



2006-07



***Enacted Budget
Overview***

2006-07 Enacted Budget Overview

- ❑ Second “on-time” budget in a row. All debt service appropriations continue to pass ahead of deadline.
- ❑ Financial Plan for 2006-07 is fully balanced.
- ❑ Governor’s vetoes preserve most of \$2 billion spending stabilization reserve that will be available to lower the outyear gaps.
- ❑ “Structural” current-services gap in range of \$3 billion to \$4 billion is based on prudent revenue and spending assumptions, consistent with past practice.
- ❑ General reserves total \$3 billion in 2006-07, equal to roughly 6 percent of spending, but will decline over the next three years.
- ❑ New capital program and TFA building aid authorization provide New York City with over \$11 billion in resources to support school construction, in full compliance with *Campaign for Fiscal Equity* “capital” directive.

Financial Plan Impact of Vetoes

- ❑ Budget adopted by the Legislature, absent action by the Governor, would have left outyear gaps in the \$5 billion to \$6 billion range.
- ❑ To reduce the gaps, maintain reserves, and highlight unconstitutional legislative revisions, the Governor vetoed \$2.1 billion in legislative additions in the General Fund, including \$1.5 billion on constitutional grounds.
- ❑ Legislature constitutionally overrode \$600 million in vetoes in 2006-07 -- but can not undo the remaining \$1.5 billion in vetoes issued on constitutional grounds. The Court of Appeals has held that:
 - Executive's disapproval of an unconstitutional item is not subject to override.
 - Even a two-thirds legislative majority cannot transform an unconstitutional item.
- ❑ Thus, the 2006-07 Financial Plan reflects savings from these vetoes of unconstitutional items⁽¹⁾:
 - Primarily related to Medicaid (\$600 million in savings in 2006-07 only) and a new tax rebate program (roughly \$800 million).

⁽¹⁾ See "Enacted Budget Financial Plan," pg. 19, for more information.

Risks to the Financial Plan

- ❑ The Financial Plan is based on reasonable, but nonetheless above-average, growth trends in revenues of roughly 5 to 6 percent annually.
- ❑ An even slower housing market than anticipated and possibility of “overshooting” by Federal Reserve pose risks for the current year; the growing Federal budget and current account deficits are long-term risks.
- ❑ Potential Federal penalties related to school supportive health services and the need to finalize transactions with New York City pose risks.
- ❑ Upcoming issues for the 2007-08 “transition” year include the Health Care Reform Act (HCRA) reauthorization, collective bargaining, and ongoing school finance reform.
- ❑ We expect the long-term emphasis on multi-year financial planning and structural balance – key components of our credit rating – to continue in future years.

2005-06 Surplus Exceeded \$2 Billion⁽¹⁾

- ❑ Third consecutive operating surplus (on both a cash and the Generally Accepted Accounting Principles (GAAP) basis).
- ❑ Revenues realized their “upside potential,” exceeding forecast at every point during the fiscal year.
- ❑ Spending generally on track with Enacted Forecast.
- ❑ Most of surplus used to increase reserves and pre-pay 2006-07 obligations.
- ❑ Rainy Day Reserve kept at statutory maximum after tenth deposit in 11 years.

Summary of 2005-06 General Fund Operating Results	
Enacted Budget to Year-End Results	
Savings/(Costs)	
(millions of dollars)	
Enacted Budget Projected Surplus/(Gap)	601
Revenue Revisions	1,800
Personal Income Tax	910
Business Taxes	801
All Other Taxes	103
User Taxes and Fees	38
Miscellaneous Receipts	(330)
All Other (incl. change in transfers/fund balances)	278
Spending Revisions	(288)
Medicaid Prepayment of 2006-07 Costs	(500)
Medicaid	(345)
MTA Prepayment of 2006-07 costs	(45)
NYC Reimbursement for CUNY	428
Welfare	122
All Other Changes	52
Rainy Day Fund Deposit	(72)
Net Surplus/(Gap)	2,041

⁽¹⁾ See DOB’s “2005-06 Year-End Financial Plan Report” for more information.

2006-07 Budget Overview

General Fund Operating Forecast: Initial Budget to Enactment (dollars in billions)			
	2006-07	2007-08	2008-09
Initial "Base-level" Surplus/(Gap)	(0.8)	(3.2)	(3.9)
Consensus Revenue/Other Revisions	1.2	0.8	0.9
Savings Actions ⁽¹⁾	1.7	0.9	1.2
Spending Additions ⁽¹⁾	(1.5)	(2.2)	(2.5)
Tax Policy Changes ⁽²⁾	(0.9)	(0.9)	(0.9)
Use of 2006 Surplus/Stabilization Reserve	0.3	0.9	0.9
Enacted Surplus/(Gap)	0.0	(3.7)	(4.3)

- ❑ 2006-07 balanced with a combination of spending restraint, “consensus” increase to revenue forecast, and use of small portion of SFY 2006 surplus.
- ❑ “Tail” of legislative additions and assumed non-recurring benefit of certain vetoes produce the increase in the outyear gaps; no substantive revisions have been made to revenues since consensus forecast.
- ❑ Outyear gaps assume that NO Medicaid cost containment savings achieved through vetoes of unconstitutional adds will continue after 2006-07.

⁽¹⁾ See “Enacted Budget Financial Plan,” pg. 12, for more information.

⁽²⁾ See “Enacted Budget Financial Plan,” pg. 36, for more information.

Economic Outlook

- ❑ DOB is projecting growth in real U.S. Gross Domestic Product (GDP) of 3.4 percent for this year — almost identical to the Executive Budget forecast — following 3.5 percent growth for 2005.
- ❑ U.S. employment is projected to grow 1.6 percent in 2006, following growth of 1.5 percent in 2005.
- ❑ DOB expects an inflation rate of 3.1 percent in 2006, following price growth of 3.4 percent in 2005. The Federal Reserve is expected to increase the Federal funds rate one more time in May to 5 percent.
- ❑ DOB's forecast is not without risks. With oil prices remaining elevated, inflation expectations appear to be rising. Higher inflation might cause the Federal Reserve to tighten more than predicted, creating significant risk for the stock market and the larger economy.
- ❑ The New York State economy is continuing to grow. Following 1.1 percent growth in 2005, State private sector employment is projected to grow 0.9 percent in 2006.
- ❑ New York personal income is projected to grow a solid 5.9 percent in 2006, while its largest component, wages and salaries are expected to grow 5.5 percent.
- ❑ Rising interest rates could affect the New York State economy disproportionately, as they did during the monetary tightening phase of 1994-95.

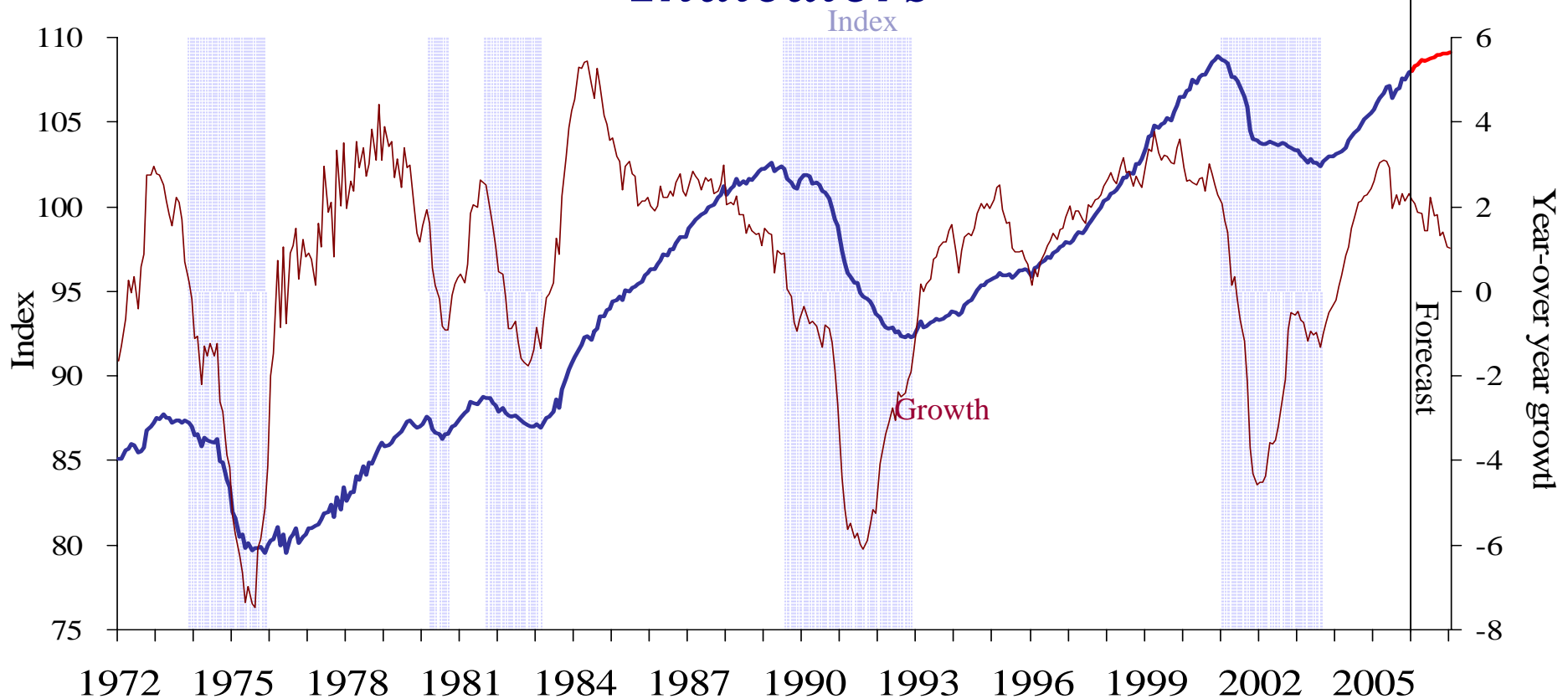
U.S. Economic Forecast Comparison

	2005 (actual)	2006 (forecast)	2007 (forecast)	2008 (forecast)	2009 (forecast)
Real U.S. GDP (% change)					
DOB	3.5	3.4	2.8	2.9	3.0
Blue Chip Consensus	3.5	3.4	3.0	NA	NA
Moody's Economy.com	3.5	3.5	NA	NA	NA
Global Insight	3.5	3.3	2.6	3.1	3.3
Macroeconomic Advisers	3.5	3.4	3.2	NA	NA
Consumer Price Index (% change)					
DOB	3.4	3.1	2.6	2.7	2.7
Blue Chip Consensus	3.4	3.1	2.5	NA	NA
Moody's Economy.com	3.4	3.4	NA	NA	NA
Global Insight	3.4	2.6	1.6	1.8	1.7
Macroeconomic Advisers	3.4	3.4	2.4	NA	NA
Unemployment Rate (%)					
DOB	5.1	4.8	4.8	4.9	5.0
Blue Chip Consensus	5.1	4.7	4.8	NA	NA
Moody's Economy.com	5.1	4.7	NA	NA	NA
Global Insight	5.1	4.7	4.9	4.9	4.7
Macroeconomic Advisers	5.1	4.7	5.0	NA	NA

Source: Projections for 2006-2009 by New York State Division of the Budget, May 2006; Blue Chip Economic Indicators, May 2006; Moody's Economy.com, Macro Forecast, April 2006; Global Insight, US Executive Summary, April 2006; and Macroeconomic Advisers, May 2006.

