CITIZENS BUDGET COMMISSION

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Dear Legislator:

I write to convey the Citizens Budget Commission's (CBC's) recommendations for legislative action on the New York State Executive Budget for Fiscal Year 2023.

Drawing on an extraordinarily improved tax receipts outlook, unprecedented federal aid, and last year's tax increases, the Executive Budget commendably proposed a financial plan that is balanced over the next five years and builds significant reserves, which will be critical to stabilize New York during the next recession or emergency.

When appropriately adjusted for fiscal maneuvers, the budget proposes a $10 billion (8.5 percent) increase in State Operating Funds (SOF) spending, a significant sum that if wisely used should be more than sufficient to meet the needs of New Yorkers.[1] Unfortunately, the budget does not include improvements in accountability, transparency, or performance management that are needed to ensure all the State's money is spent wisely and transparently.

This letter details recommendations for legislative action. Three items are especially important to highlight since they are critical to ensuring the State's ongoing fiscal stability:

- **Hold the top line on spending.** The $10 billion spending increase for fiscal year 2023 and the average of $4.6 billion annually thereafter are more than sufficient to meet the State's needs. The proposed fiscal year 2023 budget allocates over $4.2 billion for relief and recovery, including $2 billion of unprogrammed relief funds and the $2.2 billion proposed property tax rebate. This $4.2 billion total should be allocated to address identified needs with evidence based programs that are held accountable for results. While the budget is balanced over the plan, future years are balanced assuming the economy continues to grow steadily—a risky premise given the rocky recovery—and New York maintains the nation's highest combined top personal income tax rate. Spending over time should be restrained to ensure New York allows the recent tax increases to sunset, since they hamper the State's competitiveness to keep and attract residents and businesses;
- **Save for a rainy day by maintaining the planned reserve deposits and enacting improvements to the Rainy Day Fund**. The plan to build reserves to 15 percent of SOF spending deserves praise, yet still is likely less than the State will need to weather the

next recession (based on the average timing and fiscal impact of recent recessions). The enacted budget should include and improve the proposed reserves. Reducing these reserve deposits would weaken the State's ability to care for those most in need during the next recession or emergency; and

- **Improve the State's management, oversight and accountability**. Without these improvements, the unprecedented federal aid and significant State spending increase is unlikely to maximize the results New Yorkers deserve and need. The best way to ensure the additional $41 billion in federal and State school aid reverses learning loss, accelerates achievement and narrows disparities is better management of performance—setting goals, tracking results, and increasing accountability. The same is true of economic development programs and all State operations.

More specifically, CBC recommends the following 11 Legislative actions:

1. Hold the top line on fiscal year 2023 spending and restrain growth over time;
2. Reject unnecessary budget powers and lump sum appropriations;
3. Save for a rainy day and improve the Rainy Day Fund structure;
4. Do not allow the State to continue to take $250 million annually in local sales tax revenue;
5. Include financial plans with the one-house budgets and enacted budget;
6. Deliver New Yorkers value by enacting performance management;
7. Ensure the massive influx of school aid delivers commensurate results;
8. Boost housing production and enact a cost-effective 421-a replacement that supports affordable and rental housing development;
9. Reform economic development program management and transparency to ensure results;
10. Reform the Medicaid global cap and improve transparency; and
11. Better specify and target environmental policies to ensure they cost effectively help achieve climate goals.

Hold the top line on fiscal year 2023 spending and start to restrain growth over time.

The Legislature should not propose or adopt budgets that spend more than the Executive Budget. The Executive Budget includes reported spending growth of 3.1 percent ($3.6 billion) in SOF from fiscal year 2022 to fiscal year 2023. As in the past, the reported spending growth understates the actual increase. It should be adjusted to include the proposed but yet undefined $2 billion for pandemic relief (which is not counted as spending anywhere in the financial plan), the $2.2 billion homeowner rebate program (accounted for as a tax credit), extraordinary federal aid, and other accounting maneuvers. Once adjusted, year-to-year spending growth is 8.5 percent ($10 billion), significantly greater than reported and far greater than any increase in the past decade.

Several legislators have proposed to spend more for various programs. Instead of increasing overall spending, the Legislature should focus on allocating the available $4.2 billion, including the $2 billion set aside for negotiation and the $2.2 billion homeowner tax rebate program. There are likely better characteristics that identify individuals and businesses in need of pandemic and recession relief than homeownership alone.

