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Dear Legislator:

I write to convey the Citizens Budget Commission's recommendations for legislative action on the Executive Budget for fiscal year 2016. Our recommendations cover six proposals that deserve your support, three proposals that should be improved, and three proposals that should be rejected.

Six to Support

1. **Disciplined spending growth.** Prior to the Great Recession State spending grew rapidly; from fiscal years 2005 to 2008 state-funded operating spending grew 7.8 percent annually. In 2011 state leaders committed to a spending cap of 2 percent annually. With the Executive Budget proposal the Governor has again indicated spending growth should be limited to 2 percent. Controlled spending growth has improved the fiscal outlook; in January 2011, cumulative budget gaps over the four-year financial plan were $64.5 billion compared to $14.2 billion in the current budget.

   Among the "Big 3" areas of spending – education aid, Medicaid, and State operations – discipline is most evident in the latter two. The Executive Budget holds agency operations spending relatively flat, with continued efforts to find efficiencies and preserve services. It will reduce the Executive-controlled workforce from 131,741 in fiscal year 2010 to 119,160 in fiscal year 2016, a 9.5 percent decrease. The Executive Budget also commits to performance management for state agencies, as recommended by the Spending and Government Efficiency Commission (SAGE) in 2012.

   Empaneled in 2011, the Medicaid Redesign Team (MRT) has reined in Medicaid costs and was authorized to enforce a "global cap" in spending growth equal to the 10-year average of the medical component of inflation. The Executive Budget extends the MRT and the global cap; it also expands the powers of the Health Commissioner to negotiate value- rather than volume-based payments with health care providers.

2. **Design-build procurement.** In 2011 the Legislature authorized design-build procurement for three years for capital projects at the Department of Transportation and several other agencies. Under this process, one contract covers both design and construction phases of a project, allowing architects and contractors to produce better-designed and lower-cost projects. This method is common in the United States and internationally; 41 states and the

District of Columbia allow design-build. In December 2014 New York's design-build authorization lapsed; the Executive Budget permanently extends design-build authorization for all state agencies.

3. **Brownfields redevelopment and other tax credit reforms.** Proposed Brownfields tax credit reforms would tighten eligibility to better focus the program on the cost of cleanup and environmental remediation for sites in economically distressed areas. The Executive Budget also calls for a more stringent approval process for state tax breaks issued by local Industrial Development Agencies and sunsets the investment tax credit for financial services firms which no longer need it.

4. **School Tax Relief program improvements.** The School Tax Relief (STAR) program, costing $3.4 billion annually, substitutes state tax dollars for local property tax dollars. The program has three serious flaws. First, because most STAR payments are not related to individuals' incomes, it is poorly targeted as homeowner relief. Second, because the exemption is greater for communities with higher property values, communities with lower property wealth receive less generous benefits. Third, because STAR aid is paid to school districts, the program has the unintended consequence of incentivizing school district spending. The Executive Budget improves the program by providing a tax credit for new homeowners, so taxpayers bear the full burden of their school taxes directly, and school districts gradually lose the state subsidy. It also disqualifies taxpayers in New York City making more than $500,000 and freezes the exemption benefit. Although many flaws of STAR still remain, these changes better target benefits to those most in need.

5. **Rainy day reserve enhancements.** The Executive Budget makes a $315 million deposit to rainy day funds and includes sensible revisions to the funds' rules: 1) an increase in the allowable annual contribution from 0.3 percent to 1.0 percent of general fund disbursements, 2) an increase in the maximum allowable reserves from 3 percent to 8 percent of disbursements; and a 3) reduction in the number of consecutive months of economic downturn required to allow a withdrawal from five to three. The Executive Budget also sets aside $850 million for settlement of a dispute with the federal government over Medicaid payments. Shoring up the State's ability to withstand adverse economic conditions and to settle disputes is a sensible way to use surplus resources.

6. **Preschool special education rate-setting reforms.** The Executive Budget revives proposed regional rate setting for preschool special education teacher services. New York provides mandated special education for children ages 3 to 5 largely by contracting with private agencies whose rates are based on historical norms. Setting rates on a regional basis would eliminate irrational variation and help contain costs.

Three to Modify

1. **Bank settlement uses.** New York benefits this year from $5.4 billion in settlements with banks for regulatory violations. These are one-time funds and should be used for nonrecurring items yielding a long-run return for taxpayers. The Governor's list of proposed uses should be modified to focus more on greater returns.