- ❑ DOB's 2006 real GDP forecast is in line with other forecasters, while the forecast for 2007 is more cautious compared with Blue Chip and Macroeconomic Advisers.
- ❑ DOB's inflation forecast of 3.1 percent for 2006 is in the middle of the forecast range.

New York State Index of Coincident Economic Indicators



Note: Shaded areas represent N.Y. recessions; forecast is derived from the New York Leading Index.

Source: Moody's Economy.com; DOB staff estimates.

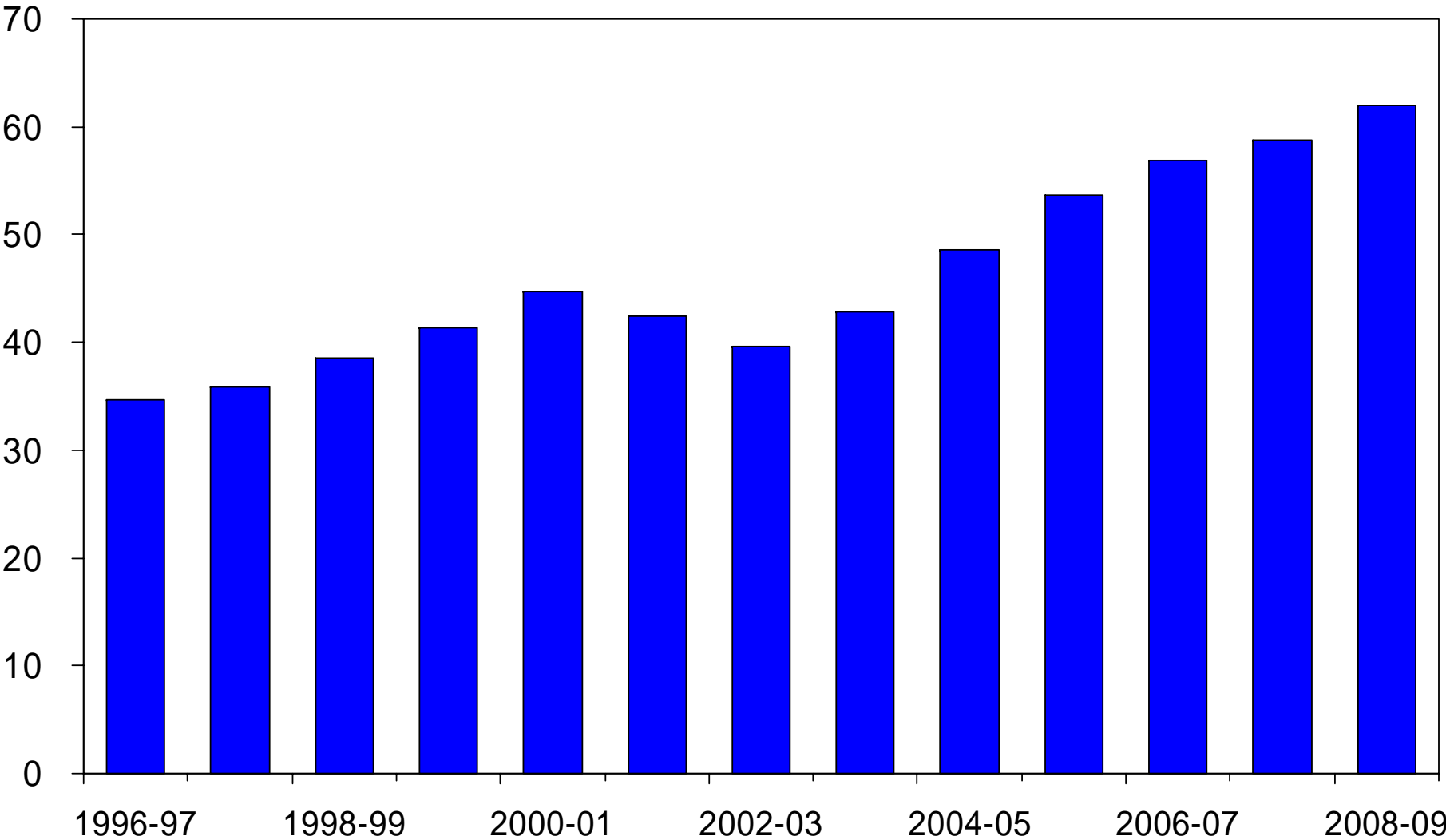
- The State economy is expected to reach its most recent pre-recession peak by the middle of 2006, following a duration of about five years. The State has recovered more quickly from the most recent recession than it did from the early 1990's recession.

Revenue Forecast

- ❑ Base revenue growth declined from 11 percent in 2005-06 to 10 percent in 2006-07. It is expected to decline to approximately 5 to 6 percent in the outyears, consistent with growth at this stage of an economic expansion.
- ❑ Enacted tax actions will reduce growth by 4.6 percent in 2006-07 and 4.4 percent in 2007-08.
- ❑ In 2006-07, bonus growth is estimated at 9.0 percent.
- ❑ In 2006, capital gains are expected to decline by 3.1 percent.
- ❑ Growth in underlying income tax liability is estimated at 4.1 percent in 2006 (4.8 percent growth in NY AGI).
- ❑ Growth in non-PIT base receipts is estimated to decline by nearly 1 percent in 2006-07, primarily as a result of the loss of about \$600 million annually from the elimination of the sales tax on clothing under \$110.
- ❑ The impact of enacted net tax actions on receipts reflects the veto of unconstitutional STAR adds of \$756 million in 2006-07 and about \$1 billion annually thereafter.

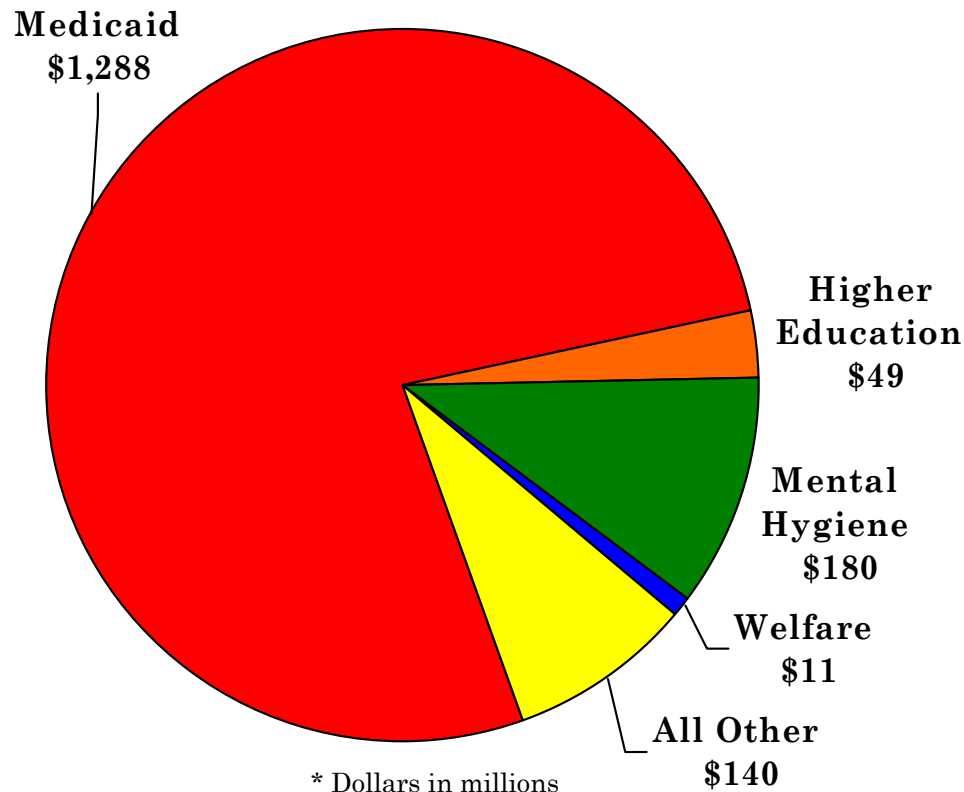
Enacted Tax Policy Changes			
(millions of dollars)			
	<u>2006-07</u>	<u>2007-08</u>	<u>2008-09</u>
Personal Income Tax			
Child Credit	(75)	(625)	(600)
Enhanced STAR	(72)	-	-
Eliminate Marriage Penalty (standard deduction only)	-	(50)	(50)
EITC Strengthening Families	-	(20)	(20)
Credit for Volunteer Firefighters	-	-	(20)
Farmer's School Property Tax Credit	-	(10)	(10)
Land Conservation Credits	-	(1)	(2)
National Guard Exemption	(1)	(1)	(1)
Sales Tax			
Permanent Exemption of Sales tax on Clothing (under \$110)	(608)	-	-
Exemption for Admission Charges to Amusement Parks	(1)	(1)	(1)
Sales Tax Vendor Credit	(24)	(54)	(54)
Business Taxes			
Eliminate S-corp Differential Rate	(40)	(40)	(40)
Film Production Credit	(35)	(35)	(35)
Empire Zones significant capital investment	-	-	(33)
Encourage Alternative Fuel Production - Biofuel	-	(10)	(10)
Commercial Production Credit	-	(7)	(7)
Low Income Housing	(4)	(4)	(4)
Marginal Tax Rate for Annuity Premiums	(3)	(3)	(3)
Other Taxes			
Pari-Mutuel Rate & Reductions	(4)	(2)	(2)
Total Enacted Tax Policy Changes	(866)	(863)	(892)
Change from Recommended Tax Policy Changes	(22)	1,348	2,377

All Funds Tax Receipts



Budget Achieves Nearly 85 percent of Proposed 2006-07 Cost Containment ⁽¹⁾

\$1.7 Billion Total



Medicaid⁽²⁾:

- Hospital, nursing home, pharmacy cost containment
- Limited Part D wrap-around
- Anti-fraud

Higher Education:

- TAP Performance-based criteria

Mental Hygiene:

- Patient Income
- Audits

Welfare:

- Work incentives

All Other:

- State operations

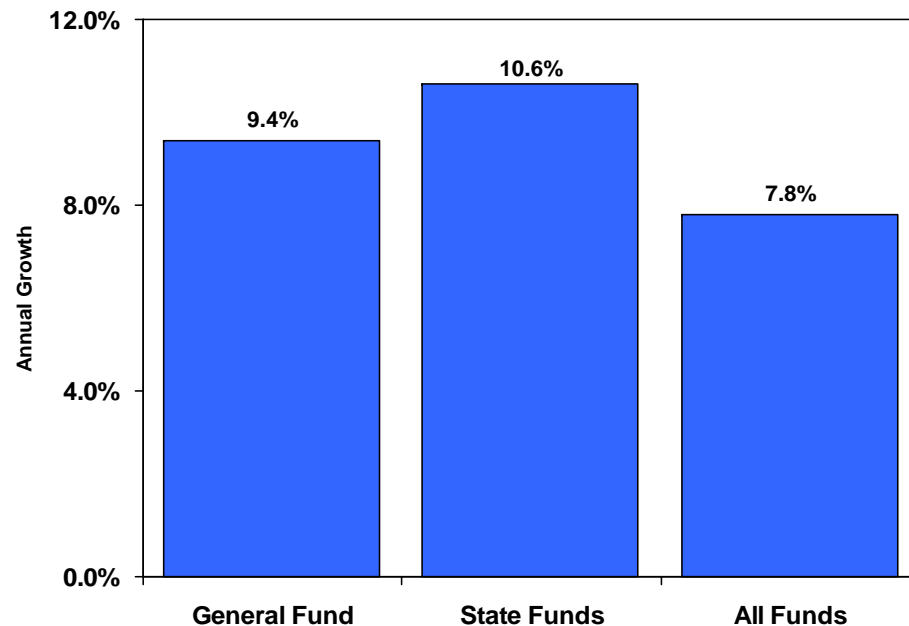
(1) See "Enacted Budget Financial Plan," pg. 12 for more information.

