioner. The new Governor was now convinced. Governor Carey then explained in his first state of the state message in January of 1975, "in the simplest of terms, this government and we as a people are living way beyond our means. Indeed, so lavish was our state of government that we came to depend on it for life itself forgetting that government was only the result of our industry and not its source."

In the spring of 1975, Budget Director Peter Goldmark brought new and concrete warnings about New York City's fiscal condition to the governor, handing him a memo he'd prepared. Since becoming budget director, Goldmark had been hearing a lot about the private worries—brewing unabated since 1974—of the major banks as well as staffers in the city comptroller's office. He had a working paper written by a group of bank representatives seeking to learn more about the city budget and its cash flow challenges. To bring the governor up to speed, and perhaps influence his actions, Goldmark's memo laid out a train wreck in the making.

By the end of 1974 the city had increased its borrowing much more in the short-term market to pay workers, suppliers, welfare clients, and mounting interest on its growing debt. About $600 million in short-term notes were sold that December. The financial community stopped discussing and started demanding higher interest rates to ensure they could quickly turn over the New York City securities they agreed to underwrite. Merrill

Lynch reported losing $50 million on the marketing of a $475 million city note after failing to discharge all of its assigned shares.

In the closing months of 1974, New York City held a stunning 29 percent of all outstanding short-term notes in the country, more than any other city. Its short-term debt grew from 8.5 percent of its total indebtedness in 1966 to 36.9 percent by 1975 or from $747 million in 1969 to about $4.5 billion. By comparison, Boston accumulated just $65 million in annual notes outstanding, and Chicago, $300 million. Even more worrisome for New York City, by 1975 banks could take their business elsewhere.

Corroborating what Berger had recently told the Governor but with greater specificity, Goldmark now foresaw a new fundamental danger: the city's huge—and fast-growing—reliance on short term debt and its murky but clearly vast budget shortfalls. These were the problems that had already raised blood pressures in the executive offices of the Clearing House banks. Sooner or later Carey would have to face them, as would many others, including President Ford.

At about that time Rohatyn received a call from a bond broker he didn't know, offering to sell him New York City notes paying an unusually high 9.5 percent interest. Rohatyn, suspicious, declined, saying, "If you're paying 9.5 percent for triple-tax-free notes of the city, they can't be a very good risk." It soon became clear that the credit markets couldn't, or wouldn't, fulfill the city's capital needs, with the bankers having come to the unshakeable conclusion that the city government lacked both cash and credibility, and probably couldn't pay off its maturing bonds except, of course, by borrowing over its head even more.

It was now becoming evident that the city could easily default on short-term debt payments at any time, with its monthly payments to bondholders totaling hundreds of millions of dollars. At the same time, some editorial writers and budget watchdog groups began faulting Carey for initially keeping his distance from the city's problems, as he continued to make trips upstate and resolutely focused on many other things. But his attempt to be governor of the entire state and not just one part of it was growing more challenging by the day.

Carey was aware that if the city defaulted and filed for bankruptcy, there would be hell to pay—possible walkouts by police, firefighters, sanitation workers, and teachers, and perhaps even outbreaks of looting, arson, and violence. In an atmosphere of civic breakdown, a federal judge would be empowered to take the entire city government and its day-to-day affairs under receivership, superseding all elected officials, labor agreements, and existing rules and regulations. The judge would seek to create immediate mechanisms for continuing public services and running the city's many departments down to the most minute levels—deploying police, regulating schools, ordering supplies, dispatching child protective workers, all the while beginning the possibly decade-long process of sorting through the claims of perhaps tens of thousands of creditors—bondholders and their lawyers, city employees, welfare clients, and suppliers.

In the wake of such dislocations, some argued, fear and loathing would roil the municipal bond market. The borrowing costs of cities and states might spike, causing service cutbacks and job losses if not additional governmental defaults. If large or small banks tottered or closed, the troubled national economy, if not the entire international banking system, as the President of France and the Chancellor of West Germany believed, would be disrupted.

So Carey and his financial advisers worried at the time. But the implications of a city bankruptcy were less than agreed upon or clear to the public at large as his staff debated how deeply he should involve himself and the state in the mounting series of New York City payment problems that were, after all, not of his making, and perhaps beyond his powers to contain or control.

In the spring of 1975, around the time Rohatyn was recruited, some aides to the governor, including budget director Peter Goldmark, warned that if the Big Apple failed to pay its obligations, the state government would follow, so interwoven and interdependent were their finances. Staying out of it, therefore, could be suicidal for the state.

Other aides noted that in their upstate travels, they regularly met people who made no secret of their distaste for the big city—a drain on the rest of the state, in their eyes—and who felt just as adamantly that Carey should force its leaders to finally feel the consequences of years of financial profligacy.

At one staff discussion at the Executive Mansion, the issue reached a boiling point. Having listened to the back-and-forth for nearly an hour, Carey finally stood and jammed his hands deep into his pants pockets—the telltale sign that his fuse might blow. He would not, he said, even consider standing idly by as the city sank. He rendered the case for assistance in the most personal terms. "I have a big family. If one of my children came to me and said he's broke, I'm not going to put him out on the street; I'm going to do what's best. I'm not going to leave him out in the cold. We're stopping this right now," he said. New York City, the governor added, was legally a child of the state—it existed only because the state granted it jurisdiction. He concluded by stating that they must avoid bankruptcy at all costs.

He sat down at his desk. No one spoke. The staff shot glances around the room. And then for good measure Carey added that if any or all of his aides strongly disagreed, he would be more than happy to accept their letters of resignation immediately.

Always influencing his judgment, Carey recalled years later, was his late father's view that bankruptcy was an irreversible stigma and what he had most sought to avoid for the once-soaring Eagle Petroleum during the years of the Depression. After Carey articulated his position to his staff, he never really looked back, or veered. Soon, in fact, he unilaterally advanced the city $400 million in state aid, directly involving the state in the city's quest for survival and thereby putting the state's own credit in potential harm's way. This was money raised from the sale of state short-term notes and technically requiring voter approval for its use. The cash narrowly allowed the city to avoid default for a short-term note that had to be repaid at the end of April, 1975. Carey would advance the city a total of $400 million more in the months ahead.

However, bigger headaches were just ahead. In March, the city was effectively shut out of the bond markets. The book, *The Man Who Saved New York: Hugh Carey and the Great Fiscal Crisis of 1975*, recounts the tense and nerve-wracking months that followed, during which the city was on the brink of collapsing under the weight of billions of dollars in short-term debt accumulated after years of profligate spending.

"His force of will," said Paul Gioia, who was an assistant counsel to the governor, "was the most important feature in keeping the city out of bankruptcy. When someone at the top makes a solid commitment like that, people working for him respond, 'We've got to figure out how to get it done'—and that's what happened." The word Carey used to describe a New York City bankruptcy was "unthinkable."

During May, 1975, in his first major move to confront the city's problems head-on, Governor Carey appointed a "blue ribbon" advisory group from the private sector, including Simon H. Rifkind, a former federal judge and advisor to President Roosevelt who was now a partner in the law firm Paul, Weiss, Rifkind, Wharton & Garrison; Richard R. Shinn, head of Metropolitan Life Insurance; Donald B. Smiley, chief executive of R.H. Macy and Company; and, of course, Felix Rohatyn.

Carey recalled that Deputy Mayor Cavanagh at a subsequent cabinet meeting with his advisory group delivered a somewhat meandering introduction to the city's budget process until Rifkind interrupted him with a pointed question: "Where are the books?"

"What books?" answered Cavanagh light-heartedly, as Carey recalled it.

"Accounts payable, accounts receivable—where are the city's books?" said Rifkind.

"But you don't understand how we do it, judge," the deputy mayor responded. Then he dipped his hands into his shirt and pants pockets and came out with small pieces of paper for illustrative effect and described the city's borrowing programs. "We have these TANs, which come from here, then we get these RANs from here, and these BANs come from here."

At the state budget division, Peter Goldmark raised the idea to Carey of creating a state tax-exempt corporation to sell bonds supported by specially diverted city tax revenue, and discussed it with Rifkind, Rohatyn, and William Ellinghaus, President of New York Telephone. Together, with others in the Carey administration, as well as outside advisors, they devised an approach that the governor felt would, if successful, provide the city with immediate and desperately needed funds to pay off its maturing bonds, giving the city breathing room to straighten out its budget, and a path back into the credit market—all within perhaps three months' time.

The tax-exempt vehicle was to be called the Municipal Assistance Corporation for the City of New York (MAC), a vehicle designed to retire the city's short-term debt and convert it into long-term obligations with a lower interest rate. In its design, the basic apparatus Goldmark suggested and the mechanics worked out by Rifkind were not much different from the city's now-contested Stabilization Reserve Corporation, or even the Project Finance Agency, which had been used to ease the Urban Development Corporation back from its brush with default. But there was one major difference: MAC, at least as initially formulated, was to enjoy extensive authority to circumvent the mayor's power when it came to managing the city's finances and balancing the city's budget in the coming years. MAC was an entity that was initially the main reason the city avoided bankruptcy that year. At the center of MAC were prominent and competent people, many of whom would go on to bigger things in the future. This group included Felix Rohatyn and Peter Goldmark. In addition to appointing Rifkind, Rohatyn, Goldmark, Donna Shalala, and Robert Weaver to the MAC Board, Carey named as Chairman Thomas Flynn, who was later succeeded by William Ellinghaus.

As the city began to tighten its belt, Carey attempted to convince the residents of New York State that all would have to give up something but not everything for the common good. It would make no difference whether they were labor leaders, bankers, businessmen, or workers. He also went out of his way to bring together on this issue Republicans as well as Democrats, and he succeeded in working with Senate Republican majority leader Warren Anderson and Democratic minority leader Manfred Ohrenstein, as well Speakers of the Assembly, Stanley Steingut and Stanley Fink.

Carey called on the unions to accept a wage freeze, while the MAC board forced Beame to agree to a deadline for a deal with the unions on a major retrenchment program. The mayor received a politically and personally distasteful menu of options, including a salary freeze, a transit fare hike, City University of New York cuts, and a change in employee work rules to ensure greater productivity. The MAC trustees also said Beame must seek an aid advance from the state, a state takeover of certain city functions such as the courts and jails, a switch to a regular accounting system, high-interest loans from the banks, and federal guarantees to insure future MAC bonds and city securities.

While the banks were keeping the pressure on, Mayor Beame and municipal labor unions initially resisted necessary cuts, and the federal government resisted calls for help. The extraordinary challenge brought out the best in Carey and his skills in conciliation and negotiation to eventually achieve his objective—to avoid bankruptcy. The unions made the most of their own political leverage over the city pension funds, which were being asked to invest in the city's bailout bonds and notes. In the end, they were forced to agree to a series of pay-raise deferrals and freezes, along with tens of thousands of layoffs.

As the pressure mounted Governor Carey and New York State showed that the state could tighten its belt. The affable Deputy Mayor of New York City who kept important budgetary information in his vest as well as other pockets soon resigned and even Mayor Beame then told the distinguished publicist, Howard Rubenstein, that he was thinking of resigning because of the pressure put upon him and his fear of losing more Mayoral power. Rubenstein, always shrewd and analytical, asked the Mayor to talk to his wife Mary about resigning as Mayor. The following day Mayor Beame called Rubenstein and told him that he had decided not to resign.

Carey had won legislative approval for a controversial city debt restructuring and tax hikes. There was plenty of trouble ahead, but the control mechanisms Carey pushed through the Legislature during that crucial year also proved to be the foundation for recovery.

Amid the deal-making in the state legislature, Carey asked the city's five municipal unions—on top of their earlier agreement to purchase $2.5 billion in MAC bonds with their pension funds—to roll over another $1.2 billion in city and MAC notes that they held in order to ease repayment pressure on the city. Trustees for the city's retirement system contended that this was asking too much, and dug in their heels by refusing to purchase $860 million in city and MAC issued securities. Carey was able to eventually change their minds, however, when he agreed to indemnify them from any future lawsuits alleging a breach of their fiduciary responsibilities. Meanwhile, the banks stepped up, agreeing to extend maturities at a low rate of interest on about $550 million of city notes and $1.1 billion of MAC bonds in their portfolios.

Some labor leaders, such as Victor Gottbaum and Jack Bigel, came aboard and accepted the plan but UFT President Al Shanker, a shrewd tactician with connections all the way to Washington, lashed back, refusing on October 1975 to commit the city's Teachers Retirement System to its earlier agreement to purchase $225 million in MAC bonds under the Financial Emergency Act, and thus imperiling the entire bailout package. The deadline to act was fast approaching when Shanker called Ravitch and asked to set up a meeting with him and Carey.

Shanker got into a cab and headed over to Ravitch's apartment, where trade union leader Harry Van Arsdale and former Mayor Robert Wagner soon arrived to join the discussion. Counsel Judah Gribetz, too, arrived, as did Carey, with Simon Rifkind. Some used the building's back staircase in case any reporters had gotten wind of the secret meeting and tried to waylay them. A tense, four-hour discussion ensued. It was after one o'clock when Shanker relented: "OK," he said. "I'll do it," and got up to leave. The banks were scheduled to close in a few hours and Shanker's agreement to invest his pension funds averted an economic disaster for New York.