The budget is balanced in future years, but assumes continued economic growth and the nation's highest personal income and business tax rates. The Executive Budget proposed accelerating the middle-class tax cuts, which would provide some temporary tax relief for many taxpayers. Still, the continuation of tax increases enacted in last year's budget cement the highest top personal income tax and corporate tax rates in the nation. Many high-income New Yorkers have taken advantage of options to reduce the impact of the federal cap on state and local tax (SALT) deductibility, but high State taxes have a detrimental impact on the State's ability to retain and attract people and businesses.[2] Furthermore, the increasingly top-heavy tax structure compounds the risk of tax receipts losses in the inevitable next recession. Spending restraint is essential to allow last year's tax increases to sunset as scheduled or, better still, to be reduced or eliminated earlier.

Reject pandemic-induced budget powers and lump sum appropriations.

The Executive Budget includes provisions that give the Executive broad, unilateral spending and borrowing authorities that are unnecessary, especially given the progress made in pandemic response.

Some of these proposals were originally enacted in response to the COVID-19 pandemic with the fiscal year 2021 budget in April 2020. At that point, the State faced an uncertain fiscal future. Broad appropriation, budget management, and borrowing authorities enacted then gave the Governor authority and flexibility to manage a dire fiscal situation.

CBC and other watchdogs recommend that these authorities be rejected or amended by the Legislature. Specifically, the Legislature should reject:

- A $6 billion "Special Public Health Emergency Appropriation;"
- Universal appropriation transfer and interchange authority within the State Operations bill;
- Authority to issue up to $3 billion in revenue anticipation notes; and
- Authority to utilize a $2 billion line of credit.

Furthermore, several proposals appropriate or transfer billions of dollars with no clearly defined purposes. Any agreement to enact the following funding should clearly define its uses and subject it to oversight from the Comptroller's Office. Specifically, we recommend amending:

- A $2 billion "Special Emergency Appropriation;"
- A $2 billion appropriation for "Reserve For COVID-19 Public Health Response;" and

- A transfer of $1 billion from the General Fund to the "Health Care Transformation Account."

Today, the State's fiscal situation is not dire; it is stable and positive. These proposals in their current form are unnecessary and create significant fiscal risk.

Save for a rainy day and improve the Rainy Day Fund structure.

The Legislature should support the Governor's proposal to add $15 billion to reserves over the next four years. This plan is fiscally prudent and will improve the State's ability to take care of those most in need during the next recession or emergency. Increasing reserve funds as proposed to $19 billion, or 15 percent of SOF spending, by fiscal year 2025 would bring New York roughly in line with national best practices and approach the level CBC recommends. The Legislature also should support the Governor's proposals to increase the legal limits to deposits and balances to the Rainy Day Fund, which would protect the reserved funds for a true emergency. Ultimately, these limits should be lifted entirely.

New York State has not maintained rainy day reserves that are sufficient to mitigate an emergency or fiscal downturn. This shortcoming was recently laid bare when projected pandemic-induced tax receipts losses led to the State possibly withhold up to 20 percent aid for critical services when those services were most needed. Fortunately, this time, federal aid and the nature of this recession saved the State from having to make dramatic reductions. Still, despite a decade-long economic expansion prior to the pandemic, the State missed opportunities to set aside funds for a rainy day.

Now, that same federal aid, strong tax receipts, and tax increases combine to provide the State an even better opportunity to build rainy day reserves. Based on national standards and prior recessions, CBC recommends the State target at least 17 percent of SOF spending in the Rainy Day Fund, with a goal of 27 percent. Deposits should also be made automatically, so that in times of strong fiscal performance, the Rainy Day Fund balance will increase. Requiring deposits equal to two-thirds of common rate and base tax receipts growth in excess of 2 percent would help consistently build the reserve balance going forward.

In the same vein, the Governor's proposals to increase deposits and similarly improve the structure of the Retiree Health Benefits Trust should be supported. The State has one of the largest unfunded other post-employment benefit liabilities in the nation, a cost that represents a growing and significant fiscal misstep and a failure in intergenerational equity.

Do not allow the State to continue to take $250 million annually in local sales tax revenue.

The Legislature should reject the Executive Budget's proposal to continue allowing the State to take $250 million in local sales tax revenue. Two years ago, the enacted budget included a temporary capture of

$250 million annually from local government sales tax receipts—$200 million from New York City and $50 million from other counties. This initiative was misguided when adopted and is even more so today with the State's improved fiscal condition and New York City and other localities still burdened by the pandemic and recession.

The Governor should be commended, however, for the budget's proposal to restore direct State funding to towns and villages in the Aid and Incentives to Municipalities (AIM) program.

Include financial plans with the one-house budgets and enacted budget.

The Governor and Legislature should reform the budget process. The Governor and Legislature can implement basic changes immediately to improve transparency. For example, financial plans—the basic tables outlining receipts and disbursement—should accompany the release of the Legislature's one-house budget proposals and the enacted budget agreement.