(2) See "Enacted Budget Financial Plan," pg. 45-46 for more information.

Annual Spending Growth

- ❑ Even after vetoes, spending grows well above the rate of inflation.
- ❑ Favorable economic environment, election-year climate fueled growth across programs.
- ❑ Growth also affected by:
 - Retroactive labor settlements.
 - Timing of Federal spending that “rolled” into 2006-07.
 - Growth in Medicaid/Family Health Plus “takeovers” that provide local tax/mandate relief.

Annual Spending Change ⁽¹⁾ (millions of dollars)				
	2005-06 Results	2006-07 Enacted	Annual Change	Percent Change
General Fund	46,495	50,843	4,348	9.4%
State Funds	69,723	77,100	7,377	10.6%
All Funds	104,341	112,463	8,122	7.8%



⁽¹⁾ See “Enacted Budget Financial Plan,” pg. 8, for more information.

Health Care Cost Containment ⁽¹⁾

- ❑ Left unchecked, Medicaid would have grown by nearly \$1.9 billion from 2005-06 – or more than half of the annual “base” growth in spending.
 - \$1.1 billion in growth for utilization, inflation, caseload, and Part-D.
 - \$764 million for Medicaid cap and Family Health Plus takeover.

- ❑ Cost containment addresses the key growth areas:
 - Medicare Part D: Federal maximization strategy; “dual-eligibles” required to enroll in Part D (exceptions for AIDS, mental illness, and organ transplant drugs).
 - Preferred Drug program: Strengthened review to avoid inappropriate utilizations.
 - Hospitals/Nursing Homes: Rate adjustments and add-ons modified.
 - Anti-Fraud: comprehensive upgrade to monitoring and enforcement capabilities; new office of Medicaid Inspector General.

- ❑ \$600 million in General Fund cost containment achieved through vetoes and not counted on to continue in the outyears (\$900 million value).
 - Hospital cost containment.
 - Long-term care.
 - Certain nursing home, pharmacy actions.

⁽¹⁾ See “Enacted Budget Financial Plan,” pg. 41-46, for more information.

Health Care Reform Act

- ❑ Expires June 2007.

- ❑ Financial Plan assumes large General Fund subsidies in the outyears to keep HCRA solvent.
 - \$627 million in 2007-08.
 - \$486 million in 2008-09.

- ❑ However, prior HCRA extensions have been “self-financing” and did not require General Fund support (and sometimes provided savings).

- ❑ Range of revenue and cost-containment options are possible to finance reauthorization.
 - Cigarette tax.
 - New conversions.

(1) See “Enacted Budget Financial Plan,” pg. 108-112 for more information.

School Aid

- ❑ School aid will total \$17.6 billion in 2006-07, or roughly 35 percent of General Fund spending.
- ❑ 2006-07 Budget authorizes a nearly \$1.3 billion school-year increase.
- ❑ State continues to make strides in complying with CFE directives:
 - Operating Aid:
 - \$700 million dedicated for Sound Basic Education grants, an increase of \$375 million from 2005-06.
 - “Traditional” school aid increase of nearly \$900 million.
 - Construction/Capital Aid:
 - \$2.6 billion school construction program will provide \$1.8 billion to NYC, \$400 million for other high-need districts, and \$400 million for other districts.
 - TFA authorized to issue \$9.4 billion in bonds for school construction, backed in part with a pledge of State Building Aid.

Capital Program and Debt Financing ⁽¹⁾

- ❑ Enacted Budget authorized \$5.3 billion in new capital investments over five years:
 - School construction program: \$2.6 billion.
 - Higher Education facilities: \$1.2 billion.
 - Economic development: \$.9 billion.
 - All other: \$.6 billion.

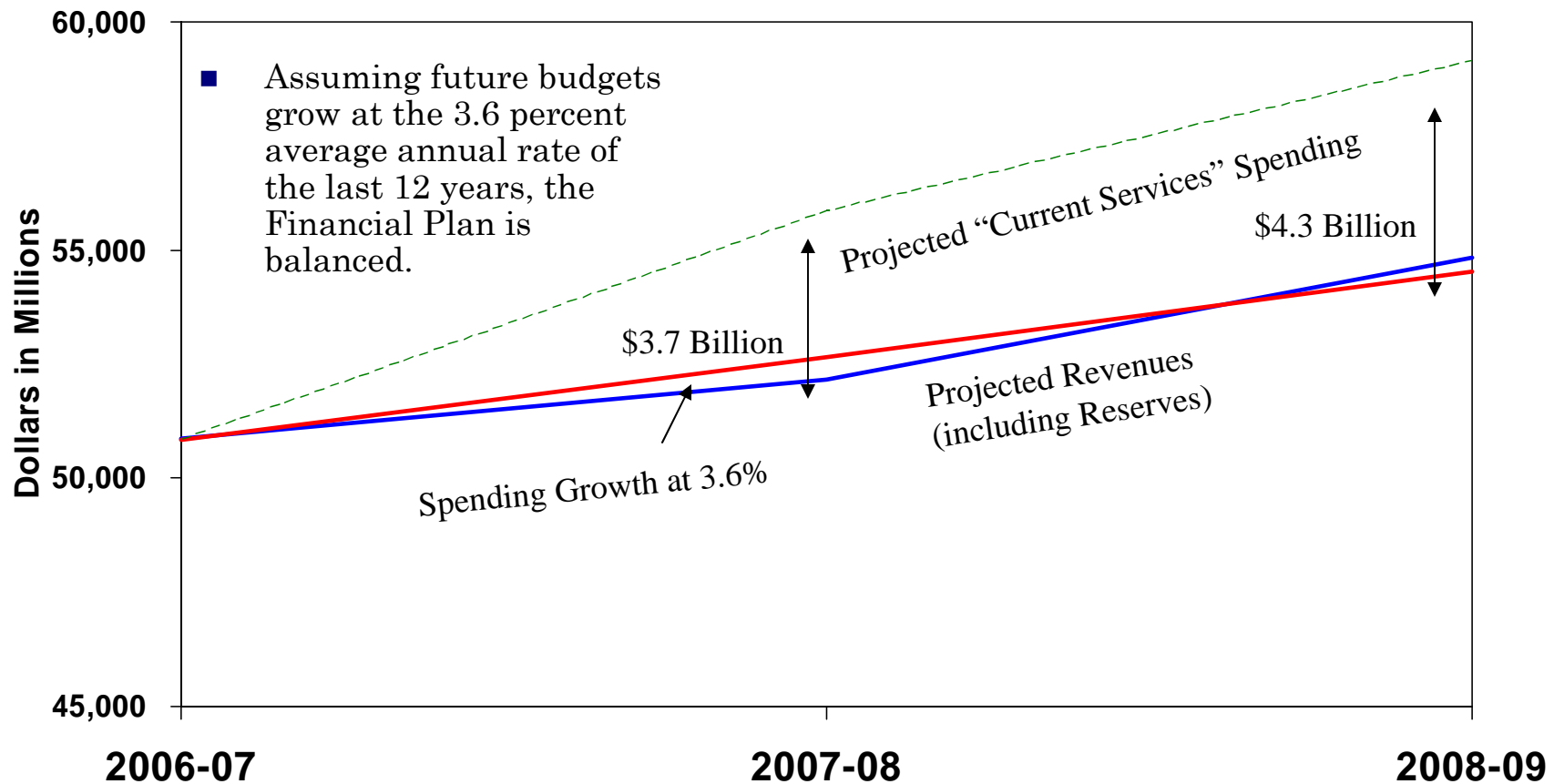
- ❑ \$250 million dedicated to reduce high-cost debt.

- ❑ Environmental Protection Fund returned to pay-as-you-go funding.

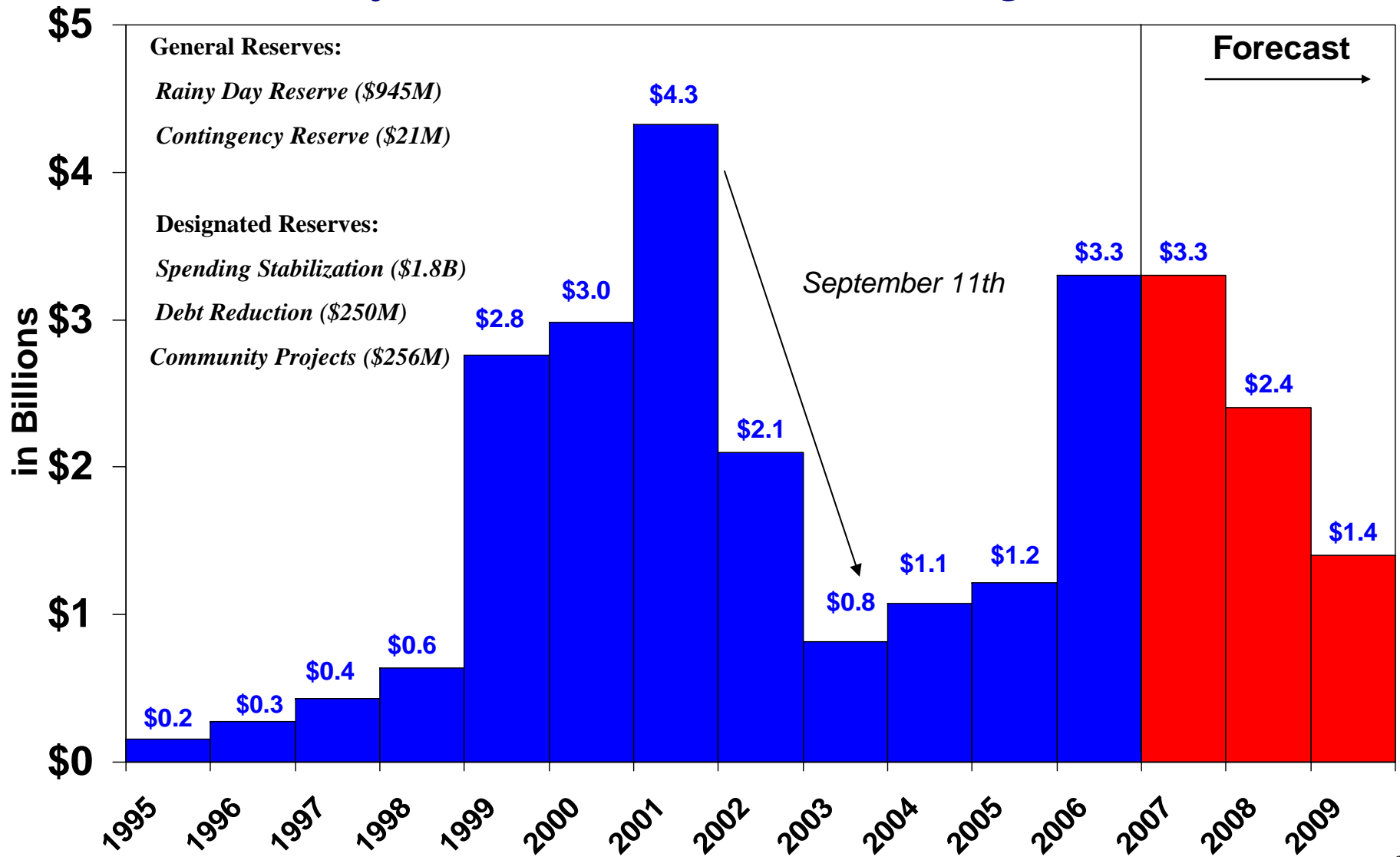
- ❑ Debt levels increase, but remains affordable through the end of Five-Year Plan (2010-11).
 - Debt as a share of personal income: 5.7 percent.
 - Debt service as a share of All Funds Budget: 5.1 percent.