Carey and key administration officials, Rohatyn, Goldmark, Gribetz, Burke, Berger, and others, began working on and soon completed a 111-page proposal that involved the creation of an "Emergency Financial Control Board," the administration's most sweeping response to the crisis thus far, subject, though, to negotiation with legislative leaders. Carey also called the state legislature into special session, and he was characteristically detailed, purposeful, and persuasive, describing a state of emergency akin to a flood or a hurricane and presenting an omnibus "Financial Emergency Act" that would create a board with the sweeping powers to approve or reject New York City's yearly estimates of anticipated revenue, its planned expenditures to aggregate, collective bargaining agreements, and long-term financial planning (of which there had been virtually none)—in short, whatever was needed to ensure the city moved aggressively toward achieving a balanced budget.

Carey initiated the largest increase in tax cuts that the residents of New York State had seen, which would make the state more viable for businessmen and others interested in investing in the state. Signs that Ford was ready to announce an aid package were evident as the flurry of activity in Albany got under way, as it was in keeping with the president's earlier demands for pain, sacrifice, and "self-help" by the city and state. Even at the beginning, though very wary of giving aid to the state, he never actually uttered the words that the *Daily News* had as a headline, "Ford to City: Drop Dead." That headline may have cost him New York State and the 1976 Presidential election, which Jimmy Carter barely won.

Ford's chief of staff Donald Rumsfeld and Deputy Chief of Staff Dick Cheney still did not agree with extending aid to New York but Vice President Rockefeller and Presidential Economic Advisor Arthur Burns, as well as several of Ford's friends became fearful that if New York became bankrupt and defaulted it would have a domino effect upon other states and perhaps even many of the industrial nations of the world. Ford's close friend, former Congressman and Defense Secretary, Melvin Laird, expressed his fears to the West German Chancellor, Helmut Schmidt, and French President Valery Giscard d'Estaing, both of whom telephoned President Ford and urged him to do something.

At an October 3rd meeting Ford asked the West German Chancellor, "How's the Bundesbank? How's the mark?" Schmidt responded, "Mr. President, never mind the Bundesbank or the mark. If you let New York go broke, the dollar is worth"—and here Schmidt used the German word for excrement—"scheisse!" Schmidt said publicly that a default by New York City would have a "domino effect, striking other world financial centers such as Zurich and Frankfurt," as well as many other major European cities.

Finally, Representative John Rhodes, the Republican leader in the House, who had succeeded President Ford, came out in support of limited federal aid for New York City on November 11, a pronouncement that signaled that the president and members of his party were now willing to help. Two days later, White House officials announced that the state and city were jointly facing up to their years of fiscal irresponsibility. Ford delivered a nationally televised press conference on November 26, calling on Congress to approve new legislation to make $2.3 billion in direct federal loans available to the city on an annual basis for up to three years.

In conclusion several major accomplishments allowed Governor Hugh Carey to avoid bankruptcy, including the creation of Big MAC (Municipal Assistance Corporation), which was headed by Felix Rohatyn and reorganized and stretched out New York City's debt.

Carey was the chairman of it and Mayor Beame and Comptroller Goldin were members. The powerhouse behind it was William Ellinghaus, while many of the leading business leaders in New York also participated in it. The EFCB forced New York City to develop a better system of accounting. Prior to this the Mayor and first Deputy Mayor would not have adequate means for appropriate bookkeeping. The changes that the city was forced to make in its accounting procedures were so good that New York City's bookkeeping is today probably superior to that of New York State.

The Metropolitan Transit Authority (MTA), under Richard Ravitch, began the difficult task of rebuilding a very dilapidated subway system. It initially generated money, among other things, to purchase hundreds of new subway cars that made a difference to the public because for the first time the subway cars were air conditioned, reliable, and attractive.

Carey's first term in office, which brought about economic recovery, laid the foundation for the restructuring of state government, and can serve as a model for our times.

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This article is based on the book by Seymour P. Lachman and Robert Polner, *The Man Who Saved New York: Hugh Carey and the Great Fiscal Crisis of 1975* (State University of New York Press 2010).

The Office of State Comptroller: Minding the State's Fiscal Store

By Mary Louise Mallick

The state comptroller acts as the chief financial officer of the State of New York. Elected to a four-year term at the same general election as that of the governor and the state attorney general, the comptroller's responsibilities are to "superintend the fiscal concerns of the State."[1] As such, the comptroller has a fiduciary obligation to the people of the State of New York to accurately present the financial status of the State, including audits of state revenues and expenditures. This obligation carries with it the responsibilities that the comptroller act as an independent observer of the budget and of budget processes. The current comptroller, Thomas P. DiNapoli of Long Island, was appointed in February 2007 to fill the vacancy of state comptroller and was elected to a new four-year term in November 2010.

New York did not always have a state comptroller. The New York State Constitution had originally established the position of the state treasurer as the chief financial officer in 1777. That same year, the Legislature appointed an auditor general to represent the people's interest in spending for public purposes. Due to competition between the treasurer and the auditor general, the legislature abolished the Office of the State Auditor, and in 1797, created the Office of the State Comptroller.

As part of the creation of the Office of State Comptroller, the legislature transferred to it many of the treasurer's responsibilities. Samuel Jones from Long Island was appointed as New York's first comptroller and issued the first Comptroller's Financial Statement, a report still produced to this day. Comptroller DiNapoli is also the first comptroller since Samuel Jones to come from Long Island.

The comptroller's current duties, as stated in Article V of the State Constitution,[2] are to audit all vouchers presented for payment, to audit the accrual and collections of receipts, and to determine such methods of accounting necessary to undertake such duties.

Over time, however, the interpretation of the comptroller's responsibilities to superintend the fiscal concerns of the state has expanded into five different roles: sole trustee of the New York State and Local Retirement System, independent auditor, fiscal overseer of state and local governments, issuer of state general obligation debt, and chief financial officer. These various duties are prescribed in state statute. In recent years, the comptroller has begun to add a sixth role: an active, although limited, participant in the enactment of the state budget, beginning with a focus on budget balance. This new role has as its basis the comptroller's role of chief financial officer and the accompanying fiduciary obligations of independence and integrity.

Over the past thirty-five years, the legislature and others have utilized this independence to resolve concerns over the State budget as well as the budget process, propelling the comptroller forward in taking a more active role in the state budget. This paper details a decision by the State Court of Appeals regarding the issuance of short term debt, enacted legislation concerning legislative pay and the state's revenue forecasting process as the primary factors in the emergence of the comptroller's role in recent years as a participant in the budget process.

"[T]he comptroller has a fiduciary obligation to the people of the State of New York to accurately present the financial status of the State, including audits of state revenues and expenditures."

Chief Financial Officer

The role of chief financial officer encompasses significant and varied responsibilities in a state as large and diverse as New York. For example, among the comptroller's duties under this title is the processing of paychecks for approximately 250,000 employees of the executive agencies, the legislature, the Office of Court Administration, the State University of New York, and the senior colleges of the City University of New York. These paychecks totaled $15.3 billion in SFY 2009-10.[3] The comptroller's office also approves and processes all state payments—a total of 140.5 million payments for an amount of $110.3 billion in SFY 2009-10 alone.[4]

In addition, all state contracts, including certain contracts of state public authorities, must be reviewed and approved by the comptroller's office. The comptroller's fiduciary obligation to the people of New York in the review of contracts is to ensure that the state receives the best value for its resources as well as deterring potential fraud and abuse. In SFY 2009-10, the Office of the State Comptroller reviewed approximately 30,000 contract transactions totaling $50 billion.[5] All of the contracts subject to comptroller review are listed on the comptroller's "Open Book" website (www.openbooknewyork.com).

The third responsibility under the role of chief financial officer is the accounting and financial reporting requirements under state statute. Located in the Bureau of State Accounting Operations, these requirements have served as the starting point in the state comptroller's emerging role as a participant in the state budget.

The State Accounting Bureau's operations are many. They (along with the Division of the Budget) implement, monitor and report on the annual state budget and on the state's financial plan as developed by the Budget Division. This bureau is also responsible for the receipt, reconciliation and accounting of all tax, miscellaneous and federal monies received by the state. The bureau is charged with establishing a central accounting system to issue and record payments made under State appropriations. Additionally, the bureau ensures that all payments are within legislatively authorized appropriations.[6]

The reporting requirements of the bureau are extensive and cover the financial status of specific programs as well as the state's overall financial plan. The bureau provides monthly reports on the state's financial plan, both on a cash and on a Generally Accepted Accounting Principles (GAAP) basis. In addition, annual reports are issued on the state's financial plan, again on a cash as well as GAAP basis. For example, this bureau is responsible for the Comprehensive Annual Financial Statement as well as a Financial Condition Report.

The comprehensive as well as specific nature of such reports are a result of the significant amount of financial data gathered by the Office of the State Comptroller from the collection of revenues and the processing of payments pursuant to State appropriations. Collection of receipts and expenditure of funds are recorded and classified in accordance to standard accounting rules as well as requirements of state finance law.[7] This independent, objective gathering of data and the preparation of related reports are a direct acknowledgement by the comptroller of his fiduciary responsibility to the people of New York to accurately account for state finances. In addition, this gathering of significant financial data as a result of the operational duties relating to the collection of receipts and the disbursement of state monies has also, over time, laid the groundwork for the comptroller to become active in the state budget process.

The first significant event that drew the comptroller into the role as a participant in the state budget process, albeit at a distance, came from the constitutional as well as statutory authority of the comptroller to issue state debt, specifically short term notes called tax and revenue anticipation notes.

Tax and Revenue Anticipation Notes

In 1920, the state constitution was revised to permit the State to issue short term notes in anticipation of the receipt of future taxes and revenues (Section 9, Article VIII). This debt is required to be repaid within one year and can only be issued in conjunction with a balanced budget for the particular state fiscal year in which the debt is issued. The purpose of this short term debt is to finance state expenses pursuant to appropriations enacted as part of a balanced budget, but for which planned revenues are yet to be received. This section also allows the issuance of short term notes to finance unanticipated deficits at the end of one fiscal year to be repaid the following fiscal year (deficit notes). The state comptroller is charged with the responsibility of issuing the notes, setting interest rates and debt service schedules, impounding revenues, and repaying the debt.

Before 1993, tax and revenue anticipation notes (TRANs) were usually issued at the beginning of a state fiscal year immediately after the state budget was adopted. This process became known as Spring Borrowing. The proceeds from the sale financed state expenditures in the first quarter of the fiscal year (April 1–June 31). The notes were redeemed throughout the remainder of the fiscal year. (The Spring Borrowing Program ended in 1994 with the issuance of long-term bonds to realign state revenue and expenditures).

In the years prior to 1993, as the state began to incur revenue shortfalls and increasing costs for programs such as education and Medicaid, the state began to delay payments from the fourth quarter of a fiscal year into the first quarter of the next fiscal year. In addition, the state began the practice, from time to time, of accelerating tax receipts from the first quarter of a succeeding fiscal year into the fourth quarter of a prior fiscal year. Since the first quarter of the fiscal year already had substantial payments due, such as education aid and payments to the Public Employees Retirement System, the disparity between state payments due and owing in the first quarter of a state fiscal year and the revenues available to pay such obligations escalated.[8]

By fiscal year 1975–76, 47.2 percent of state expenditures were made in the first quarter of the fiscal year. In comparison, only 21.9 percent of state revenues were collected over the same time period. The difference between revenues and expenditures in the first quarter of SFY 1975–76 totaled $3.369 billion. The amount of TRANs issued in the first quarter to pay the state's obligations totaled $3.385 billion.[9]

In comparison, in SFY 1967–68, 31.9 percent of state expenditures occurred in the first quarter while 20.5 percent of state revenues were received during the same time period. The difference between expenditures and revenues in the first quarter of SFY 1967-68 totaled $592 million. That year, the comptroller, at the request of the governor, issued $825 million in tax and revenue anticipation notes.[10]

The fiscal year 1975–76 is chosen for comparison because in 1975, New York State and a number of its municipalities, including New York City, became unable to market their securities, setting off a severe financial crisis in New York State. Certain public authorities including the Urban Development Authority (UDC) and the Housing Finance Agency (HFA) were facing the same access problem as well. The state, as part of an overall solution, advanced $800 million to New York City in the first quarter of each of the 1975–76, 1976–77 and 1977–78 fiscal years. In addition, in the fall of 1975, the state advanced another $250 million to New York City and $500 million to the newly created Municipal Assistance Corporation (MAC) which was created to assist the city with a long term refinancing of its short term debt. These fall advances were also financed through the issuance of tax and revenue anticipation notes. Unlike the earlier advance of $800 million, this advance to both the City and MAC was repaid in the fall of 1975.[11] As a result of this increased financial activity, the state issued $3.39 billion in TRANs in the first quarter of the 1975–76 State Fiscal Year.[12]

The State ended the 1975–76 Fiscal Year with a deficit of $446.8 million. To close the deficit, the state transferred the remaining balance in the Tax Stabilization Reserve Fund ($64.8 million) to the state's General Fund and issued the remaining $382 million in deficit notes. These notes were purchased by the Employees Retirement Fund, public authorities and other funds under the control of the state.[13]

In the first quarter of SFY 1976–77, the state issued $3.72 billion in TRANs to finance the following: $2.54 billion for regular operating expenses in the first quarter, $800 million to finance accelerated payments to New York City and $382 million to replace state revenues that were impounded to repay the prior years' deficit notes.[14]

The 1976–77 Fiscal Year also ended with a budget deficit. As a result, the state once again issued deficit notes of $158 million which were repaid early in the next fiscal year (1977–78). As with the prior fiscal year, the revenues impounded by the comptroller to repay the deficit notes were to be "replaced" from proceeds of the $3.6 billion TRAN issuance in the spring of 1977.[15] It was this series of deficit notes and the annual issuance of short term tax and revenue anticipation notes that triggered a lawsuit by Leon E. Wein on the constitutionality of the recent issuances of TRANs.