   New York has significant unfunded capital needs in its transportation and transit infrastructure, and these are worthy investments. The Executive Budget allocates $1.3 billion to the Thruway Authority and $750 million for other bridge and road projects. The Metropolitan Transportation Authority (MTA) is allocated $400 million for its Access to Penn Station project and for parking and development near commuter rail stations. These potential high-yield investments should accompany comprehensive financing plans to address the full cost of the Tappan Zee Bridge replacement and the hole in the MTA's full five-year capital plan.

   The remaining proposed uses of the settlement funds—including $1.5 billion for an economic development competition among seven regions upstate, $500 million for broadband investments, and $300 million for resiliency/emergency response and government consolidation grants—are of dubious value. These investments are unlikely to pass a rigorous cost-benefit test. A stronger framework to evaluate proposed investments relative to return on investment should be developed and adopted.

2. **Property Tax Relief "Circuit Breaker" Credit.** The fiscal year 2016 Executive Budget proposes a new income tax credit, a "circuit breaker" program for taxpayers whose property taxes as a share of income exceed 6 percent. Homeowners with incomes up to $250,000 and renters with incomes up to $150,000 would benefit according to graduated schedules. The proposal is an improvement over the current property tax rebate programs and the STAR program, but it is a large, new unfunded commitment. Its cost grows to $1.7 billion when fully phased in. To "fund" the credit the Governor relies on unspecified future savings based on the assumption that spending growth will be held to 2 percent over the four-year period. Until specific plans to achieve the savings are in place, it is unwise to make large future commitments. A better alternative is to repurpose existing resources to provide more targeted relief; for example, additional reforms to STAR could shrink and convert it to a circuit breaker program.

3. **Substantial school aid increases without a distribution plan**. School aid increases in the past two years exceeded a previously agreed upon cap, and the Executive Budget continues this pattern with a 4.8 percent increase, well above the 1.7 percent under the cap. The Executive Budget conditions the increase on adoption of policy changes including modifications to teacher evaluations and tenure and intervention in failing schools. If the

proposals are adopted, school aid would increase to $23.1 billion, exceeding the pre-recession peak by $1.5 billion and fueling New York's highest-in-the-nation per pupil spending. The withholding of school aid runs traditionally released with the budget to detail the proposed distribution of funds and policy changes have sparked debate, but this controversy should not overshadow the real and pressing need to overhaul flawed school aid formulas. School aid should be distributed according to student need and district ability to pay. Loopholes, exceptions, and other provisions that misallocate funds should be corrected regardless of whether other education policy changes are made.

Three to Reject

1. **Pension fund contribution deferrals.** During the Great Recession, the State approved a plan to defer required contributions to state employee pension funds. By the end of the current fiscal year, the State will have deferred $3.2 billion in required payments. These deferrals must be repaid with interest over a 10-year period. These deferrals are, in effect, borrowings from the pension funds. The Executive Budget compounds this problem by proposing an additional such borrowing of $395 million in fiscal year 2016. Although the State's fiscal circumstances were bleak when the original plan was adopted in 2010, conditions have markedly improved; further deferral is unwarranted in a year State coffers are awash in surplus resources.

2. **Excessive economic development spending.** Over the last four years economic development spending has expanded greatly; initiatives include allowing certain companies to operate tax free for 10 years through START-UP NY and $600 million in capital grants through new Regional Economic Development Councils (REDCs), as well as a myriad of other programs. The Executive Budget would continue on this path despite the paucity of information showing the initiatives yield a worthwhile return. The Executive Budget proposes using $1.5 billion of bank settlement funds for an Upstate Revitalization fund to award $500 million each to three of the seven REDCs. It also proposes a fifth round of $150 million in capital grants to the REDCs, a $50 million expansion to the State's venture capital fund, $110 million to SUNY and CUNY for challenge grants, and extends Excelsior tax credits to entertainment companies. These proposals should be rejected and a moratorium declared on expansions in this area until the benefits of existing programs can be examined carefully and unsuccessful programs terminated.

3. **Education Tax Credit.** The Executive Budget proposes a new tax credit for donations to public and private schools to replace the existing income tax deduction. Taxpayers would receive a credit equal to 75 percent of the contribution, converting the value of the contribution from a deduction from income to a subtraction from tax liability. The value of the credit would be capped at $1 million per taxpayer and $100 million total for the State, allocated to taxpayers on a first-come, first-served basis. The measure creates an enhanced,

potentially costly subsidy for private education. Benefactors of education charities should continue to enjoy the same benefits available for other charitable contributions.

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

Sincerely,

Carol Kellermann
President