⁽¹⁾ See “2006-07 Enacted Budget Capital Program and Financing Plan,” for more information.

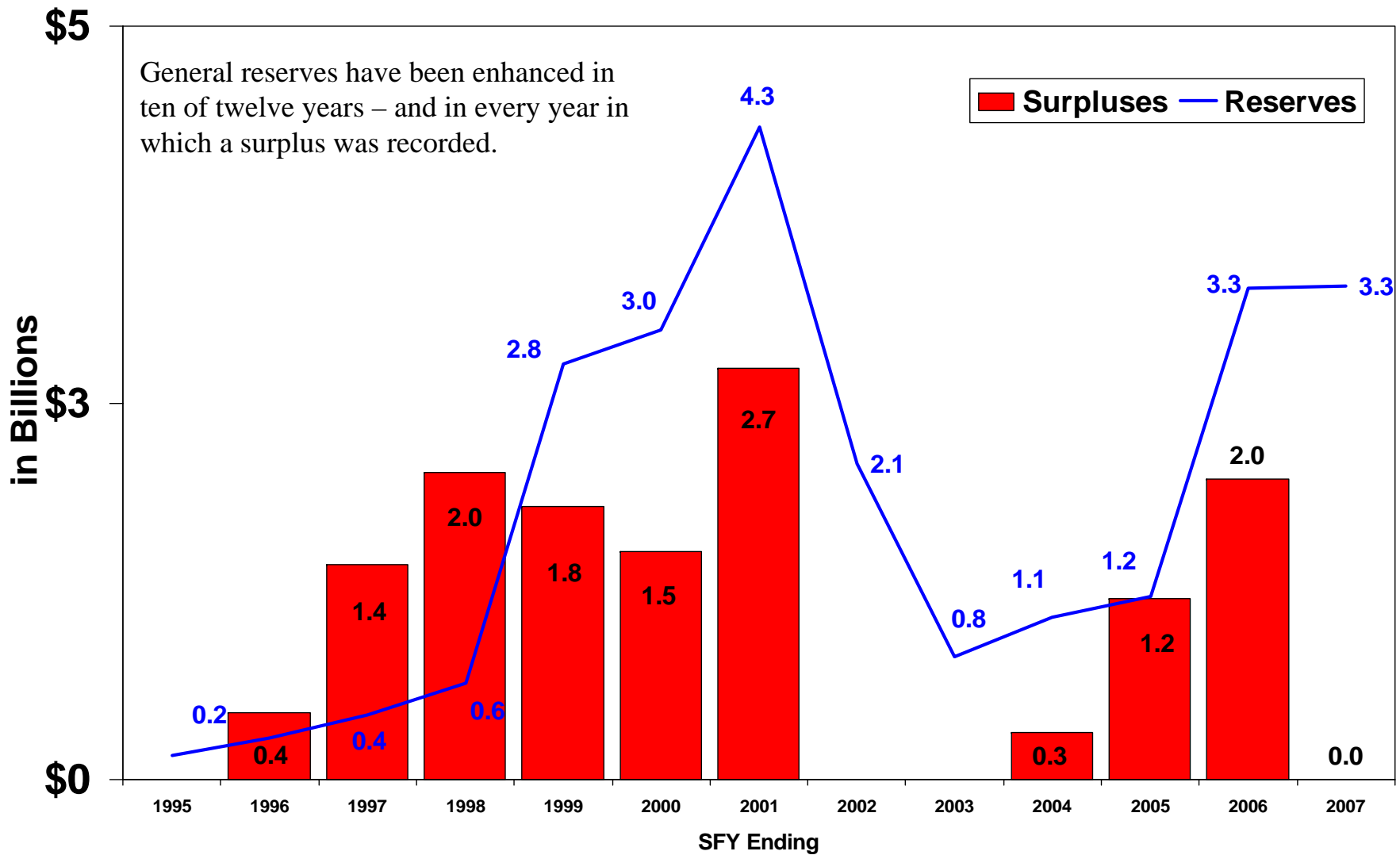
General Fund Spending Forecast with Spending Held at Average Annual Rate



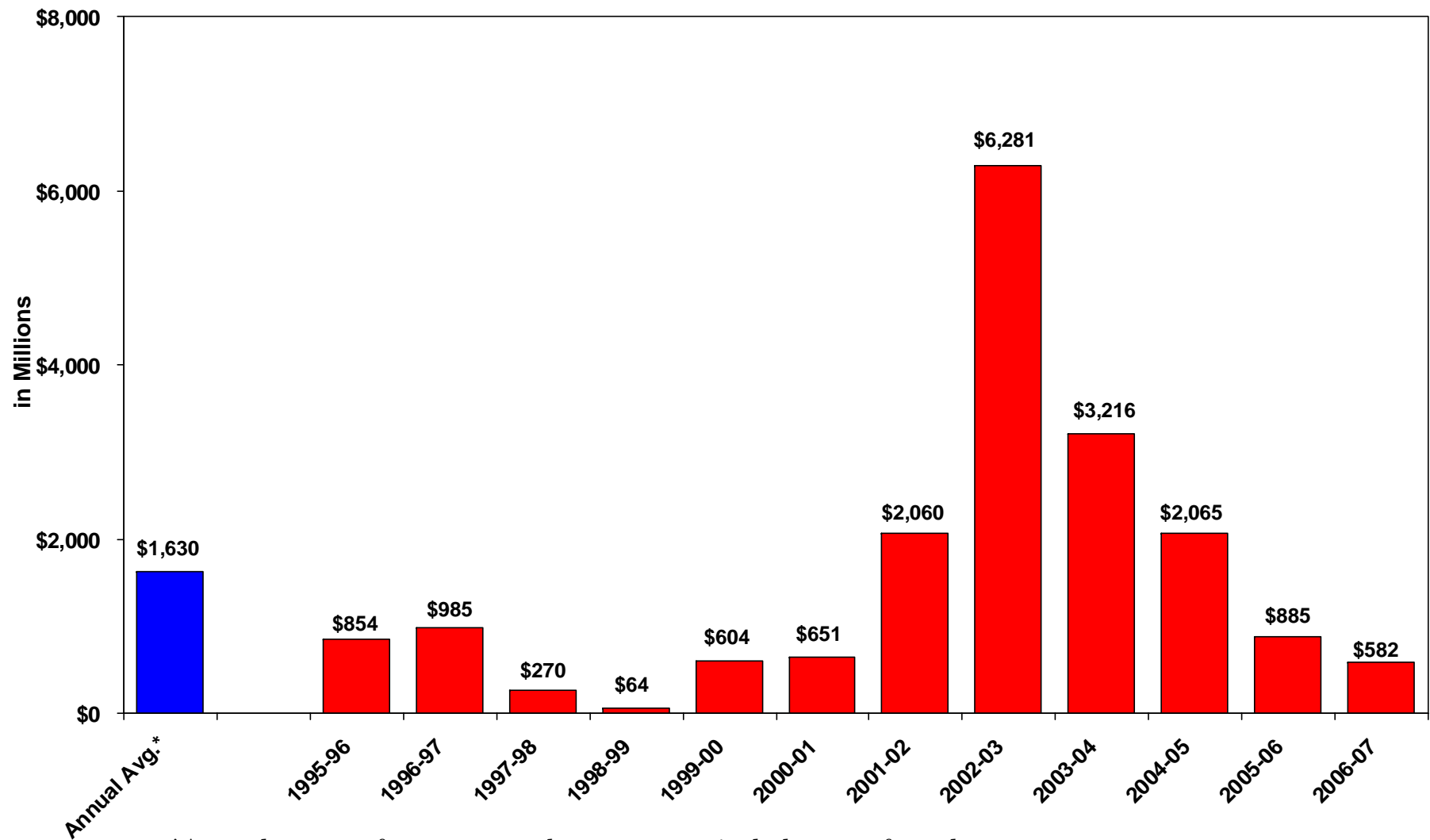
Reserve Levels are High But Projected to Decline Over Planning Horizon