Wein v. Carey

On March 31, 1977, the New York State Court of Appeals issued an opinion in the case of *Wein v. Carey* which allowed the state comptroller to move forward with the issuance of $3.72 billion in TRANs in the spring of 1977.[16] The plaintiff, Leon W. Wein, had argued that the issuance of TRANs in 1976 and that the planned issuance for 1977 were a violation of section 9 of Article VII of the state constitution, which required budget balance as a condition of issuing TRANs. The plaintiff pointed out that the state had incurred a series of budget deficits which were financed through deficit notes that were repaid in the next fiscal year. In that next fiscal year proceeds from the annual Spring Borrowing were used to replenish the state's General Fund for revenues impounded to redeem the prior year deficit notes. Therefore, the state was "rolling" the budget deficit from one year into the next fiscal year. The plaintiff argued that since the state had incurred a series of deficits at the close of the fiscal year, the subsequent issuance of TRANs was unconstitutional, because the occurrence of these budget deficits indicated that the State <u>had not</u> enacted a balanced budget at the beginning of the fiscal year, i.e., that there was "no authentic balance" between revenues and expenditures in the state budget.[17] Mr. Wein relied on the holding of an earlier case which stated that "if repayment of tax and revenue anticipation notes may only be made by creating, directly or indirectly, a budgetary deficit in the year of repayment, such borrowing is not an anticipation of the receipt of taxes and revenues and thus violates constitutional limitations."[18] As part of his lawsuit, Mr. Wein requested an injunction against the planned release of TRANs in April 1977.

The Court of Appeals decided that the planned issuance of TRANs was constitutional and the injunction against the 1977 Spring Borrowing was denied. The court reasoned that a succession of budget deficits did not indicate that the State budget was out of balance at the time of enactment. Instead, the proof of a planned budget imbalance was to be found by an examination of the estimates of tax and revenue receipts and of expenditures to show that the resulting deficit was expected or planned. If so, the notes issued to finance such deficit would be unconstitutional. In other words, if at the time the notes were issued, the state could not reasonably anticipate that sufficient tax and revenue receipts were available to repay such notes within one year, based on authentic estimates, the borrowing would be unconstitutional.[19] The Court of Appeals further noted that Mr. Wein had not presented any analysis indicating that such estimates were not authentic.[20]

In addition, the court observed that a balanced budget at the beginning of a fiscal year will in all likelihood end the year with either a surplus or a deficit. Therefore, even assuming an invalid rollover of anticipated deficits, a current budget plan is valid if it provides for payment of such deficit notes.[21] After the decision by the Court of Appeals, the state moved forward with the issuance of $3.6 billion in TRANs in April 1977.

The Wein Certificate

As a result, underwriters for the Spring Borrowing program and for any additional issuance of tax and revenue anticipation notes began to request the state comptroller to certify the reasonableness of the estimates of revenues and expenditures in the state budget and therefore, budget balance, prior to issuance. This certification became commonly known as the Wein Certificate.

Attached as Appendix A is a photocopy of a Wein Certificate signed by the then-Comptroller Arthur Levitt as part of the 1977 Spring Borrowing sale. In this document Mr. Levitt certifies that after consultation with outside consultants, in his judgment, the state would have sufficient taxes and revenues to pay not only the notes to be issued but all notes maturing in the 1977–78 Fiscal Year as well as all expenditures of the state throughout the fiscal year *without incurring a deficit*. Mr. Levitt based his opinion on a review of the estimates of revenues and expenditures provided to him by the Director of the Budget. This wording follows clearly the language of the court decision.[22]

In addition to the certification by the state comptroller, the Director of the Budget, at that time, Peter C. Goldmark, also presented a certification attesting to the availability of sufficient taxes and revenues to repay the Spring Borrowing proceeds, all debt maturing within the fiscal year and all expenditures anticipated to be paid in the fiscal year, again without incurring a deficit. Mr. Goldmark goes further to attest that in accordance with the policies of the Governor, he would apply expenditure controls to avoid a deficit in the 1977-78 State Fiscal Year.[23]

The majority and minority leaders of both the senate and the assembly also certified that the appropriation bills enacted by the legislature are in balance and sufficient revenues would be available to meet projected expenditure levels. Finally, the governor, Hugh L. Carey, also certified that sufficient taxes and revenues would be available to meet all expenses of the budget in the current fiscal year without incurring a deficit.[24]

The comptroller's certification, as the issuer of the tax and revenue anticipation notes and the state official charged with repaying such notes, became the primary certification issued to satisfy underwriters' concerns of the constitutionality of an upcoming TRAN sale. Over time, the role of the comptroller in issuing this certification seeped into the state budget process as both houses of the legislature became aware of the importance of the certification for a successful Spring Borrowing. Although the state comptroller was not at the negotiating table, the fact that the comptroller would review the state budget and opine upon the reasonableness of estimates and budget balance placed additional pressure on the legislature and governor to enact a balanced budget in a timely manner, since the proceeds for the Spring Borrowing TRANs issuance would finance payments in the first quarter of the upcoming fiscal year.

By Fiscal Year 1991-92, the state had incurred four successive years of operating deficits and Spring Borrowing had grown to $3.9 billion with interest costs exceeding $200 million. The state's accumulated deficit, measured on a GAAP basis, had reached $6.3 billion, primarily due to the annual practice of deferring payments from one fiscal year into the next.

Due to the significant interest costs associated with Spring Borrowing, the drastic gap between available revenues and payments due in the first quarter of the fiscal year and, finally, pressure from Wall Street, legislation was enacted in 1990 to create the Local Government Assistance Corporation. This corporation, also known as LGAC, was authorized to issue up to $4.7 billion in long term bonds for certain aid payments to local governments, primarily school aid. The use of these bond proceeds to meet these payments allowed the state to restructure the timing of payments so that revenues would be available to meet obligations, thus eliminating the need for a Spring Borrowing program. By Fiscal Year 1993-94, Spring Borrowing, and the comptroller's accompanying certification of a balanced budget disappeared. However, the image of the comptroller as having a duty to review and comment on the financial plan has continued. As such, the comptroller has taken an active role in the analysis of the state's financial plan, including comment on the state's projections of revenues and disbursements and the potential for budget deficits or surpluses. These analyses have become monthly, quarterly, and annual public reports by the Office of the State Comptroller.

Legislative Pay

The second significant action that propelled the comptroller into the role of an active participant in the enactment of the state budget was the passage of legislation in the fall of 1998 that required the comptroller to withhold the paychecks of members of the senate and of the assembly in the absence of a completed state budget. Under this new law—section 5 of Article 2 of the Legislative Law—if legislative passage of the State budget has not occurred prior to the beginning of the State fiscal year, the issuance of bi-weekly salary payments for members of the senate and the assembly would be suspended until the requirements of a legislative passage of the budget have been met.

The statute defines the legislative passage of a budget to mean that the appropriation bills submitted by the governor pursuant to Article VII of the State Constitution have been finally acted upon by both houses of the legislature and that the comptroller has determined that such appropriation bills are sufficient for the ongoing operation and support of state government and for local assistance payments for the ensuing state fiscal year. An additional requirement is that all legislation submitted by the governor pursuant to Section 3 of Article VII of the State Constitution deemed by the legislature necessary to implement the appropriations has also been enacted upon.[25]

Many have interpreted this statute as requiring the state comptroller to "certify" the state budget in order for members of the legislature to receive their bi-weekly salary payments. The definition of certification varies by both the public and the media ranging from assuring budget balance to looking at, and commenting on, many of the more granular details of the state budget such as revenue estimates, etc. Contrary to what has been reported, this statute *does not require* the comptroller to certify the state budget to be balanced.

Instead, the statute only requires the state comptroller to ascertain as to whether sufficient appropriations have been acted to allow state government to function fully, meeting its obligations to local governments and municipalities as well as to the people of the State of New York. This language implies that if sufficient appropriations have been acted upon, no other appropriations would be necessary to implement the state budget. The language does not require the comptroller to determine the sufficiency of revenues to support the actual disbursements behind the enacted appropriations and hence budget balance.

In addition, the statute requires legislative enactment of Article VII legislation submitted by the governor deemed by the legislature to be sufficient for the effective implementation of the appropriation bills to be finally acted upon as well.[26] Again, the determination of the level of sufficiency of such legislation to support the enacted appropriations rests with the legislature and not the comptroller. Therefore, it becomes incumbent upon the legislature to determine budget balance, not the comptroller. This language refers to process (passage of bills) as opposed to the substance of such legislation.

As with the issuance of Wein Certificates in the state's short term Spring Borrowing Program, the comptroller is once again asked to make a specific determination about the state budget. Unlike the Wein Certificates whereby the comptroller certifies budget balance, the legislation surrounding legislative members pay relies more on the sufficiency of appropriations for the operation of state government. Yet, this legislation again draws the comptroller into the budget process, and is misquoted by many, to request the comptroller to "certify" budget balance.

State Revenue Forecasts

The budget process for many years has followed a rather singular process as follows: the governor submits the budget; the legislature holds hearings and at the same time begins the process of estimating revenues from taxes and miscellaneous receipts for the current and the next state fiscal year; the legislature publishes its revenue forecasts and then the governor and the legislature try to come to an agreement on the amount of available revenues to support appropriations for the upcoming state fiscal year.

In a perfect world, an agreement would be reached, and the budget process would move forward with the negotiation of appropriations bills given the agreed level of available revenues. However, in past years, more often than not, no agreement was reached, delaying the budget process at times for weeks.

In an effort to force an agreement, as part of an overall budget reform package, in 2007, the legislature enacted into state finance law a provision requiring the comptroller to intervene in the event the legislature and the executive could not reach a revenue agreement.[27]

Under section 23 of Article 3 of the State Finance Law, if the legislature and governor do not issue a consensus revenue report by March 5th of each fiscal year, the state comptroller is then required to provide estimates of receipts for the current and succeeding fiscal years. Included in these estimates are projections of all receipts from sources available to finance the disbursements authorized by the appropriations bills submitted by the governor. This estimate by the state comptroller is not a binding estimate, i.e., the comptroller's estimate does not take the place of the required consensus estimate by the legislature and the governor. Yet, the comptroller is now directly engaged in the budget process, becoming a participant in the determination of the availability of state revenues.

Since enactment of this statute, the legislature and the governor have come to an agreement on state revenues, including tax and miscellaneous receipts and lottery revenues. The strong independent role of the state comptroller's office and its associated level of integrity had been sufficient to force an agreement even though the comptroller's estimate would not be binding on the legislature and the governor.

Observations

The independence and integrity of the Office of the State Comptroller has resulted in the comptroller being called upon to provide opinions in times of conflict. Two of the examples described above, the decision of the Court of Appeals in *Wein v. Carey* and the restrictions on legislative pay, have involved the comptroller, albeit not directly, in the budget process.

The recent legislation on revenue forecasting has moved the comptroller closer to being a direct participant in resolving the annual debate on the amount of revenues available to support appropriations. As debate and conflict over the various aspects of the state budget and budget process continue, it is not unreasonable to expect the comptroller to be called upon to take a more active role. The risk associated with a more active role is at what point does the comptroller's participation conflict with his independent role as chief financial officer and chief auditor of the State of New York? Although such a conflict does not exist at present, as the comptroller becomes more active in the state budget process, it is critical that the comptroller's role remains limited to preserve the independence of the comptroller's office and the comptroller's primary duties: audits, contract review and approval, issuance of general obligation debt and as the fiscal overseer of state and local governments including school districts.

"As debate and conflict over the various aspects of the state budget and budget process continue, it is not unreasonable to expect the comptroller to be called upon to take a more active role. [But] at what point does the comptroller's participation conflict with his independent role as chief financial officer and chief auditor of the State of New York?"

Endnotes

1. New York State Fin. Law § 8 (McKinney 2009).
2. N.Y. Const. art. V, § 1.
3. N.Y. State Comptroller, Office of Operations: Briefing for the First Deputy Comptroller 11 (Jan. 2011) (on file with author).
4. *Id.* at 6.
5. *Id.* at 5.
6. *Id.* at 4.
7. New York State Fin. Law §§ 8, 8-a, 8-b (McKinney 2009).
8. The term "Public Employees Retirement System" is used in the April 15, 1976 Official Statement for the sale of $2.75 billion in tax and revenue anticipation notes to include the New York State Employees Retirement System and the Policeman's and Fireman's Retirement System, both administered by the New York State Comptroller.
9. N.Y. State Comptroller, 1977 Tax and Revenue Anticipation Note 19 (Apr. 1977).
10. *Id.* at 19.
11. N.Y. State Comptroller, 1976 Tax and Revenue Anticipation Note 29 (Apr. 1976).
12. *Id.* at 4.
13. *Id.* at 24.
14 *Id.* at 13.
15. N.Y. State Comptroller, *supra* note 9, at 5.
16. 362 N.E.2d 587.
17. *Id*.
18. *Wein v. State of New York*, 347 N.E.2d 586, 592 (N.Y. 1976) (citations omitted).
19. *Wein v. Carey*, 362 N.E. 2d at 591-592.
20. *Id.* at 592.
21. *Id.* at 591.
22. N.Y. State Comptroller, Certificate of Issuance of Tax and Revenue Anticipation Notes (Apr. 1977).
23. N.Y. State Dir. of the Budget, Certificate of Issuance of Tax and Revenue Anticipation Notes (Apr. 1977).
24. N.Y. State Governor, Certificate of Issuance of Tax and Revenue Anticipation Notes (Apr. 1977).
25. New York State Legis. Law § 5 (McKinney 1994).
26. *Id*.
27. 2007 N.Y. Laws ch. 1.