Currently, one-house bills are accompanied by resolutions and other documentation that describe fiscal impacts of individual actions. The Legislature also should release multi-year financial plans and any needed gap-closing plans and data in line with key tables included in Executive Budget financial plan.

The same data should be released with the Enacted Budget. Current practice is to announce finalization of budget bills at the end of negotiations, with some basic data outlined in press releases. But a financial plan is not released with the budget bills, some of which pass without public deliberation via messages of necessity. Put differently: one of the largest public budgets in the nation is enacted without meaningful public review and without a table of the dollars and cents the State plans to raise and spend.

CBC will be releasing a plan for State budget reform (including those improvements described above) in the near future.

Deliver New Yorkers value by enacting performance management.

The Legislature should enact a law or work with the Executive to implement a statewide comprehensive, performance management program that sets goals for each major program, uses a robust portfolio of indicators to assess operations and measure progress, and employs a management review and accountability process to ensure the State efficiently and effectively delivers results. New Yorkers have waited too long for improvements in performance, transparency, and accountability.

The State has been a national leader in spending; it has the most expensive Medicaid program per capita, spends more than double the national average per pupil on schools, and grants large and broad tax breaks and subsidies for economic development. Yet, the State is not a leader in health care delivery, learning outcomes, or job creation.

The Executive Budget Briefing Book includes broad language related to performance management, and appropriations include $25 million for "data analytics." While these two items suggest some intention to improve performance measuring and evaluation, detail is needed. CBC's analysis of state performance management systems identified that codifying performance management in state law is often necessary for success. The Legislature and Governor should work together to enact a performance management system to help deliver the results that New Yorkers deserve.

Ensure the massive influx of school aid delivers commensurate results.

The impacts of the pandemic and additional $41 billion cumulatively flowing to schools over the next five years emphasize the need for the State to focus on ensuring school aid delivers results. The Executive Budget continues the school aid increases enacted last year and adds funding. Already New York's schools spend roughly double the national average per pupil. State school aid alone is set to increase from $29.1 billion in the current school year to $38.4 billion by fiscal year 2027, a 32 percent increase. In addition, districts will spend $11.4 billion in extraordinary federal aid now and over the coming years.

The aid provides a great opportunity to reverse learning loss, accelerate achievement, and narrow disparities. However, the budget continues to increase aid without considering why this nation-leading spending is not delivering nation-leading results, identifying and insisting on the spread of best practices, or requiring accountability for results and quality. Successes will only happen if aid and education services are carefully evaluated and well managed.

Finally, given the State's long run fiscal risks, the Legislature should work to better target school aid to high-need districts, shifting some expense-based aids to foundation aid, eliminating the hold harmless and restraining aid to wealthy districts, especially those that receive $2.7 billion in aid per year despite already self-funding a sound basic education.

Boost housing production and enact a cost-effective 421-a replacement that supports affordable and rental housing development.

Supporting expeditious housing production downstate should be a priority since housing production has not kept pace with population and job growth. Boosting production will increase affordability and foster the State's competitiveness and economic growth. The Governor's Executive Budget included provisions to ease conversions of hotels and commercial buildings to residential uses, lift the cap on floor area ratio for residential development in New York City, facilitate transit-oriented development outside New York City, and allow for accessory dwelling units. We support each of these proposals. Unfortunately, the proposal for transit-oriented development was removed as part of the Governor's 30-day budget amendments, and the proposal for accessory dwelling units was amended to apply only to New York City in a limited fashion. Still, the urgent need to boost housing production remains, and the Governor and

Legislature should still work toward a solution to implement transit-oriented development and accessory dwelling units.

Missing from this budget are proposals to support the New York City Housing Authority (NYHCA). The State should approve the proposed NYCHA Preservation Trust bill, enact procurement reform, and increase financial support for Rental Assistance Demonstration (RAD) public-private partnerships that bring in capital and often new management. The enacted budget should include these provisions to help stabilize NYCHA, which provides the City's most deeply affordable housing.

The Governor also proposes replacing the existing 421-a affordable housing program with Affordable Neighborhoods New York (485-w), which maintains the structure of an as-of-right incentive, but simplifies and deepens affordability requirements and moderately reduces the lifetime cost of the tax expenditure for the largest projects. CBC continues to analyze the implications of the proposal, yet four things are clear. First, an as-of-right property tax exemption is necessary to make development of rental housing feasible in New York City. Second, allowing 421-a to lapse would dramatically reduce housing production and worsen the affordability crisis. Third, 421-a's replacement program should come with greater transparency and public reporting of data to support a robust assessment of the program's impact and effectiveness. And fourth, the City and State should harmonize any 421-a replacement with other affordable housing programs and reduce bureaucratic hoops to development.

Reform economic development program management and transparency to ensure results.