Reserves Expanded in Good Times



General Fund “One-Timers” Near Lowest Level Ever



*Annual average from 1994-95 thru 2005-06 – includes use of surplus

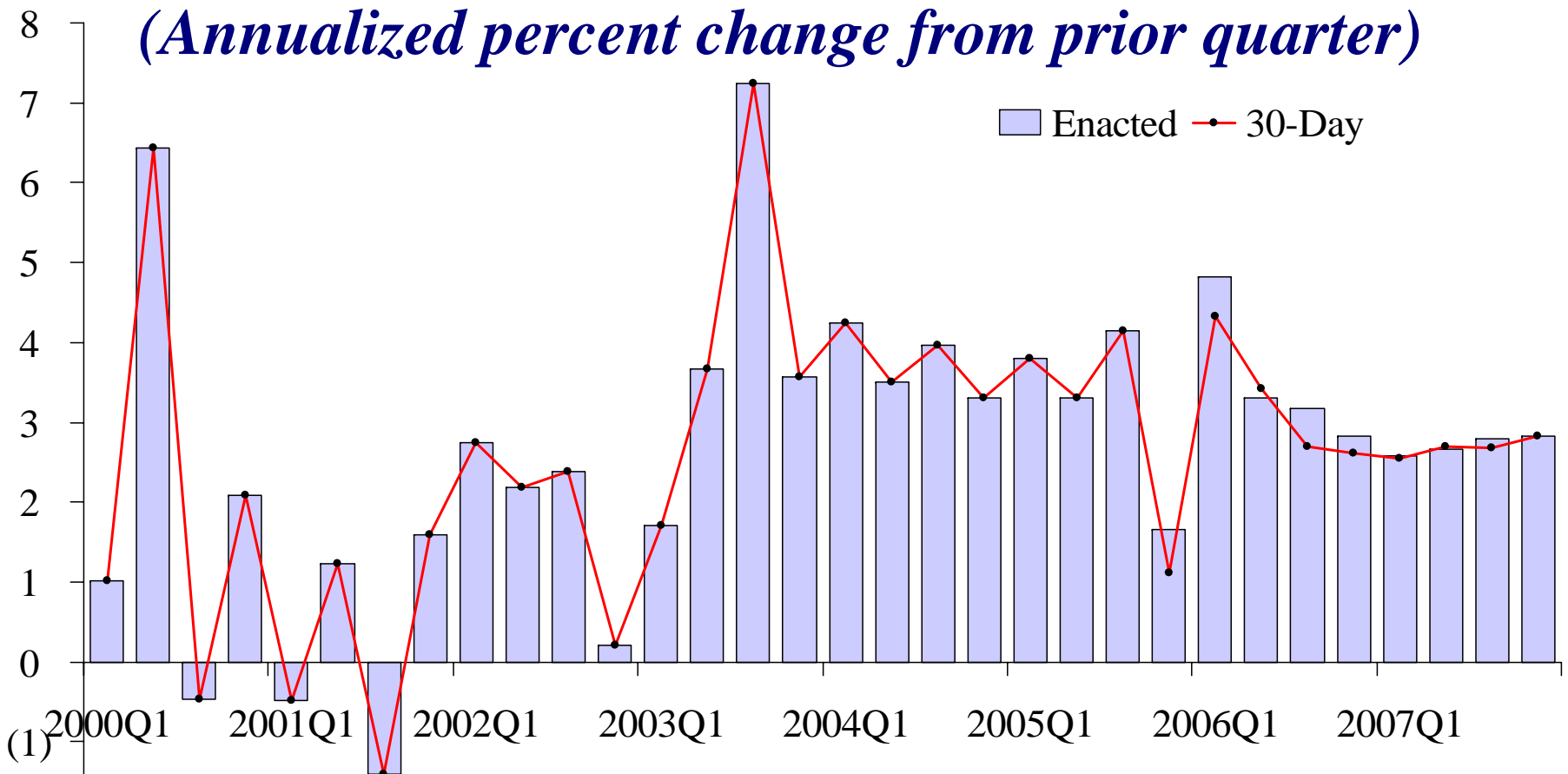
Outlook

- ❑ The 2006-07 budget is balanced and the structural gap remains within manageable limits.
- ❑ \$1.8 billion in resources that were available to spend in 2006-07 are instead preserved to lower the outyear gaps and guard against risks.
- ❑ Absent a major economic shock, State finances should remain in good shape as we approach the 2007-08 “transition” year.

APPENDIX: ECONOMIC FORECAST

Real Gross Domestic Product

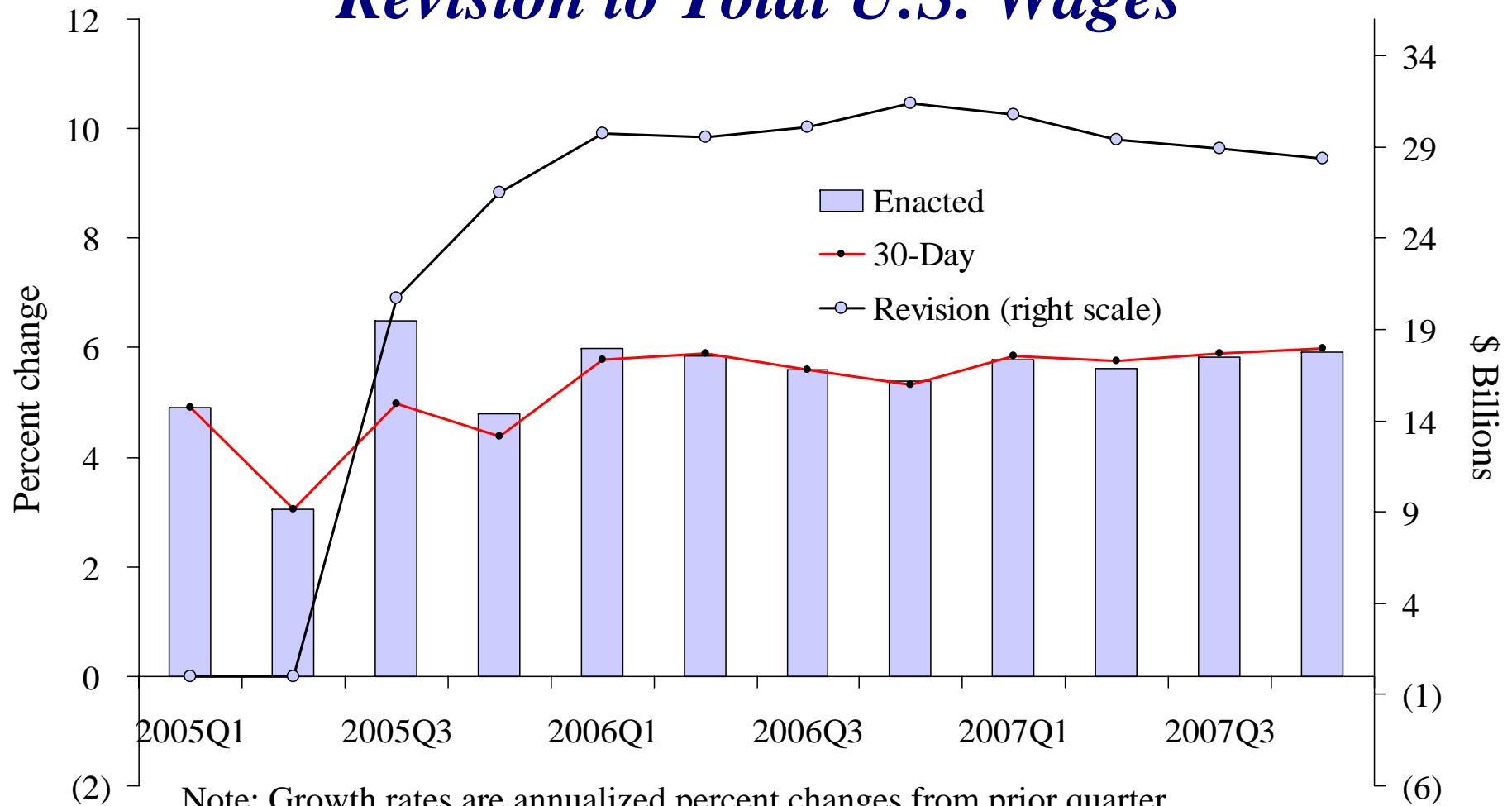
(Annualized percent change from prior quarter)



(2) Source: Moody's Economy.com; DOB staff estimates.

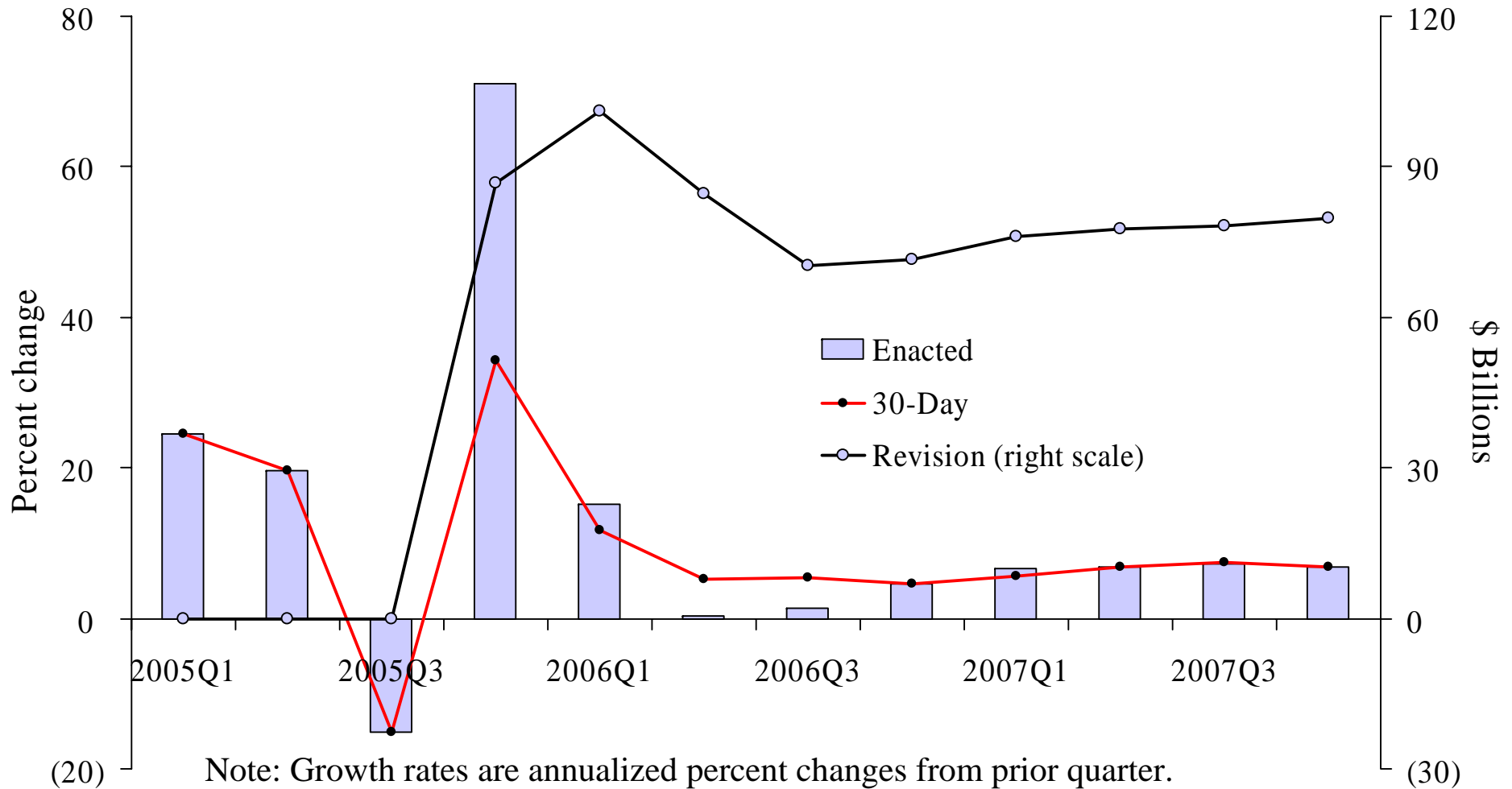
- Real U.S. GDP is expected to grow 3.4 percent in 2006, following 3.5 percent for 2005. DOB's current forecast is slightly above the forecast contained in the Executive Budget.