Mary Louise Mallick is Senior Policy Advisor to the Comptroller of the State of New York. She has more than 21 years of experience in shaping the state budget and guiding fiscal policy.

Appendix A

CERTIFICATE

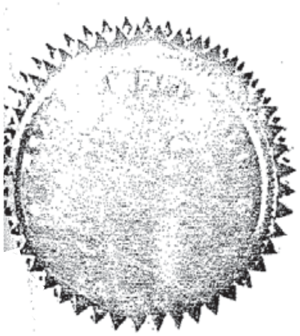
I, ARTHUR LEVITT, Comptroller of the State of New York (the "State"), do hereby certify, in connection with the issue and sale today by the State to the Underwriters defined in the Purchase Contract of $3.6 billion principal amount of tax and revenue anticipation notes of the State (the "Notes") that:

1. Upon the basis of information available to me (after due inquiry and investigation, including consultation with outside consultants with respect to the methodology used by the State in preparing its statement of Projected General Fund Cash Flow for the 1977-78 State fiscal year), in my judgment, the State will have sufficient taxes and revenues during the 1977-78 State fiscal year, based on realistic estimates furnished to me by the Director of the Budget, which I have reviewed, to pay the Notes and all tax and revenue anticipation notes of the State currently outstanding or anticipated to be issued, maturing in such fiscal year, when due at stated maturity (together with interest thereon) and to pay all other expenditures of the State (including debt service requirements) anticipated to be paid in such fiscal year, without incurring, directly or indirectly, a deficit in such fiscal year.

2. Representatives of my Department of Audit and Control participated throughout the preparation of the Official Statement and I have personally reviewed the Official Statement of the State, dated April 7, 1977 (the "Official Statement"), including the information contained therein relating to the Financial Plan of the State, which information was prepared and furnished by the Division of the Budget of the Executive Department of the State.

3. As of this date, nothing has come to my attention that would lead me to believe that the Official Statement, as of its date and, as amended or supplemented to the date hereof, on the date hereof, is not complete and fairly presented in all material respects, contains any untrue statement of a material fact or omits to state any material fact necessary in order to make the Official Statement, or the statements and information therein contained, in light of the circumstances under which they were made, not misleading.

WITNESS my signature and the seal of my office this 15th day of April, 1977.



ARTHUR LEVITT
Comptroller

Observations on Debt, the Budget and Infinity

By Kenneth W. Bond

Introduction

Among the 50 states, New York carries one of the highest combined state and local government debt loads both in total debt and debt per capita.[1] Yet a law student from China studying the New York State Constitution (herein, the "Constitution") might not get that impression. Article VII of the Constitution requires a bill to authorize state debt to be approved by the voters.[2] Article VIII of the Constitution requires debt of municipalities and school districts not to exceed quantitative limits based on percentages of average full valuation of taxable real property.[3] "Constitutional debt," we might call it, requires the state and local governments to pledge their respective "faith and credit" which in the case of the state simply means that if debt service is not appropriated by the legislature in the budget, the comptroller is required to pay it from whatever funds he or she has available.[4] In the case of local governments and school districts, the Court of Appeals made clear during the midst of the mid-1970s New York City financial crisis that the term "first revenues" relating to the faith and credit pledge requires payment to bondholders in full to the detriment of all other appropriations.[5] Importantly, the court later modified its view: only real property taxes—the tax base exclusively reserved for local governments—are subject to the prior lien of the "first revenues."[6] So constitutional debt, conceived in the mid-19th and 20th centuries through a succession of constitutional conventions, whose delegates were anxious to limit the power of state government from saddling taxpayers with infinite debt, is not really a budget issue: whether debt service is appropriated or not, the state, local governments and school districts must pay if any one is paid. If there is too much debt, the voters have only themselves, not the legislature and not hundreds of state authorities, to blame.

Now in the 21st century, with these restrictive constitutional limits on incurring debt still very much the black letter law, the comptroller reported in 2010 that (i) between 2000 and 2005, 41.4% of state capital project spending was debt authorized and issued by "state authorities" and 4.3% of such spending was constitutional debt; (ii) between 2006 and 2010, 48.9% of such spending was state authority debt and 3.6% of such spending was constitutional debt; and (iii) it is projected that between 2011 to 2015, 46.8% of such spending will be state authority debt and 4.6% of such spending will be constitutional debt.[7] Clearly, today's state debt burden is not a function of the voters pulling the "yes" lever every time a bond proposition appears on the ballot.[8] At the state level it is a function of authority debt, its validity in the face of constitutional challenges well established after judicial battles in the 1970s and 1990s.[9] At the local government level the more restrictive constitutional limits on incurring debt require more imagination not yet bench tested in the courts: the use of *de facto* public authorities in the form of government-related not-for-profit corporations known as "local development corporations."[10]

It is with state and local authority debt that budgets become important because, not carrying the issuer's faith and credit, the amount of debt which may be issued absent constitutional restraints is infinite, and payment of authority debt, being subject to budgetary appropriation, can cease in the legislature's discretion.[11] In theory, if the debt service is not appropriated, the bond holders do not get paid. As Robert Amdursky observed over 20 years ago, with constitutional debt, the taxpayers are at risk for nonpayment, and with authority debt the investors are at risk.[12] Yet why does the debt of certain state authorities hold higher credit ratings than the state's constitutional debt? And what of debt incurred to balance the budget?

In very round numbers, the state's total receipts budgeted for FY 2011-2012 fiscal year is $133 billion, down from $134.5 billion in FY 2010-2011.[13] All constitutional debt and authority debt for state public purposes is around $55 billion and other authority debt is around $105 billion. Depending on your source, the annual debt service on this $160 billion of debt is around $6.6 billion or about 4.125% of budgeted expenditures or 5.0% of all fund receipts—by no means a budget crisis.[14] However, there is a perception that the state is in a debt crisis because there is so much of it, especially when compared with other states. But focusing on the amount of state debt misses the point. It's the legal methodology employed by the state, and increasingly local governments, to authorize and incur debt that should concern us when we look at budgets.

Authority Debt—Not a Burden on the Budget—The Special Fund Doctrine

The development of authority debt is, as I have pointed out,[15] a function of the automobile, something that sprang from its acceptance as a preferred mode of personal transportation in the 1920s. All those cars and trucks needed highways, bridges, tunnels and parking facilities to move around (and they still do). Not surprisingly, the first authorities were created to finance these facilities.[16] The debt these authorities issue are revenue bonds, debt paid from revenues collected for the use of the facilities, i.e., tolls. When challenged as being unconstitutional debt, revenue bonds were recognized by the courts as valid special limited obligations under what became known as the Special Fund Doctrine, i.e., their source of payment derives from operating revenues placed in a separate fund in an amount sufficient to pay debt service on the bonds without an invasion on taxes or general fund moneys.[17] The debt service may be appropriated through a state, authority or local government budget, but not from the general fund or taxes. Thus, these authority bonds have no effect on the government's operating budget nor threaten the resources available to honor the faith and credit pledge of constitutional debt. In much the same way, the debt to finance water and sewer systems, municipal gas and electric systems is paid from special funds derived from water and sewer rents and gas and electric charges—not general fund moneys or taxes.

Within the confines of the Special Fund Doctrine authority debt is not a budgetary concern. No one complains that the debt of the Port Authority of New York and New Jersey is excessive or increases budgetary appropriations or raises taxes. The Port Authority's debt may be excessive, some of its expenditures wasteful and inefficient, or its management personnel bloated and overpaid. But you don't have to pay for any of it unless you want to come back from New Jersey.

Authority Debt—A Budget Item

Constitutional debt is transparent and democratic. If it is state debt, the amount of the debt is right on the ballot label and you can pull the lever "yea" or "nay." You know that if approved, your taxes may go up. Special fund doctrine authority debt paid from operating revenues is less transparent and not very democratic: users of bridges, water systems and electric systems are not permitted to participate in setting rates (unless you find an obscure published notice of a legally required hearing). But you get to see and feel the things the debt produces—the water from the tap, the stuff in the toilet that mysteriously goes away with a pull of the handle, the view of the New York skyline when you come back from New Jersey.

Rather, it is with authority debt paid from general fund appropriations where the problems start. Until forty years ago, a court would have granted a motion to declare unconstitutional non-voted state debt paid from legislative appropriations.[18] After all, without voter approval or debt limits the amount of debt which the legislature could authorize and pay for out of taxes and general fund revenues is infinite. Certainly neither Article VII nor Article VIII of the New York Constitution could be read any other way. Yet while New York's debt and the legislative appropriations to pay for it are hardly infinite, there is today hypothetically no constitutional restraint to avoid such a result. For that we can thank the Court of Appeals in the landmark *Wein v. State of New York* and *Schultz v. State of New York* cases from the 1970s and the 1990s and *LGAC v. STARC*[19] from 2004 which upheld appropriation-backed authority debt as not prohibited under the Constitution on the premise that authority debt is not debt of the state but gifts from and to the state's public authorities to the state or its political subdivisions is not prohibited.[20] As the court said in *LGAC*, "we do not question the wisdom of the Legislature" in developing complex financing schemes.[21] Thus, when the legislature includes budget appropriations for the Metropolitan Transportation Authority[22] or the Thruway Authority,[23] for example, which appropriations are clearly authorized in their enabling laws and included in the state's adopted budget each year to pay for authority debt, from the standpoint of the Constitution as interpreted by the state's highest court, it's just a gift. The same is true for the Dormitory Authority of the State of New York[24] when it issues bonds to finance SUNY and CUNY facilities the debt service on which is paid for by legislative appropriations. And if the budget is out of balance during a fiscal year (there being no requirement in the Constitution that the legislature adopt a balanced budget),[25] the state or an authority may issue short-term tax and revenue anticipation notes, indeed year after consecutive year, and give the proceeds to the state treasury to pay for appropriations to its authorities. That is also a gift, not invalid constitutional debt.[26] These arrangements between the state and its public authorities may be denominated as leases or service contracts to create obligations to pay debt service on authority bonds, but the appropriations are constitutionally permitted gifts, not illegal, unconstitutional, or disguised loans in the consistent opinion of the Court of Appeals. These appropriations may be made without limit if included in the budget.

Authority Bonds—Synthetic Constitutional Debt

State law is clear that except for constitutional debt, any payment obligation of the state must be appropriated by the legislature before the comptroller may order payment.[27] A legislative decision to reduce budget expenditures by failing to appropriate debt service on authority debt, while a legal possibility, would be a pyrrhic act because notwithstanding the amount of debt, debt service is a relatively small percentage of total expenditures. But that's not the reason the failure to appropriate debt service is never raised as a budget balancing remedy.

New York's authority debt is not a casual promise to pay just because it falls outside the requirement of the faith and credit pledge of the Constitution. Billions of dollars of authority debt is held by investors participating in the $3 trillion municipal securities market. It is rated by the national rating agencies and described in elaborate and complex offering documents, each referred to as an "official statement." In recent years investors have required that appropriation-backed debt be enhanced to more closely resemble the faith and credit pledge of constitutional debt. That result has been achieved from the decision in *Quirk v. MACC*[28] in which the Court of Appeals ruled that New York City was not required to pledge any tax other than the real property tax to its constitutional debt. Other taxes, namely, sales taxes and personal income taxes, pledged to other debt, in this case bonds of the Municipal Assistance Corporation for the City of New York, was held to be a valid appropriation.

Applying the *Quirk* principle, legislation enacted in 2001 permits the bonds of five state authorities to be secured with state personal income taxes, segregated when collected and first applied to debt service on Personal Income Tax (PIT) revenue bonds before the balance is transferred to the general fund.

Likewise, the New York City Transitional Finance Authority (TFA), enacted by the legislature in 1997,[29] permits the capture of state aid for educational purposes and applies it first to debt service on TFA's Building Aid Revenue Bonds (BARBs). Again, state aid is collected and segregated when collected and applied first to debt service on BARBs. This way investors have a synthetic first lien to a secure stream of state revenues, the payment of which is subject to appropriation. Yet it looks and feels a lot like constitutional debt—particularly to the rating agencies.[30]

PIT revenue bonds and BARBs, by locking up a stream of tax payments or state aid for education payments, enhance the security for these bonds and by applying the revenues first to debt service on bonds before releasing the taxes or revenues collected to the general fund, mimic the "first revenue" pledge of constitutional debt. The lock-box enhancement of these authority bonds helps to sell them to investors. Yet the question remains how much personal income tax and state aid is being retained for debt service and not available for government operations if the amount of debt increases. For example, when New York City's constitutional debt would have exceeded its debt limit in the 1990s the solution was not to amend the Constitution and raise the debt limit. The solution was to create the TFA. By statute the TFA debt limit is $13.5 billion[31] but the legislature can always raise it.

The state's authorities bring new bond issues to the market throughout the year. These bonds enjoy the highest ratings from the national credit rating agencies because of the credit enhancing structures such as locking up taxes and revenues, making bondholders the beneficiaries of virtual first lien securities. Any notion that the state or its authorities would fail to appropriate payments for debt service on their bonds would cause their ratings to decline and discourage investment banks and investors from continuing to buy these securities.