While New York is a leader in the scope and amount of its economic development spending, it is not a leader in job-creating projects. This year's budget would extend some existing programs (including film tax credits and horse racing subsidies) and add funding for new initiatives such as workforce development.[3] Perhaps the most notable aspect of this year's economic development budget is what is missing: meaningful reform to management and accountability of the State's economic development portfolio.

At a Senate hearing on economic development earlier this year, CBC reiterated the need to implement reforms to economic development programs. To bolster oversight and management, the State should establish a unified economic development budget, standardize metrics for economic development programs, enhance the Database of Economic Incentives ("Database of Deals"), improve program design and evaluation, and support oversight authorities (restoring procurement powers to the Comptroller and increasing funding for the Authorities Budget Office).

Already, the annual price tag of the State's economic development spending is roughly $10 billion. The Legislature should prioritize reforms to these programs in this year's budget.

Reform the Medicaid global cap and improve transparency.

Absent efforts to improve the program and control spending, Medicaid risks destabilizing the State's future finances as it did just a few years ago. The State should adopt appropriate and meaningful changes to the Medicaid global cap and dramatically improve the program's transparency. While the Global Cap has not been a wholly effective cost management tool because of its gaps and its lack of sensitivity to demographic changes within the program, allowing Medicaid costs to grow at unsustainable rates jeopardizes the State's ability to support other programs.

Immediately prior to the pandemic's onset, the Medicaid Redesign Team held meetings to identify a path for fiscal sustainability in Medicaid. Fiscal policy in the program has been guided over the past ten years by the Medicaid Global Cap, and the Fiscal Year 2023 Executive Budget proposes the most significant modification to the Cap since it was enacted. The modification effectively doubles the allowable year-to-year growth rate. However, it does not get to the core problems of the Global Cap: it is neither 'global' nor a 'cap.' Billions in State share costs are exempted from the Cap and payments have been manipulated to adhere to it.

A better Global Cap would be comprehensive, designed on accrual-based accounting, and fiscally sustainable. To be fiscally sustainable, the rate of growth should be limited to the lesser of common rate and base tax receipts growth or the proposed federal calculation of Medicaid cost growth. Furthermore, any growth in excess of base tax receipts should be offset by savings within the program (as is the current practice) or from other areas of the budget.

The Medicaid program is also plagued by a lack of transparency. The Legislature successfully negotiated Medicaid reporting requirements several years ago, but required timely monthly reports from the Department of Health have become belated quarterly reports. Reporting requirements should be improved, as outlined by CBC in our public comment to the Medicaid Redesign Team in 2020.

Better specify and target environmental policies to ensure they cost effectively help achieve climate goals.

The Executive Budget proposes increasing the Environmental Bond Act from $3 billion to $4 billion, subject to approval on the general election ballot later this year. The $3 billion Bond Act was first passed in 2020, but tabled due to the pandemic, and then passed again last year. This year's proposal would increase funding overall and for the few generic pots of funding outlined within it. While the Bond Act has merit, the Legislature should re-evaluate its funding allocations. The spending plans are highly ambiguous, and there is no clear needs assessment linked to the specific allocations. The State's needs have changed even in the two years since the Bond Act first passed, and the Legislature should strengthen the basis for purposes and projects funded by the Bond Act.

The budget also proposes implementation of Extended Producer Responsibility (EPR), a law aimed to shift cost and responsibility of reducing and recycling products and packaging onto producers. In considering this bill, the Legislature should weigh how its provisions interact with local government sanitation programs, especially New York City's. EPR laws may transfer the costs associated with recycling from the municipality and onto the producer. This could reduce recycling costs for local public sanitation departments, and the Legislature should be careful to maximize the benefits of EPR for municipalities and the environment while avoiding complicated programs for producers or individuals, or costly requirements for businesses and consumers.

Thank you for considering CBC's recommendations. As always, my staff and I are happy to answer questions or discuss these issues.

Sincerely,

Andrew S. Rein
President
Citizens Budget Commission

[1] The Executive Budget Financial Plan reports spending growth of $3.6 billion (3.1 percent). CBC's analysis of the financial plan then adjusts for year-to-year disbursement shifts, off-budget maneuvers, and other accounting actions that impact spending. After accounting for these adjustments, the year-to-year spending growth is $10 billion (8.5 percent). These adjustments will be presented in detail in a forthcoming CBC report.

[2] See E.J. McMahon, "NY was leaking income millionaires in pandemic run-up" (Empire Center Blog, December 7, 2021), www.empirecenter.org/publications/ny-was-leaking-income-millionaires-in-pandemic-run-up/.

[3] See Emilie Munson, "How New York bankrolls horse racing with billions" *Times Union* (February 18, 2022), www.timesunion.com/projects/2022/new-york-horse-racing-subsidies/.