Revision to Total U.S. Wages



- Following BEA's upward revision to U.S. wages for the second half of 2005, DOB raised its forecast for 2006 wage growth to 5.5 percent, following growth of 6.2 percent for 2005.

Revision to U.S. Corporate Profits

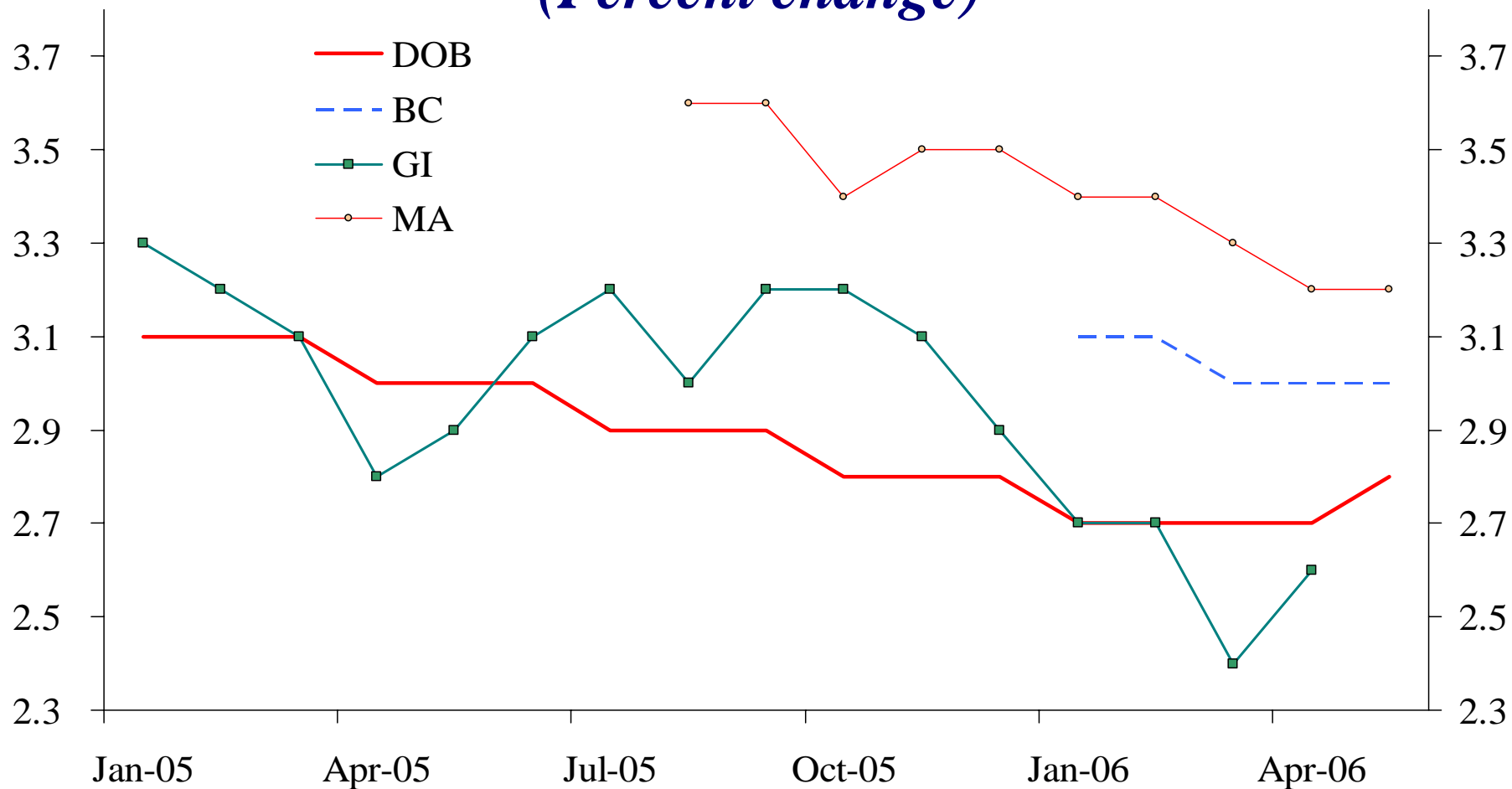


Note: Growth rates are annualized percent changes from prior quarter.

Source: Moody's Economy.com; DOB staff estimates.

- Corporate profits for the last quarter of 2005 were higher than expected; therefore, DOB raised its forecast for 2006 to 13.9 percent.

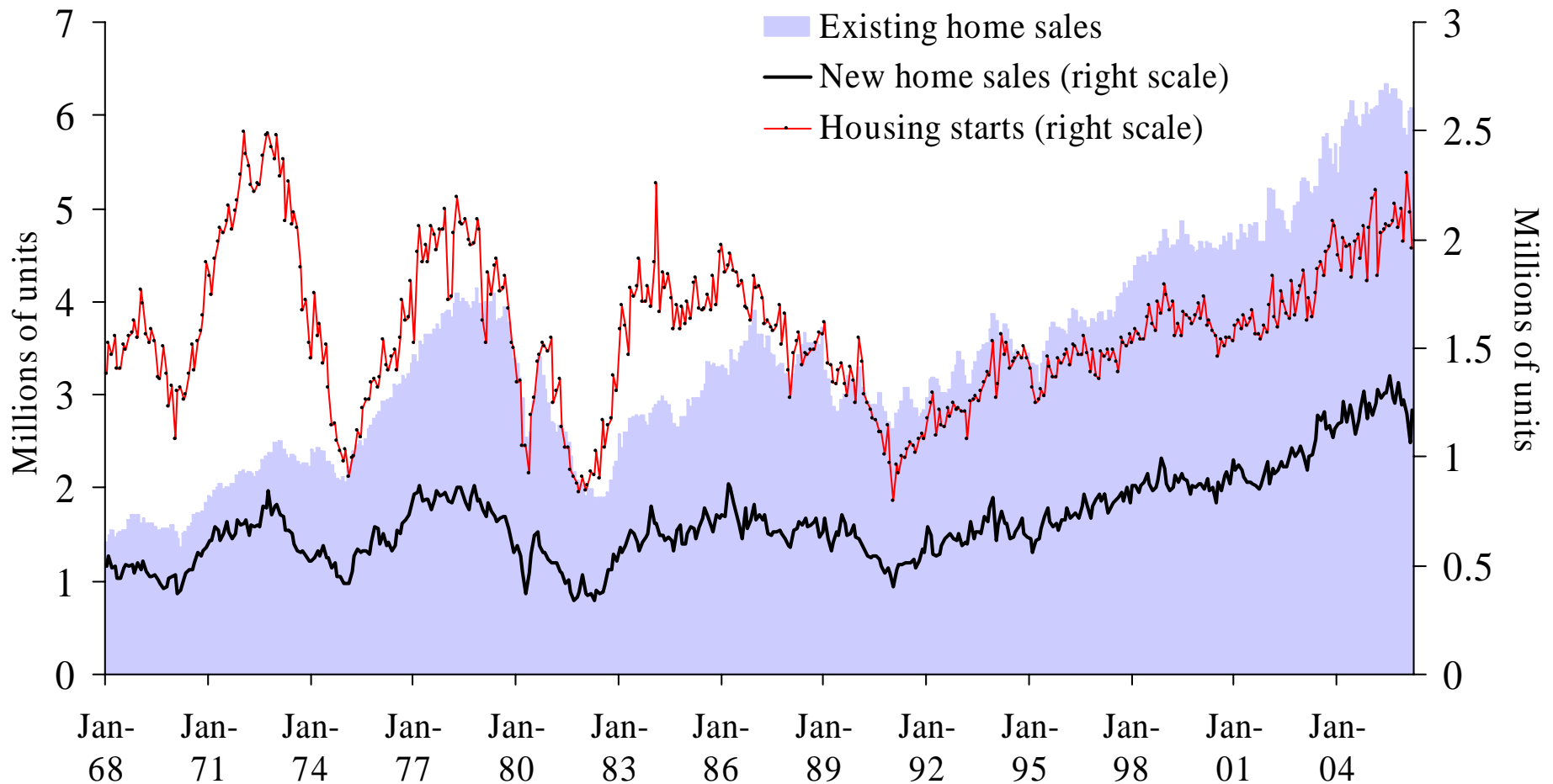
Forecast Comparison: Real U.S. GDP for 2007 (Percent change)



Source: Global Insight; Macroeconomic Advisors; Blue Chip; DOB staff estimates.

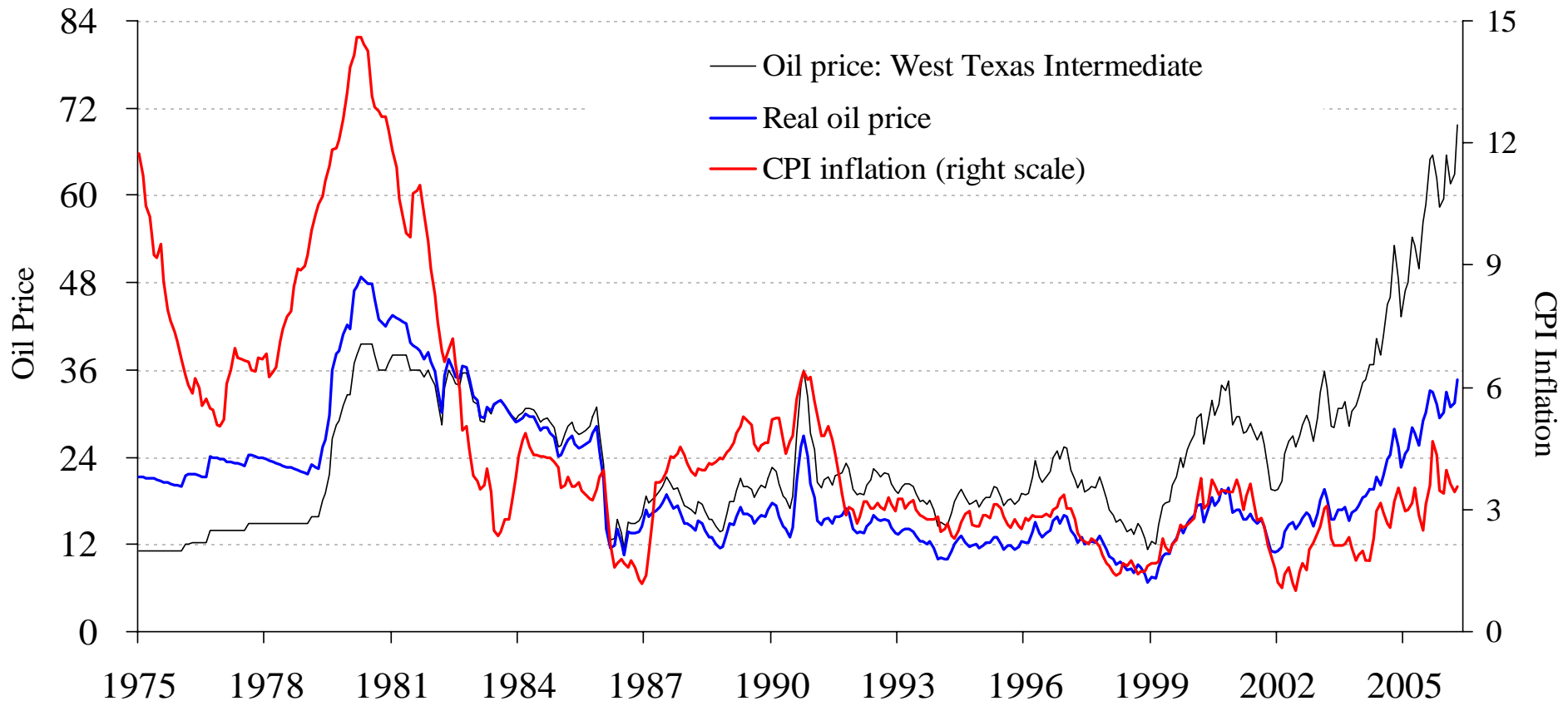
- Compared with other forecasters, DOB's outlook for 2007 is relatively conservative.