The Debt We Ask For

Finally, it would be naïve to suggest that all this debt has been produced at the urging of public officials. For the professionals in the municipal securities industry, New York, California and other large states are fertile ground to do deals. And it is no secret that the relationship between public officials who are legislators authorizing debt and chief fiscal officers responsible for issuing debt and the world of broker/dealers, bankers and financial advisors (and bond lawyers, too) is ethically challenged. After all, we earn our livelihoods doing bond issues, keeping our client relations on a genuinely personal level, and hunting for new deals and clients. However, at the local government level the legal restraints of competitive bond sales, constitutional debt limits and public referendum historically temper the enthusiasm for trying to make a killing doing the next creative big deal. Not quite so at the state authority level. With a permissive judicial response to cases challenging authority debt under the Constitution, in the absence of constitutional constraint, appropriation-backed authority debt, borne solely of malleable statutory authority, is easier to expand. Financing tools like PIT revenue bonds, BARBs, swaps, and auction rate securities are not developed at authority board meetings by citizens serving the public interest. They are developed by bankers, lawyers and financial advisors to create a bond issue in which they will earn a fee, then sold to unschooled board members as being a good financial package and in the public interest. The potential ethical problem is huge. While the Muncipal Securities Rulemaking Board (MSRB) rules provide that bankers relate to issuers as fiduciaries,[32] and bar rules require attorneys to act with competence, diligence and confidentiality in giving legal advice, for practitioners doing a bond issue, it is strictly doing business. Whether some of the state's authority debt is primarily a function of professionals eying an opportunity for a deal is debatable. Certainly, nothing in recent times has reached the height of a solid waste plant in Harrisburg, Pennsylvania that does not work, which the city signed on to pay for,[33] or a $3.2 billion sewer plant in Jefferson County, Alabama built a little too large for a service population of 665,000.[34]

Then there is the debt that finances deficits rather than capital projects. The purpose for which authorities may issue bonds under the Public Authorities Law, and the Constitution for that matter, does not specify that proceeds only be applied to brick and mortar and related costs. There are several authorities whose purpose is to finance cumulative operative deficits of major urban local governments.[35] Although the criticism that the state issues debt to pay the expenses of government is overblown, the comptroller's estimate that over $10 billion of outstanding debt was issued for non-capital purposes is probably accurate.[36]

There are two more fundamental reasons why New York has such seemingly high debt. First, it is generally forgotten that New York's public finance and budget practices are in fact a direct outgrowth of the Constitution, last enacted in 1938—when Packards, Studebakers and Nashes still proudly cruised the highways. State constitutions do not grant people rights; they restrict the actions of government under the reserved powers granted by the federal constitution, i.e, the power to spend, tax and borrow in the name of the state and its political subdivisions. What is extraordinary about the 1938 Constitution is that it *expands* the power of state government to tax (Article XVI), provides a system of social welfare to be provided by the state, including prisons, mental health facilities, and public hospitals (Article XVII), and provides a system of public housing and nursing homes to be provided by the state (Article XVIII). Indeed, Article VIII of the Constitution lists these purposes and more as those which the state may incur debt to finance. There was just one little problem—all the debt would have to be voted constitutional debt. The 1938 Constitution's version of the New Deal enacted in the depth of the Great Depression (Franklin D. Roosevelt, then president, was New York's governor from 1928 to 1932) provided no new financing mechanism to fund these constitutional mandates. In hindsight, the Constitution might have been further amended to provide a financing mechanism with restraints similar to constitutional debt to fulfill these constitutional objectives. Instead, the legislature created authorities to finance them subject to unlimited budgetary appropriations.

Second, the building of schools, colleges and universities, hospitals, nursing homes, prisons and all the things the Constitution mandates creates employment and economic activity. It is no secret that the private sector economy never replaced the upstate manufacturing-based economy which went into permanent decline following the closing of the Erie Canal in the 1950s.[37] That economy was largely replaced by the public sector and facilities which provide employment and benefits to an increasing number of the state's citizens—financed by authorities.[38]

What Authority Reform Missed

There are over 1,000 state and local government authorities established by the legislature, according to the comptroller.[39] With state authority debt rising and becoming a public concern and political issue in the past few years, the legislature adopted comprehensive "reform" in 2005 and 2009 to curb the activities of authorities, make their actions transparent and make their board members accountable.[40] These are corporate governance statutes intended to place the activities of authorities and their board members in full view of the public and the comptroller in the post-Enron era. These reforms complement the powers of the Public Authorities Control Board established by the legislature in 1976 to approve bond issues and projects of the state's major authorities, it being the finding of the legislature thirty-five years ago that authority debt at that time was growing dramatically.[41] However, the 2005 reforms say little about authority debt. The 2009 reforms established a Public Authorities Budget Office (PABO) which requires state and local authorities to submit a mission statement, annual budget reports, audit reports and personal financial information on board members to PABO.[42] It requires, among other things, sole-source contracts in excess of $1 million to be approved by the comptroller and the establishment of a 4-year capital plan but no PABO or comptroller approval of debt an authority might issue other than the requirement to form a three-man finance committee. These reforms are not aimed so much at monitoring authority debt or state budget appropriations as watching for abuses in board spending of authority funds—like a five-day conference on economic development in Bermuda, giving a consulting contract to the board chair's nephew, or selling authority property cheap to a board member's friend.

The absence of focus on authority debt where one might expect to see statutory debt limits, coverage requirements, statements of source of debt repayment, or the power to suspend a debt issue if it increases state appropriations, is surprising. The 2005 and 2009 reforms simply require more paperwork, staff and expenses and discourage high net worth persons—often the most connected and capable board members, unwilling to make financial disclosures—from serving on an authority board.

The Unintended Consequences of Authority Reform

One of the effects the 2005 reform legislation was to expand the definition of authorities to include not-for-profit corporations, the local development corporations (LDC) discussed earlier herein (a so-called "local authority").[43] When challenged on not submitting reports required in the 2009 reform legislation, an LDC sued PABO and the comptroller for a judicial finding that an LDC is not a public benefit corporation included in the definition of a "local authority." In *Griffiss LDC v. DiNapoli and PABO*,[44] Supreme Court, Albany County, affirmed on appeal, agreed with PABO and the comptroller that an LDC is an authority. The decision may place a not-for-profit corporation in the same position as a public authority created by the legislature to issue debt and give the proceeds to a local government for a municipal purpose under a similar reading of the gift or loan of credit prohibition in Article VII of the Constitution.[45]

The Unintended Consequences of a Tax Cap

Heralded as a remedy for reducing or limiting the cost of government, the legislature adopted a tax cap act (Ch. 97, Laws of 2011) in the current legislative session which limits the increase in the real property tax levy to not more than two percent of the prior year's levy (or CPI index if less) with complicated, if not confusing, override provisions and no guidance as to carryovers of unused cap, adjustment for further state mandate costs, or the cost of economic development activities.[46] Most chilling, the act contains no exceptions to the cap to clearly provide that it does not apply to real property taxes which may be levied "without limit or amount" to fulfill the constitutional pledge of faith and credit on local government and school district constitutional debt. The predictable result of the tax cap act may be that local governments will (i) push capital items out of their budgets into debt to the extent of debt limit capacity to avoid tax increases, and (ii) put pressure on LDCs to engage in off-budget, on-behalf-of appropriation-backed financing without restraints on the amount of debt an LDC may issue and without comptroller authority to audit LDC financing activity.[47] With future tax levies all but frozen in time (but for lively override efforts), appropriation pressures on local government budgets will increase and the PABO will be (if it is not already) overwhelmed with keeping up with these *de facto* public benefit corporations. And all this comes at a time when in a stabilizing or weakly growing economy, local government and school district real property taxes are experiencing revenue stability or growth more slowly than state revenues, which rely on sales and income taxes on account of declining assessments of residential real property.[48]

Another Rational Budget Approach to Infrastructure Finance

Having the benefit of an adopted state budget for FY 2011-2012 before the end of summer vacation, we know that budget costs can be reduced without significant tax increases or borrowing to close deficits.[49] But there will be a budget appropriation overhang for many years to amortize existing authority debt (as evidenced by my ever increasing Metro North monthly rail pass) as concern grows about neglecting to finance repairs and improvements to the state's infrastructure. The problem is illustrated no better than in an article in the April, 2011 edition of the American Automobile Association's magazine, *Car and Travel*, entitled "New York's Road to Ruin."[50]

Laying aside the authenticity of the data in and the editorial viewpoint of the article, the writer states that according to a Washington, D.C.-based not-for-profit research organization, TRIP,[51] forty-six percent of the state's roads are rated "poor" or "mediocre," twelve percent of the state's bridges are "structurally deficient" and twenty-five percent "functionally obsolete," and forty-five percent of "urban highways" are congested—suggesting the state needs to build more of them.[52] Further, according to the article, the cost of maintaining state highways exceeds $16 billion annually and it would take a cool $175 billion to put the system into good condition, including, one assumes, the cost of replacing the iconic Gov. Malcolm Wilson Tappan Zee Bridge. The budget issue the article notes is that moneys in the Dedicated Highway and Bridge Fund, lock-box funded with gas taxes and automobile fees, is raided periodically for debt service on Thruway Authority bonds and will be largely depleted in a few years. The writer laments that "politicians, policy-makers and other experts see no clear way out."[53] But, of course there is always a solution.[54] It exists across the pond.

Since the early 1990s the United Kingdom has been financing public infrastructure through the private sector. We know this financing scheme as public-private partnerships, or P3. Much has been written and spoken on the topic with little action taken.[55] The comptroller has recently reported on it and, not surprisingly, does not think much of it.[56]

Imagine that the state decided it was sick and tired of maintaining its roads and highways, of struggling to pay its authority debt, of negotiating with unions and hearing driver complaints of work crews standing around talking on cell phones and holding up traffic flow and apparently not doing much work. Imagine further the state decided to sell off its transportation system and use the money to retire authority debt and fund budget reserves. Under current state law this is impossible.[57] But if it were possible, legally that is, how would P3 work to maintain and finance the state's roads and highways?

The system would be sold to a special purpose corporation (SPC), something like a Wagnerian LDC, in which the state had a controlling interest. The SPC would sell stock—yes, raise *equity capital*—which would exact a high rate of return but be at absolute risk for the system's financial failure. The SPC would also sell subordinated debt which would also receive a high rate of return but assume financial risk of failure. Finally, the SPC would sell senior debt with a high credit rating secured by financial institution guaranties and state guaranties (leveraged through budget appropriations to a state infrastructure bank). The senior debt would closely resemble municipal bonds in credit quality and investment return issued by public authorities but in fact be taxable corporate debt. The equity would come from global capital resources organized by an international consortium of banks and the contractor, a global firm with experience in major public infrastructure design, construction, maintenance and operation. The contract negotiated between the state and the SPC would include all aspects of design, construction, maintenance and operation of the system with state regulation and supervision. Labor would be employees of the corporation, not the state, with some aspects of public employment benefits preserved. The system would be leased to the state and the state would appropriate the rent annually. The revenues for the system would be derived from tolls and user fees—higher and more prevalent than now, but adjusted through technology for congestion, type of vehicle and ability to pay factors.

The implications of a statewide P3 transportation system are important. First, the financial burden for financing the system would be transferred from the state to the private sector, particularly equity investors. Those rich Saudis and South Americans could now place their liquidity in public infrastructure stock rather than buying their fifth condo in South Beach. Second, the pricing of transportation services would be based on rational economic data, not political considerations of public officers motivated to get re-elected or otherwise keep their jobs. Third, ownership of the assets becomes unimportant—if the system doesn't perform as advertised public officials can blame the consortium and, of course, sue. The comptroller points with pride that the Constitution forbids the sale of the Erie Canal[58]—wrong, it should have been dumped 50 years ago and developed by the private sector into a waterway theme park from Schenectady to Niagara Falls. Fourth, a lot of statutes would need to be repealed (competitive biding, separate contracts, etc.) and a lot of new ones written. But the Constitution could probably be left alone and given the funeral it deserves since its financing constraints have been effectively repealed by the state's highest court and ignored by the legislature in establishing authorities.

Using a P3 model for the state's highway system is actually the low hanging fruit. We are used to paying tolls and understand the public policy equity behind "the more you use the more you pay." But P3 can be applied to any public service enterprise; the point being that public infrastructure can be partially converted from dependence on real property tax and other taxes to a revenue-based user fee expense. In effect, P3 would return non-constitutional infrastructure finance, at least to the extent of debt, to the Special Fund Doctrine, where appropriated discrete streams of revenues provided from whoever uses public facilities, not general budget appropriations, pay for them. P3 places the constraint on budget appropriations through pricing, cost, use and return on equity of public services, something which the Constitution is no longer capable of doing. With these market-based constraints, appropriations and debt would face economic limits, in all likelihood turning the line away from pointing toward infinity.

The municipal securities industry is not comfortable with the P3 model if only because the players are different and the industry has devoted its energies to preserving the tax-exempt status of municipal bonds and absence of federal regulation of public finance issuers for nearly 50 years. And state and local governments, as the comptroller points out,[59] are wary of being ripped off by the private sector. Yet efforts to explore P3 as an alternative to traditional debt financing and to streamline public infrastructure procurement and finance are under way.[60] Perhaps the economy will rebound as in the recession of the early 1990s which muted the general discussion of P3. If not, unlimited state debt and potentially infinite appropriations liability may be difficult to sustain.

Endnotes

1. Citizen's Budget Comm'n, Fixing New York State's Fiscal Practices 12 (2003), *available at* http://www.cbcny.org/fixingnys.pdf.
2. N.Y. Const. art. VII, § 11 ("No law [authorizing debt] shall take effect until it shall, at a general election, have been submitted to the people, and have received a majority of all the votes cast.…").
3. N.Y. Const. art. VIII, § 4 ("[N]o county, city, town, village or school district…shall be allowed to contract indebtedness for any purpose or in any manner…which shall exceed an amount equal to the following percentages of the average full valuation of taxable real property of such county, city, town, village or school district….").
4. N.Y. Const. art. VII, § 16 ("If at any time the legislature shall fail to make any such appropriation, the comptroller shall set apart from the first revenues thereafter received, applicable to the general fund of the state, a sum sufficient to pay such interest, [and]…principal… and shall so apply the moneys thus set apart.").
5. *See* Flushing National Bank v. Municipal Assistance Corporation, 358 N.E.2d 848 (N.Y. 1976) (holding that the faith and credit pledge is a prior lien on the revenues of the issuer).
6. *See* Quirk v. MAC, 363 N.E.2d 549 (N.Y. 1977).
7. N.Y. State Comptroller, Planning for the Long Term: Capital Spending Reform in New York State 8–12 (2010) [hereinafter Planning for the Long Term], *available at* http://www.osc.state.ny.us/press/releases/nov10/capital_spending_report_nov2010.pdf.
8. The last voted state debt was in 2005, a $2.9 billion transportation bonds act to finance the Second Avenue subway and the link between Grand Central Terminal and the Long Island Railroad. *See* Citizens Budget Comm'n, New York's Public Authorities 7 (2006), *available at* http://www.cbcny.org/Authorities%20Book%209-06.pdf.
9. *See* Wein v. City of New York, 331 N.E.2d 514 (N.Y. 1975) (holding that proceeds of bonds issued by the NYC Stabilization Reserve Corporation to finance operations of New York City following its 1975 fiscal crisis was a gift not prohibited by N.Y. Const. art. VIII, §8); Wein v. State of New York, 347 N.E.2d 586 (N.Y. 1976) (holding revenue anticipation notes issued by the Municipal Assistance Corporation for the City of New York to reimburse New York City for expenses to balance the City's budget were also a permitted gift); Schultz v. State, 639 N.E. 2d 1140 (N.Y. 1994) (holding non-voted bonds issued by the Thruway Authority did not violate N.Y. Const. art. VII, §11 (voter approval required) even though revenues for debt service were the same as those for debt service on constitutional debt, and annual appropriations were tantamount to the faith and credit pledge since the state would never not appropriate and risk default); Schultz v. State Legislature, 676 N.Y.S. 2d 237 (App. Div. 1998) (holding bonds of the Transitional Finance Authority to fund a New York City capital project were a gift even though when added to the City constitutional debt would exceed the constitutional debt limit (N.Y. Const. art. VIII, §4)).
10. Local development corporations are established under N.Y. Not-for-Profit Corp. Law §1411 (McKinney 2005). *See* Summers v. City of Rochester, 875 N.Y.S.2d 658 (App. Div. 2009), where the Appellate Division, 4th Department, opened the door for limited liability companies to also serve as a *de facto* public authority. *But see* New York State Office of the State Comptroller, Municipal Use of Local Development Corporations and Other Private Entities, Background, Issues and Recommendations 9-10 (April 2011) (wherein the comptroller recommends that the use of LDCs be restricted to private sector economic development financing and not used as revenue bond issuers for municipal public purpose financing), available at http://www.osc.state.ny.us/localgov/pubs/research/ldcreport.pdf.
11. N.Y. State Fin. Law § 4 (McKinney 2009) (no money can be spent without a legislative appropriation), *Id.* §41 (no indebtedness may be contracted without a legislative appropriation). Further, the governor has no discretion to make a payment not appropriated in the budget, even if payment is ordered by a court. *See* NYS Ass'n for Retarded Children v. Carey, 631 F. 2d 162 (2d Cir. 1980).
12. Robert S. Amdursky & Clayton P. Gillete, Municipal Debt Finance Law: Theory and Practice 22 (1992 & Supp.).
13. N.Y. State Comptroller, Report on the State Fiscal Year 2011-2012 Executive Budget 1 (2011) [Executive Budget], *available at* http://publications.budget.state.ny.us/eBudget1112/fy1112littlebook/BriefingBook.pdf.
14. N.Y. State Div. of the Budget, New York State Executive Budget for FY 2011-2012, at 5 (2011), http://publications.budget.state.ny.us/.
15. See: Kenneth W. Bond, *Conduit Financing: A Primer and Look Around the Corner*, 11 N.Y. State Bar Ass'n Gov't L. and Policy J. 68 (2009).
16. The Port Authority of New York and New Jersey was established in 1921 through an interstate compact between New York and New Jersey approved by Congress. The NYS Bridge Authority and the Triborough Bridge and Tunnel Authority were both created by the state Legislature in 1939. *See* 1939 N.Y. Laws ch. 870.
17. *Id.*; Amdursky & Gillete, *supra* note 12, at 181.
18. As late as 1993, the West Virginia Supreme Court distinguished between authority debt which is paid from discrete enterprise revenues under the Special Fund Doctrine (constitutional) and authority debt paid from legislative appropriations from general fund sources to a state school building authority (unconstitutional as an end run around constitutional restraints on gifts and lending the state's credit). *See* Winkler v. State Sch. Building Auth., 434 S.E.2d 420 (W. Va. 1993). In 1994, a year after the *Winkler* decision, the Court of Appeals affirmed in *Schultz*, 639 N.E. 2d at 1140, that New York's legislative appropriation funding of state transportation agencies is permitted because, it reasoned, debt of authorities is not state constitutional debt. See also: Elizabeth McNichol et al., Ctr. on Budget and Policy Priorities, States Continue to Feel Recession's Impact 8 (2011), *available at* http://www.cbpp.org/files/9-8-08sfp.pdf (pointing out that West Virginia is one of 6 states without a budget deficit in 2011 whereas New York had a $15.9 billion budget deficit in 2011).
19. Local Gov't Assistance Corp. v. Sales Tax Asset Receivables Corp., 813 N.E.2d 587 (N.Y. 2004).

20. Wein v. City of New York, 331 N.E.2d 514 (N.Y. 1975). The *Wein* and *Schultz* cases rely on the pretext that Article VIII of the Constitution does not prohibit a gift from the state to its authorities or political subdivisions under the principles stated in Comereski v. Elmira, 125 N.E.2d 241 (N.Y. 1955), as well as the enabling legislation in the Public Authorities Law that the debt of an authority is not the debt of the state.
21. Local Gov't Assistance Corp. v. Sales Tax Asset Receivables Corp., 813 N.E.2d at 587.
22. N.Y. PUB. AUTH. LAW §§ 1260–79 (McKinney 2007).
23. *Id.* §§ 350–87.
24. *Id.* §§ 1675–94.
25. *See* Country of Oneida v. Berle, 404 N.E. 2d 133 (N.Y. 1980).
26. Wein v. Carey, 362 N.E.2d 587 (N.Y. 1977); Schultz v. State, 585 N.Y.S.2d 802 (App. Div. 1992) (upholding tax and revenue note financing at end of fiscal years to fund deficits as not state debt).
27. N.Y. STATE FIN. LAW § 4 (McKinney 2009) ("[N]o money shall be paid from any fund under the management of the state, or any agency or officer thereof except in pursuance of an appropriation by law.").
28. Quirk v. MAC, 363 N.E.2d 549 (N.Y. 1977).
29. N.Y. PUB. AUTH. LAW §§ 2799aa–uu (McKinney 2007).
30. Two of the major national credit rating agencies rate PIT revenue bonds higher than the state's Constitutional debt, apparently because the billions of personal income taxes trapped under the trust indentures of state authority bonds available for debt service is viewed as a better investment than the state's full faith and credit pledge under the Constitution, leaving the impression that the credit rating agencies consider the appropriation risk to be zero. *See* N.Y. STATE COMPTROLLER, DEBT IMPACT STUDY 8–9 (2008), *available at* http://www.osc.state.ny.us/reports/debt/debtimpactstudy08.pdf.
31. N.Y. PUB. AUTH. LAW § 2799-gg.
32. *See* MUNICIPAL SECURITIES RULEMAKING BOARD RULE G-36.
33. On September 15, 2010, the city of Harrisburg, PA defaulted on a $3.29 million debt service payment on bonds issued to finance a solid waste facility which failed to generate enough revenues to pay such debt service.
34. Jefferson County (Birmingham), AL issued approximately $5 billion in the mid-1990s in sewer debt through pay-to-play schemes with the underwriter of the bonds. The County has not had sufficient revenues to pay debt service on the bonds since 2009 and the underwriter was disciplined and fined by the U.S. Securities and Exchange Commission for its acts.
35. *E.g.,* N.Y. PUB. AUTH. LAW §§ 3650–3973 (containing three titles establishing fiscal oversight authorities for Nassau County, Erie County and the City of Buffalo).
36. PLANNING FOR THE LONG TERM, *supra* note 7, at 15.
37. See, generally, Kenneth W. Bond, Presentation at the Robert H. Jackson Center, "Transforming New York Local Governments from the 18th to the 21st Century," (Oct. 2006), *available at* www.roberthjackson.org.
38. BUSINESS COUNCIL OF N.Y. STATE, INC., AHEAD OF THE CURVE 3 (2006) (reporting that between 1990 and 2005, although 129,200 new jobs were created in upstate New York, all but 43,200 of them were public sector/healthcare employment).
39. N.Y. STATE COMPTROLLER, NEW YORK'S PUBLIC AUTHORITIES BY THE NUMBERS 1 (2010), *available at* http://www.osc.state.ny.us/pubauth/reports/pub-auth-num.pdf.
40. *See* Public Authorities Accountability Act of 2005, 2005 N.Y. LAWS ch. 766; Public Authorities Reform Act of 2009, 2009 N.Y. LAWS ch. 506.
41. N.Y. PUB. AUTH. LAW §§ 50–51.
42. *Id.* §§ 4–7.
43. *Id.*
44. 891 N.Y.S.2d 873 (Sup. Ct. 2009), *aff'd*, 925 N.Y.S.2d 712 (3d Dept. 2011).
45. Affirmation of *Griffiss* may imply the expansion of the gift exception to the constitutional restraint on debt in Article VIII of the Constitution building upon *Comereski.*
46. S. 2706, 2011 Leg., 234th Reg. Sess. (N.Y. 2011).
47. N.Y. Charter Schools Ass'n. v. DiNapoli, 914 N.E.2d 991 (N.Y. 2009) (holding that the legislature's grant of authority to the comptroller to audit not-for-profit charter schools exceeded the duties of the comptroller in N.Y. CONST. art. V, § 1).
48. See presentations and reports from ROCK. INST. OF GOV'T, ww.rockinst.org (last visted May 1, 2011).
49. *Id.*, Fn 13, pp.10-12; former Lt. Governor Richard Ravitch reported to Governor Paterson on March 10, 2010 that $6 billion in new deficit borrowing over a 3-year period was required to begin closing the state's structural budget deficit. The adopted FY 2011-2012 budget contains no borrowing denominated as deficit financing.
50. AAA New York, *Car and Travel*, April 2011, at 12 [hereinafter *Car and Travel*].
51. *See* THE ROAD INFORMATION PROJECT, www.tripnet.org (last visted May 1, 2011).
52. *Car and Travel*, *supra* note 50, at 13.
53. *Id.*
54. Traditional state fiscal reform concepts, which have never been embraced by state government, are well summarized in CITIZENS BUDGET COMM'N, THE PALISADES PRINCIPLES: FIXING NEW YORK STATE'S FISCAL PRACTICES (2004) and CITIZENS BUDGET COMM'N, THE ARMONK AGENDA: NEXT STEPS TO FISCAL REFORM (2006).
55. For a useful introduction to P3, visit the website of the NAT'L COUNCIL ON PUB. PRIVATE P'SHIPS, www.ncppp.org (last visited May 1, 2011). By no means a P3 model statute, S.8331, relating to alternative project delivery methodologies designed for large capital projects of certain state authorities, introduced in the 2010 legislative session, advances modern concepts for infrastructure procurement. S. 8331, 2010 Leg., 233rd Reg. Sess. (N.Y. 2010).
56. *See* N.Y. STATE COMPTROLLER, CONTROLLING RISKS WITHOUT GIMMICKS: NEW YORK'S INFRASTRUCTURE CRISIS AND PUBLIC-PRIVATE PARTNERSHIPS (2011), *available at* http://www.osc.state.ny.us/reports/infrastructure/pppjan61202.pdf (detailing everything that can go wrong in a P3 transaction).
57. The State Asset Maximization Commission, within the N.Y. State Empire State Development Corporation, established by executive order in October, 2008, issued a final report in June, 2009, listing several P3 concepts to improve efficiency and reduce costs in infrastructure procurement and finance but offered no guidance in changes to state law or the Constitution which authorize a P3 regime. *See* STATE ASSET MAXIMIZATION COMM'N, http://esd.ny.gov/resources/sam.html (last visited May 1, 2011).
58. *See* note 56 and accompanying text.
59. *Id.*
60. The Section of State and Local Government (SLGL) of the American Bar Association has established a task force to model state project finance laws as an companion to the 207 Model Code for Public Infrastructure Procurement, sponsored by the ABA Section of Public Contract Law and the SLGL.