New and Existing Single Family Home Sales Have Peaked



Source: Moody's Economy.com

Real Oil Prices and Inflation

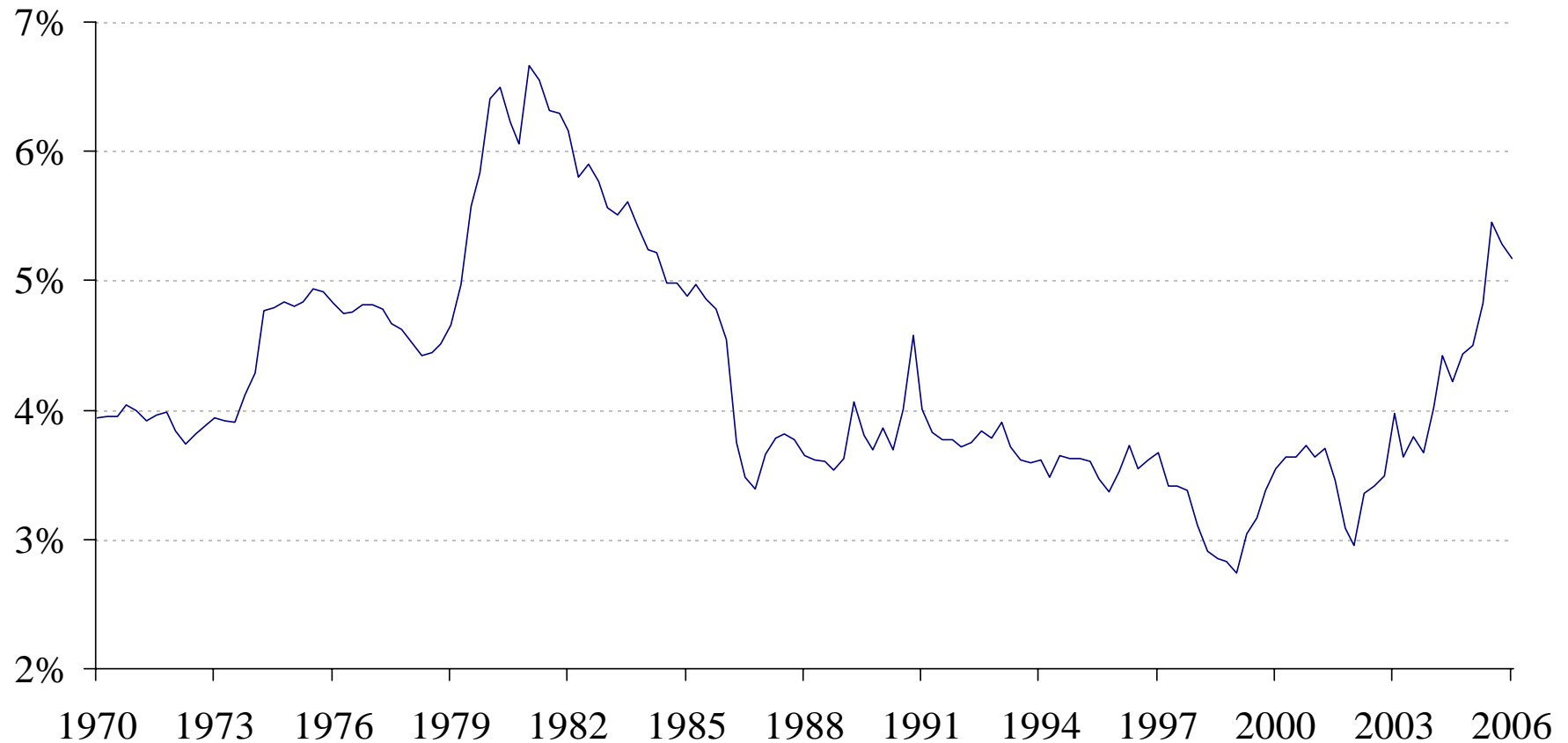


Note: Real oil prices are measured in 1982-84 dollars; the CPI is estimated to have grown 0.6 percent in April; the real oil price for April 2006 is estimated based on the actual WTI price and estimated inflation.

Source: Moody's Economy.com

- The price of oil, adjusted for inflation, has almost reached its 1980 peak. Persistently high oil prices could create significant inflationary pressure on prices for other goods and services.

Personal Consumption of Gasoline and Oil as Percent of Wages

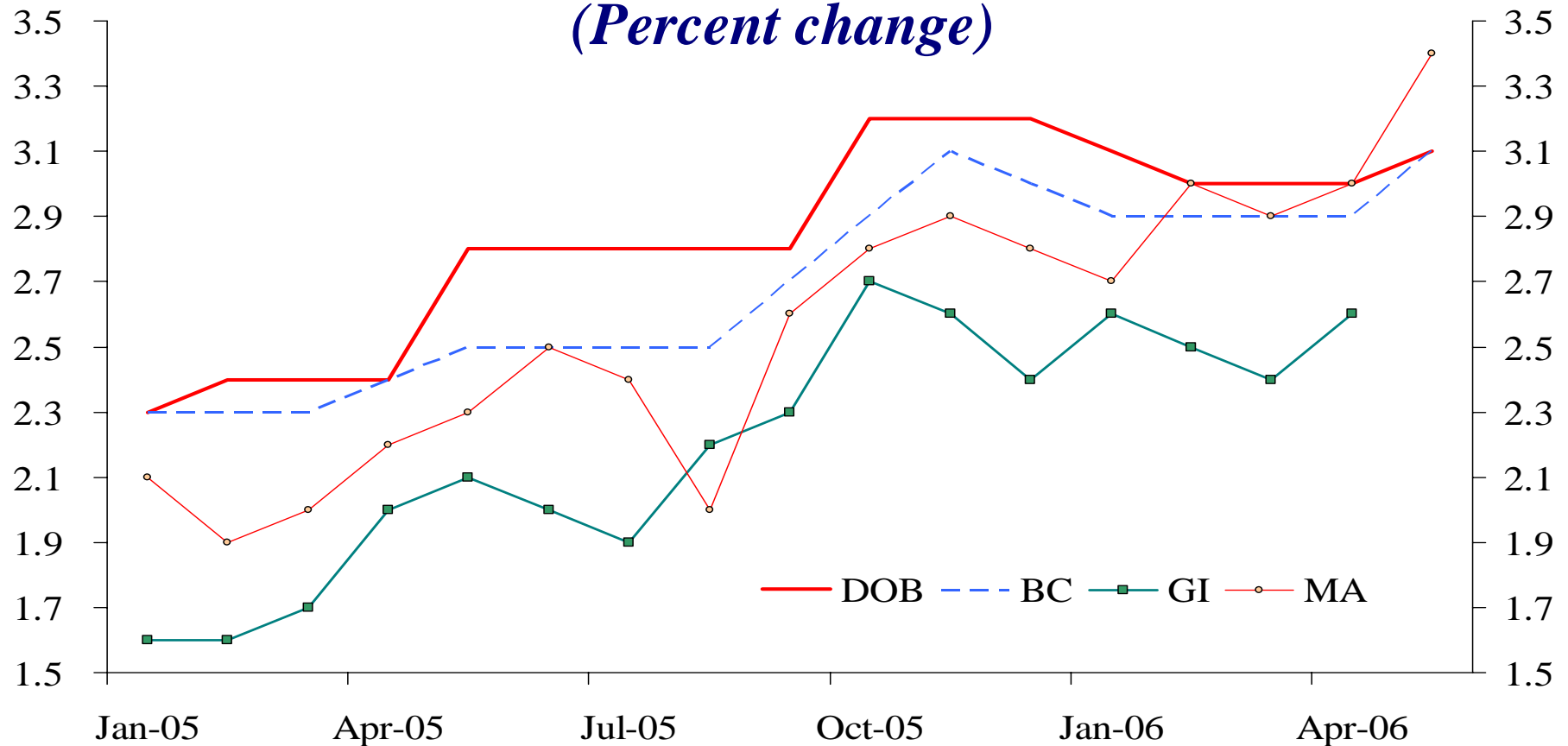


Source: Moody's Economy.com

- Although high gasoline prices have impacted consumers negatively, the share of total wages spent on gasoline and oil consumption has not yet reached the levels that followed the 1979 oil shock.