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The Two New Yorks

By Robert B. Ward

> *"This city is ruled entirely by the hayseed legislators at Albany. In this State the Republican government makes no pretense at all. It says right out in the open: 'New York City is a nice big fat Goose. Come along with your carvin' knives and have a slice.' They don't pretend to ask the Goose's consent."*[1]

So said the immortal George Washington Plunkitt, one of the powers of Tammany Hall when the Democratic organization enjoyed its heyday in the early 1900s. His characterization of government at the State Capitol as solidly "Republican" did not always hold true over the remainder of the 20th century—demographic, political and legal changes saw to that.[2] Still, the perception of an unfair relationship between the Empire State and its largest city has remained very much in place.

The belief in a skewed relationship between the two New Yorks is not a partisan matter; Democrats and Republicans sometimes sing the same song, if different verses. The suspicion and occasional bitterness flows in both directions between residents of New York City and upstate. Signposts of such thinking are many. They include, for example, former Mayor Ed Koch's portrayal of Upstate as "sterile…a joke" in an infamous *Playboy* interview that is often blamed for costing him the 1982 Democratic nomination for governor. Political figures and pundits, both upstate and in the city, have argued for splitting the two apart.[3] Virtually every year, the state budget debate includes claims that New York City is shortchanged; that upstate pays for liberal policies imposed from the big city; that suburban schools do not receive a fair share of education assistance, and other regional grievances that tend to be mutually contradictory.

This article reviews major developments over time in the relationship between the two New Yorks. It concludes that disputes over "fairness" may distract attention from more important considerations that affect all the state's regions equally. Such concerns might include, for example, the overall state-local division of authority—and whether more attention should focus on how effectively state budget dollars are used, rather than the issue of who gets how much.

A Long History of Regional Tension

Sharp political differences between New York City, and its suburban and upstate cousins, go back to the early

years of the United States. In 1787, the Congress, which had been born in the Articles of Confederation, sent the states a proposed Constitution. The goal was to create a stronger central government with greater power to impose taxes, regulate commerce and otherwise oversee the business of the nation. Pitched debates took place in many states, with none more divided than New York. When delegates at a state convention in Poughkeepsie voted on the Constitution in July 1788, the vote was 30-27 in favor. All the delegates from what we now call upstate opposed a more powerful government. All those from South of Dutchess and Orange counties were in favor.[4]

The regional split on the idea of a powerful national government was rooted in economic and social differences that continued through two centuries and still remain today, in varying degrees. The political-economic character of what would become New York City was well established under the Dutch in the mid-1600s. The "island at the center of the world" was among the most ethnically diverse on the globe. Its inhabitants saw directly the value of international trade and immigration; that understanding and the Dutch traditions of religious liberty and individual rights informed popular thinking.[5] The upstate economy, by contrast, was built on farming and then manufacturing, with communities that were more isolated from each other and (at least in many residents' understanding) from the global marketplace. Immigrants from various corners of Europe made their way to upstate cities, but never in the numbers or variety of those who made their homes in New York City. Early settlement by New England Protestants, who often established communities intended for religious conformity, contributed to a tradition of less social diversity upstate than in the big city.

As of 2000, thirty-six percent of New York City's residents were foreign-born, according to the Census Bureau. The proportion elsewhere in the state: nine percent. The city's proportions of African-Americans, Hispanic Americans, and Asians were all much higher than the statewide average. The poverty rate tends to be substantially higher in the city than outside.[6] At the same time, the city—particularly, Manhattan—is home to one of the world's greatest concentrations of wealth. In 2008, with roughly eight percent of the state's population, New York County was home to forty percent of taxpayers reporting more than $500,000 of adjusted gross income.[7] Such disparities contribute to the idea, more prevalent in New York than in most states—and especially strong within the city—that a central role of government is to redistribute income.

A booming center of manufacturing and shipping in the 19th century, New York City played a central role in giving birth to the American labor movement. This trend was one of several major forces establishing the Democratic party as the overwhelming political force in the city, and the party's statewide base in the city. As of November 2010, sixty-nine percent of New York City voters were enrolled Democrats and eleven percent were Republicans; elsewhere in the state, the figures were thirty-eight percent and thirty-three percent, respectively.[8] The plurality of Democratic voters outside the city is a new and important development; historically and as recently as 2007, Republicans outnumbered Democrats in the rest of New York State.[9]

The latter half of the 20th century saw New York City's economic fortunes decline sharply relative to the rest of the state, and then rebound. From 1950 to 1980, the city's population fell by more than 800,000, and its share of the statewide total plunged from fifty-three to forty percent.[10] This was the period of the suburban boom, but upstate was also doing well—growing from 4.7 million to more than 6 million.

Over the last two decades, the trends in New York City and upstate—especially the region west and north of Albany—reversed. A 2004 report found that upstate's only job gains from 1990 through 2003 were in government or health care and social assistance, which are largely funded by tax dollars. If upstate were a separate state, its 1990-2000 growth would have lagged behind every other state except North Dakota and West Virginia—and nearly thirty percent of the residents upstate added during the decade were prison inmates.[11] During his 2006 campaign for governor, Eliot Spitzer described much of upstate as "Appalachia." The comment drew criticism from some promoters of the region. But, in fact, population and employment trends at the time were more positive in West Virginia and other areas of Appalachia than in much of upstate New York.[12]

Meanwhile, the state's largest city has enjoyed something of a modern golden era. The 2010 Census found New York City's population at an all-time high of 8,175,133.[13] Tourists increasingly flocked to the city, international immigration remained strong, personal income jumped, and a number of other economic indicators improved during the 1990s and 2000s. The 9/11 terrorist attacks in 2001 pushed employment, broader economic activity and tax revenues down sharply, but over the ensuing six to seven years the city made a comeback. In the wake of the Great Recession, turmoil and dramatic restructuring in the financial markets raised questions about the long-term sustainability of the city's (and state's) most important industry: Wall Street. For now, at least, Wall Street and its associated financial and business services are, thankfully, doing quite well and continue to power the city's economy.

Political Tension Over Time

Social and economic differences between New York City and the rest of the state reinforced but did not directly create the political tensions that Plunkitt complained about in the early 20th century. The legislature that he accurately described as often hostile to the city was shaped by constitutional provisions dating to the late 1700s.[14]

Similar to the decisions by the nation's founders that the U.S. Senate would have equal representation from each state regardless of population, the state's first Constitution assured each county, except Fulton and Hamilton, at least one seat in the assembly.[15] This and other provisions guaranteed voters in less populated areas proportionally greater electoral power than those in the cities (similar rules existed in most other states, as well). During the first half of the 20th century, New York City consistently was home to more than half the state's population but held less than a majority of seats in the legislature. In the 1960s, landmark decisions by federal and state courts imposed "one person, one vote" rules on legislative districting.[16] By then, New York City was in decline and housed only forty-six percent of the state's residents. It has not regained a majority of the population since.

Still, internal politics within the legislature provide that if a given region or regions make up more than half of the partisan majority within the house, even a minority of the entire house can constitute a working majority. Such has been the case in the assembly since 1975, when the Watergate elections brought Democrats to power. The New York City delegation of sixty-five assembly seats is forty-three percent of the total, but two-thirds of the Democratic majority that controls the house.[17] The city delegation brought Speaker Sheldon Silver to the top leadership position, and establishes the overall ideological and political positions of the assembly. On Medicaid, taxes and other issues, these positions are often contrary to those of upstate representatives, including many Democrats. In the senate, even after the districting changes of the 1960s, Republicans have usually managed to retain the majority. Their geographic strongholds are Long Island and upstate, so that power is more regionally dispersed than in the assembly.

The Two New Yorks and the State Budget

Even more than in Plunkitt's time, New York City indeed is the leading source of the golden eggs that help pay for services across the state. Taxes paid by individuals who live or work in the city make up more than half of the statewide total, although its share of the population is around forty-three percent. Wall Street is the productive goose, generating some twenty percent of tax revenues.[18]

On the expenditure side of the budget, the city also dominates the state's largest spending program, Medicaid. As of early 2010, sixty-seven percent of Medicaid recipients and sixty-four percent of expenditures were within the five boroughs, according to state health department data.[19] Concerns about human services, local economic activity, political influence and—at least in a few cases—personal financial gain make the program especially important to many legislators from the city. Elected officials often refer to the health-care sector as the primary source of job growth in poorer sections of the Bronx, Brooklyn and other boroughs.

The distribution of state education aid to the city and the suburbs has been a primary political battlefield for decades (upstate districts and legislators want their fair share, too, but historically have not placed as much emphasis on the issue as their downstate colleagues). For New York City representatives, the issue is complicated by their focus on Medicaid, a concern of much lesser importance in the suburbs. Long Island representatives in the Senate, particularly, historically maintained that Nassau and Suffolk school districts were entitled to a certain percentage of total state aid. A series of education-finance commissions dating at least to the 1960s recommended sending more funding to districts with relatively lower wealth and higher proportions of needy students.[20] Periodic bursts of especially high increases in state aid have generally been characterized, though, by significant increases for suburban as well as poorer urban and rural districts. The most recent example came in 2007, when Governor Eliot Spitzer proposed a four-year increase of $7 billion, or 40 percent, in total school aid.[21] The plan was driven partly by a desire to address the Court of Appeals' rulings, in the Campaign for Fiscal Equity cases, that the state must provide additional aid to New York City schools in particular.[22] The New York State Council of School Superintendents noted:

> Governor Spitzer challenged the legislative custom of regional shares in school aid in his very first presentation of his budget. While proposing school aid reforms to drive more aid to high need districts, he noted that, considering school aid and STAR property tax relief combined, regional shares of total state revenues directed to schools would have remained the same as in 2006-07. Old habits die hard, though. At one point it was reported that Senate Majority Leader Joseph Bruno invited his Long Island members to vote against the budget if dissatisfied with school aid. But in the final budget, their region actually increased its share of aid—without factoring in STAR or property tax rebates.[23]

The legislature added several hundred million dollars to the Spitzer education proposal and reordered some funding based on programmatic and regional concerns. The Council of School Superintendents said the final 2007-08 budget retained New York City's "traditional 38.86 percent share of the total aid increase."[24] That proportion was not applied to building aid, however, a departure from past practice—and a reflection that even fixed formulas may be applied in differing ways to allow for changing political needs. Including all categories of school aid, New York City received 41.02 percent of the total; Long Island 12.71 percent; and the rest of the state 46.27 percent, according to the council.[25] Long Island benefited from a $100 million pot of funding known as High Tax Aid, of which Nassau and Suffolk districts received seventy percent.[26]

Education aid is by far the largest element of the state's own-source expenditures—those dollars it collects from its taxes and other in-state charges and fees, separate from federal revenue. In fiscal 2008-09, state-funds spending on school aid was $22.5 billion, compared to $12.5 billion for Medicaid, the second-largest program.[27] Adding expenditures on the School Tax Relief (STAR) program brings the education total to $25.7 billion, more than double the Medicaid total.[28] The outcome of the 2007 negotiations on school aid, and the longstanding New York City predominance of Medicaid funding, are two major factors that illustrate the results of political give-and-take in distribution of state resources. Some studies by independent analysts have concluded that, overall, both the downstate suburbs and New York City are losers in the intra-state distribution of state receipts and expenditures, while the Capital Region in particular and upstate more generally are net winners.[29] For upstate, the tradeoff is to accept broad policies that reflect New York City's political philosophy in areas such as an expansive Medicaid program and strong public-employee protections, despite opposition by many upstate voters.

Can There Be One New York?

Among the most dramatic developments in the long city-state relationship was the set of decisions by Governor Hugh L. Carey and the legislature to rescue New York City from likely bankruptcy in 1975. The senate, at that time as in most of recent history, was controlled by Republicans whose political bases were primarily upstate and in the suburbs. Some members of the senate, reflecting constituents' opinions, opposed additional financial aid or putting the state's own credit at risk to support the city's efforts. The senate majority leader was Warren Anderson of Binghamton, who later recalled:

> When the City of New York was in trouble, it was quite clear to me that the

> whole State was in trouble. You couldn't take any comfort from the fact that it was a Democratic-controlled City at the time. The worst thing would have been that people around the country and around the world would not make the distinction between the City and the State. If New York City had gone under everybody would have thought that the State of New York was bankrupt, too. And, of course, it would have weakened the State.… [A]lthough we talked about the problem at great length in Conferences, I never brought the items up for a vote as to whether we would put the bill on the floor or not. I didn't want to put those people in a position where if they were asked at home how they voted in Conference, they would have had to say that they voted to put the bills on the floor.[30]

As the upstate economy has suffered a long, slow decline relative to the rest of the state and the nation, many of its communities have become especially dependent on state aid. In 2009, for example, the Buffalo school district relied on state assistance for seventy-three percent of its revenues, compared to a statewide average of slightly more than forty percent.[31] Many upstate towns depend on state prisons or institutions for the mentally disabled as their most important source of employment. Governor Cuomo's 2011 budget proposals included several recommendations to close or downsize such institutions.[32] But, reflecting an assumption of continued state responsibility for the economic well-being of communities where such institutions are located, the Cuomo strategy also included transition assistance to help develop new sources of employment.

As of 2011, upstate represented a much-diminished share of the state's population, economic activity and legislative representation, compared to its position decades earlier. Yet the region retains disproportionate political importance, delivering forty-six percent of votes in the 2010 gubernatorial election. The suburbs, with total population less than half of New York City's, sent two-thirds as many voters to the polls as did the five boroughs.

The city remains, by far, the most powerful player in the state's economy, and increasingly dominant in politics. As of 2011, New Yorkers were represented by a governor, attorney general, senior U.S. senator, and majority in one house of the legislature whose political base is New York City. Demographic trends present a strong possibility that the Senate, too, will switch back to the Democrats in coming years—a change that would almost certainly mean dominance of both houses by legislators from the five boroughs.

Whatever the regional balance of power, local officials from throughout the state occasionally join forces to drive changes in Albany that may have statewide benefit. One example was the cap on local-government Medicaid costs enacted in 2005. By concentrating future cost increases at the state level, the cap has forced more attention on discussions of making the $52 billion program—long criticized as wastefully inefficient—more cost effective. School boards from around the state, historically often at odds over regional shares of education assistance, more recently have joined forces to promote best practices in using taxpayer dollars more efficiently.[33]

The state's budget troubles are not likely to end soon. Representatives of New York's different regions may find it tempting—and some interest groups will urge elected officials—to fight over resources that will not be expanding as in the past. Some leaders might promote a more promising approach of bridging regional differences, in hopes of identifying the next agenda of reforms to make limited dollars stretch further in every area of the state.

Endnotes

1. George Washington Plunkitt, *New York City is Pie for the Hayseed*, *in* PLUNKITT OF TAMMANY HALL 25 (William L. Riordan ed., 1963).
2. Democrats controlled at least one house of the legislature for a third or so of the period, and the governor's office was occupied for fifty years by each of the two major parties, with New York City-based candidates serving twenty-four of the last thirty-six years in the office. Furthermore, New York City voters elected Republicans as mayor six times during the 1900s.
3. For a representation of both arguments, see John Tierney, The *Big City; The Moochers From Upstate? Cut 'Em Loose*, N.Y. TIMES, May 24, 1999, *available at* http://query.nytimes.com/gst/fullpage.html?res=9802EED91531F9 37A15756C0A96F958260.
4. *See* ROBERT B. WARD, NEW YORK STATE GOVERNMENT 36 (2006).
5. RUSSELL SHORTO, THE ISLAND AT THE CENTER OF THE WORLD *passim* (2004).
6. As of 2009, the Census Bureau calculated New York City's poverty rate at 17.3 percent and the statewide figure at 14.2 percent. City officials, adjusting for higher living costs and the value of benefits such as food stamps and housing assistance, put the city rate at 19.9 percent. *See* Sam Roberts, *Food Stamps and Tax Aid Kept Poverty Rate in Check*, N.Y. TIMES, Mar. 20, 2011, at A19.
7. N.Y. DEP'T OF TAXATION AND FINANCE, NEW YORK ADJUSTED GROSS INCOME AND TAX LIABILITY (2011), *available at* http://www.tax.ny.gov/pdf/stats/stat_pit/cor/analysis_of_2008_ny_state_personal_income_tax_returns_ by_place_of_residence.pdf.
8. NELSON A. ROCKEFELLER INST. OF GOV'T, 2009 NEW YORK STATE STATISTICAL YEARBOOK 185–226 (2009).
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10. *See* CAMPBELL GIBSON, U.S. CENSUS BUREAU, POPULATION OF THE 100 LARGEST CITIES AND OTHER URBAN PLACES IN THE UNITED STATES: 1790 TO 1990 (1998), http://www.census.gov/population/www/documentation /twps0027/twps0027.html.
11. *See* DAVID F. SHAFFER, COULD NEW YORK LET UPSTATE BE UPSTATE? 7 (2004), *available at* http://www.ppinys.org/reports/2004/letupstate.pdf.
12. WARD, *supra* note 4, at 47.
13. The 2010 count was the highest ever in the official decennial census count. Some previous intra-decade estimates had been slightly higher—for example, the 2005 estimate was around 8.2 million. *See* Sam Roberts, *New York City's Population Barely Rose in the Last*

Decade, the Census Finds, N.Y. Times, Mar. 25, 2011, http://query.nytimes.com/gst/fullpage.html?res=9A07E4D91031F936A15750C0A9679D8B63.

14. Ward, *supra* note 4, at 36.
15. *Id.*
16. Relevant decisions include Baker v. Carr, 369 U.S. 186 (1962); Westberry v. Sanders, 376 U.S. 1 (1964); WMCA v. Lorenzo, 377 U.S. 633 (1964); and *In re* Orans, 15 206 N.E.2d 854 (N.Y. 1965).
17. *See* Jeffrey Kraus, *Bloomberg Triumphant: The Collapse of Democratic Hegemony in New York City*, 5 The Forum 4–6 (2007) (discussing the New York City delegation in the state senate and assembly).
18. *See* Media Release, N.Y. State Comptroller Thomas DiNapoli, Wall Street Bonuses Declined in 2010 (Feb. 23, 2011), http://www.osc.state.ny.us/press/releases/feb11/022311a.htm.
19. *See Medicaid in New York State*, N.Y. State Dep't of Health, http://www.health.state.ny.us/health_care/medicaid/index.htm (last visited May 1, 2011).
20. *See* Mark Vivacqua, *School Aid Equity Still a Problem in New York State*, Observer-Dispatch (Utica, NY), Jan. 10, 2011, *available at* http://www.cfequity.org/articles/school_aid_equity_still_a_problem_in_new_york_state.php.
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24. *Id.* at 6.
25. *Id.* at 12.
26. *Id.*
27. *State Aid*, N.Y. State Dep't of Educ., https://stateaid.nysed.gov/ (last visited May 1, 2011).
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29. A forthcoming report by the Rockefeller Institute of Government and the Citizens Budget Commission will examine the statewide sourcing of revenues and distribution of expenditures. Readers are invited to contact the author for further information.
30. Gerald Benjamin & Robert T. Nakamura, The Modern New York State Legislature: Redressing The Balance 73 (1991).
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33. For example, see N.Y. State School Boards Ass'n, www.nyssba.org.

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Join a Subcommittee

2011–2012

The New York State Bar Association's Committee on Attorneys in Public Service (CAPS) invites all interested NYSBA members to consider joining one or more of its subcommittees, which are open to all members of the Association. CAPS members themselves are expected to join at least one subcommittee. The following are brief descriptions of the work of the CAPS subcommittees. If you are interested in joining a subcommittee or would like additional information, contact the committee co-chairs listed below or send an email to CAPS@nysba.org. You may also call the NYSBA Membership Services Department at 518-487-5578.

Subcommittee on the Administrative Law Judiciary

This subcommittee focuses on issues of concern and provision of services to the Administrative Law Judges and Hearing Officers (ALJs) that conduct administrative hearings in federal, state and local agencies in New York State. The subcommittee is the only one of its kind in the New York State Bar Association. Most recently, the subcommittee devoted its efforts to the development of a Model Code of Judicial Conduct for State Administrative Law Judges, which was approved by the Association's House of Delegates on April 3, 2009. Although the subcommittee is devoted to the interests of ALJs, its membership is not limited, and anyone interested in issues regarding the implementation of administrative justice in New York State is welcome to join.

Hon. James F. Horan, Acting Chief ALJ, jfh01@health.state.ny.us
Hon. Elizabeth H. Liebschutz, Chief ALJ, elizabeth_liebschutz@dps.state.ny.us

Subcommittee on Ethics

The Ethics subcommittee will continue to concentrate its efforts this year on understanding how the new Rules of Professional Conduct will affect public service attorneys, and how certain promulgations of the Commission on Public Integrity impact the Association's ability to benefit from the experience of public sector attorneys through their participation in CLE events, without causing ethical conflicts both for the attorney as well as the Association. The Ethics subcommittee will also look at how ethics reform legislation currently under consideration will impact public sector attorneys assuming it becomes law.

Terryl Brown, Esq., Terryl.Brown@ag.ny.gov
Hon. James McClymonds, Chief ALJ, jtmcclym@gw.dec.state.ny.us

Subcommittee on Awards and Citations

The Subcommittee on Awards and Citations devotes its efforts to choosing recipients of the Committee's Award for Excellence in Public Service, bestowed each year at the Association's Annual Meeting, as well as CAPs' relatively new Citations for Special Achievement in Public Service, the first of which were awarded in June 2009. This Subcommittee was responsible for originating the Citation award during 2008. In accomplishing these responsibilities, the subcommittee solicits nominations for the awards and citations, reviews all nominations received, and identifies the most worthy nominees. The subcommittee then presents a list of finalists to the full CAPS committee, from which the award and citation recipients are chosen.

Donna Giliberto, Esq., donna_giliberto@dps.state.ny.us
Terri Egan, Esq., terri.egan@dmv.state.ny.us

Subcommittee on Technology

The Subcommittee on Technology, together with NYSBA staff, developed the CAPS blog in 2010, and is responsible for postings now that it is up and running.

Jackie L. Gross, Esq., jlgross@nassaucountyny.gov

Subcommittee on the Annual Meeting

The Subcommittee on the Annual Meeting, as its name suggests, is charged with planning and executing our annual day-long CLE program at the Annual Meeting. The subcommittee strives to present programs with broad appeal to attorneys in all areas of government service on timely issues. It has become an annual tradition for the morning program to consist of a Supreme Court review, while the afternoon sessions have focused on a wide variety of issues, including protecting civil liberties during the fight against terrorism, ethics and lobbying, eminent domain and governmental reform.

Catherine Christian, Esq., cchristian@specnarc.org
Hon. Anne Murphy, ALJ, amurphy@oata.nyc.gov

Subcommittee on Membership and Association (Section) Outreach

The relatively new Subcommittee on Membership and Association (Section) Outreach will endeavor to brainstorm ways of bringing more public sectors attorneys into the Association and to identify specific ways that CAPS can work with Sections within the Association that also attract public sector attorneys, such as Municipal Law, Health, Criminal and Environmental Law. This could include joint sponsorship of CLE programs and other activities.

Co-chairs to be named

CAPS 2011 Annual Meeting

Jason Mazzone

William D. Araiza and Jason Mazzone

The Committee on Attorneys in Public Service hosted its 2011 Annual Meeting Program on January 25th. The program was comprised of two educational programs and concluded with its annual Awards for Excellence in Public Service ceremony. Hon. Peter S. Loomis, ALJ (ret), serves as committee chair; Spencer Fisher and Michael Barrett were program chairs.

The first program was "Supreme Court Update: The Roberts Court at Age Five." This program presented a commentary on the five years that John G. Roberts has served as Chief Justice of the Supreme Court, and changes to the Court during this period. This session covered Supreme Court decisions of the October 2009 term and cases pending in the 2010 term and explored where the Chief Justice has taken the Court and Constitution to date and what the future may hold. Featured speakers were William D. Araiza, Professor of Law, and Jason Mazzone, Gerald Baylin Professor of Law, both from Brooklyn Law School.

William D. Araiza

The Honorable Ann Pfau

The second program was "Government in a Time of Economic Crisis: Doing More with Less." The events of 2009 focused considerable attention on the role of the State Legislature and issues of succession to vacancies in State offices, as well as on the constitutional structure and function of State government as a whole. These timely subjects were the focus of the afternoon program. Chief Administrative Judge Ann Pfau, Office of Court Administration, Richard Ravitch, Lieutenant Governor to Gov. David Paterson and Blair Horner, Legislative Director, NYS Public Interest Research Group were panelists for the first session. The second session featured Robert Ward, Deputy Director, The Rockefeller Institute of Government, Timothy Gilchrist, President of the Moynihan Station Development Corporation and Mary Kavaney, Deputy Secretary for Public Safety for Governor David Paterson.

The 2011 Awards for Excellence in Public Service reception took place also on January 25th. Anthony Cartusciello and Donna Hintz served as Award co-chairs. The 2011 Award Recipients were: **Norman Goodman**, New York County Supreme Court; **Jerome Lefkowitz**, Public Employment Relations Board; and **Frederick P. Schaffer**, The City University of New York.

Jerome Lefkowitz and his wife

Peter Loomis and Rick Schaffer

Judge Pfau and Richard Ravitch

Peter Loomis, Norman Goodman, Rick Schaffer, Jerome Lefkowitz, Pat Bucklin (NYSBA Exec. Dir.) and Steve Younger

Jerome Lefkowitz

Timothy Gilchrist

Spencer Fisher, CAPS Annual Meeting Program Co-chair

Mary Kavaney

NYSBA past president Stephen Younger

Robert Ward

Norman Goodman and Steve Younger

Blair Horner

Robert Ward, Mary Kavaney, Timothy Gilchrist

Award Event attendees

Judge Ann Pfau, Richard Ravitch and Blair Horner

Norman Goodman and family

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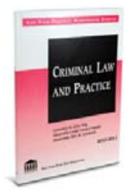

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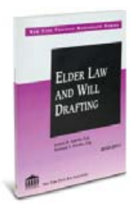

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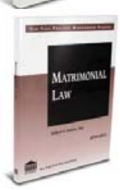

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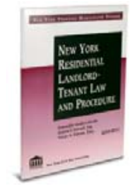

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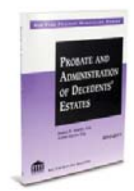

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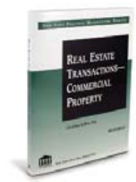

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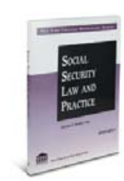

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