Evolution of the CPI Forecast for 2006

(Percent change)

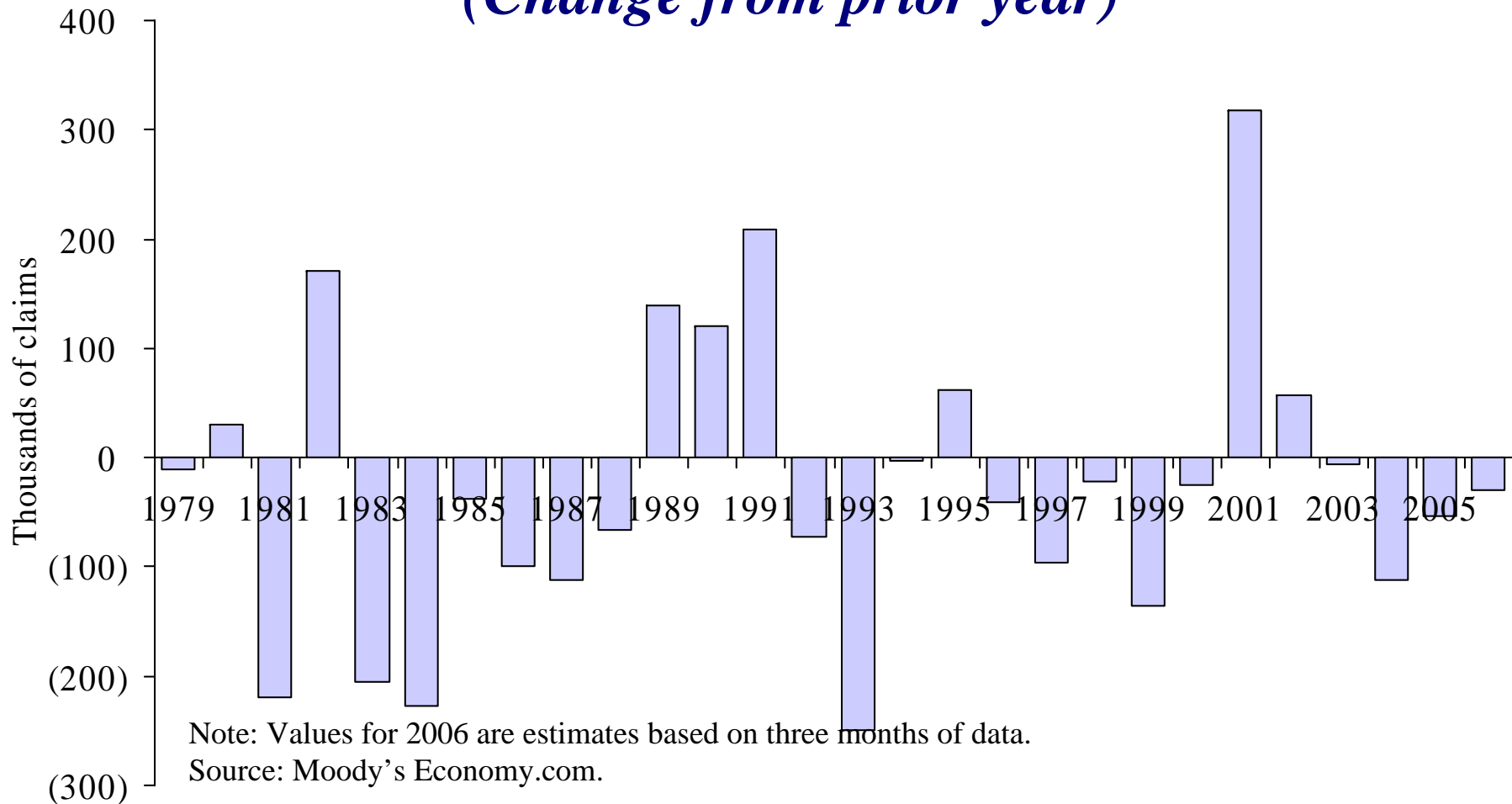


Note: DOB does not produce a forecast every month; the most recent official forecast is used to fill in the missing months.

Source: Global Insight; Macroeconomic Advisors; Blue Chip; DOB staff estimates.

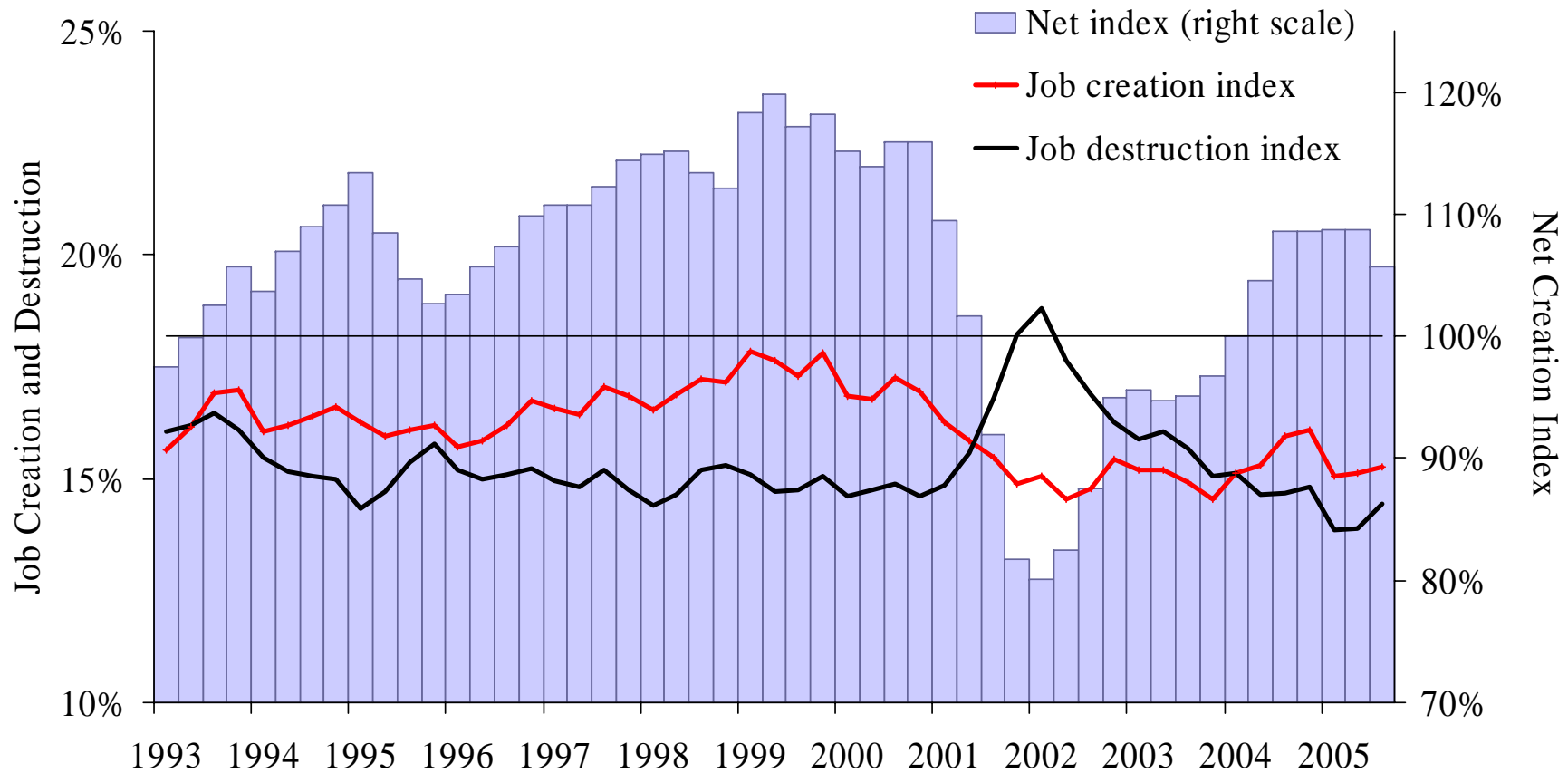
- ❑ Until recently, Global Insight's and Macroeconomic Advisors' 2006 forecast for Consumer Price Index (CPI) inflation was much lower than that of DOB and Blue Chip.
- ❑ As forecasters' inflation expectations rise, the risk of additional tightening by the Federal Reserve increases.

Initial Claims (Change from prior year)



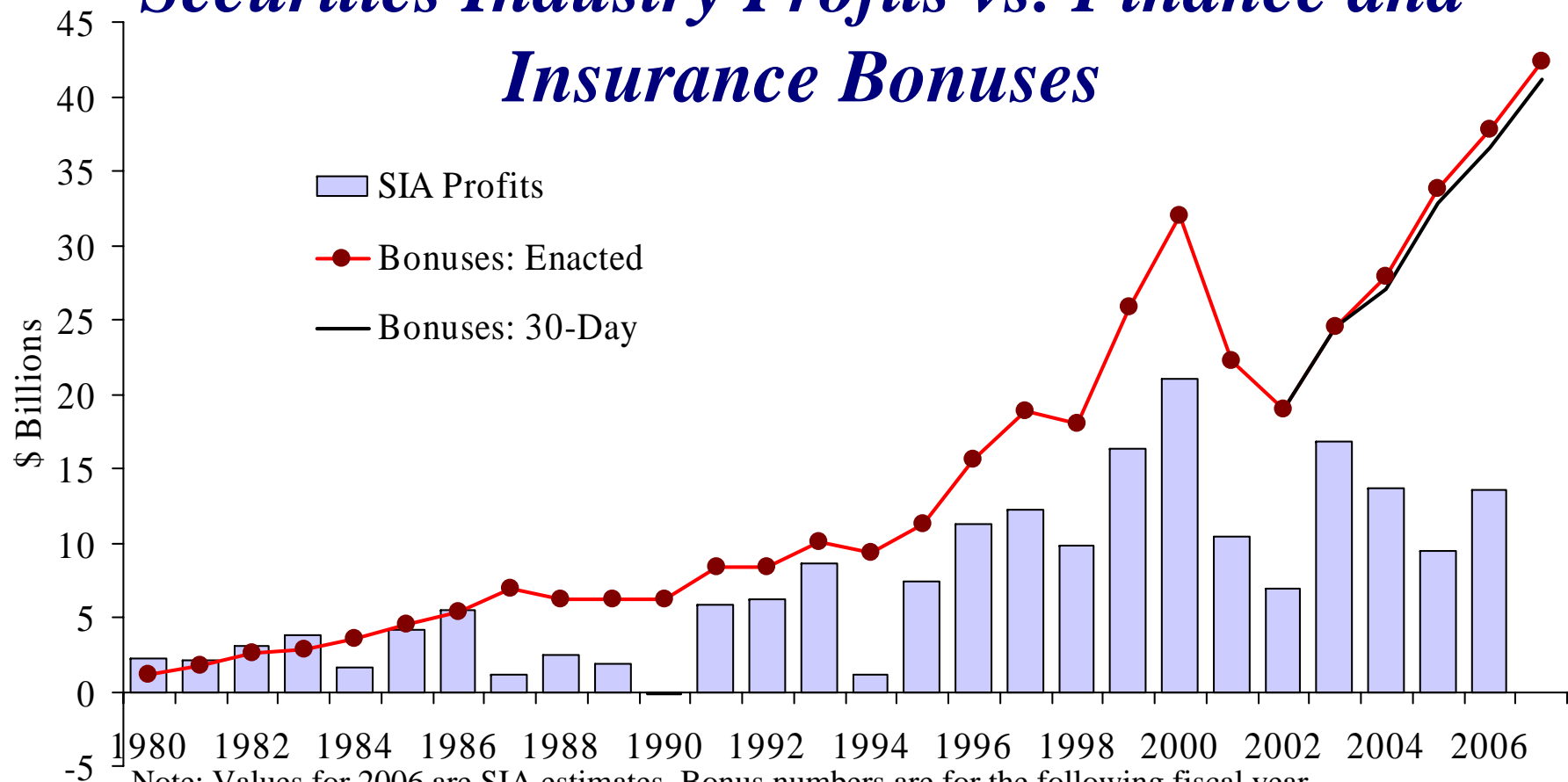
- The New York State labor market has been growing on a year-ago basis since March 2004.
- Initial claims fell at an annualized rate of 30,000 during the first three months of this year, following a total decline of 53,500 in 2005.

NYS Private Sector Employment Dynamics



Source: NYS Department of Labor; DOB staff estimates.

Securities Industry Profits vs. Finance and Insurance Bonuses

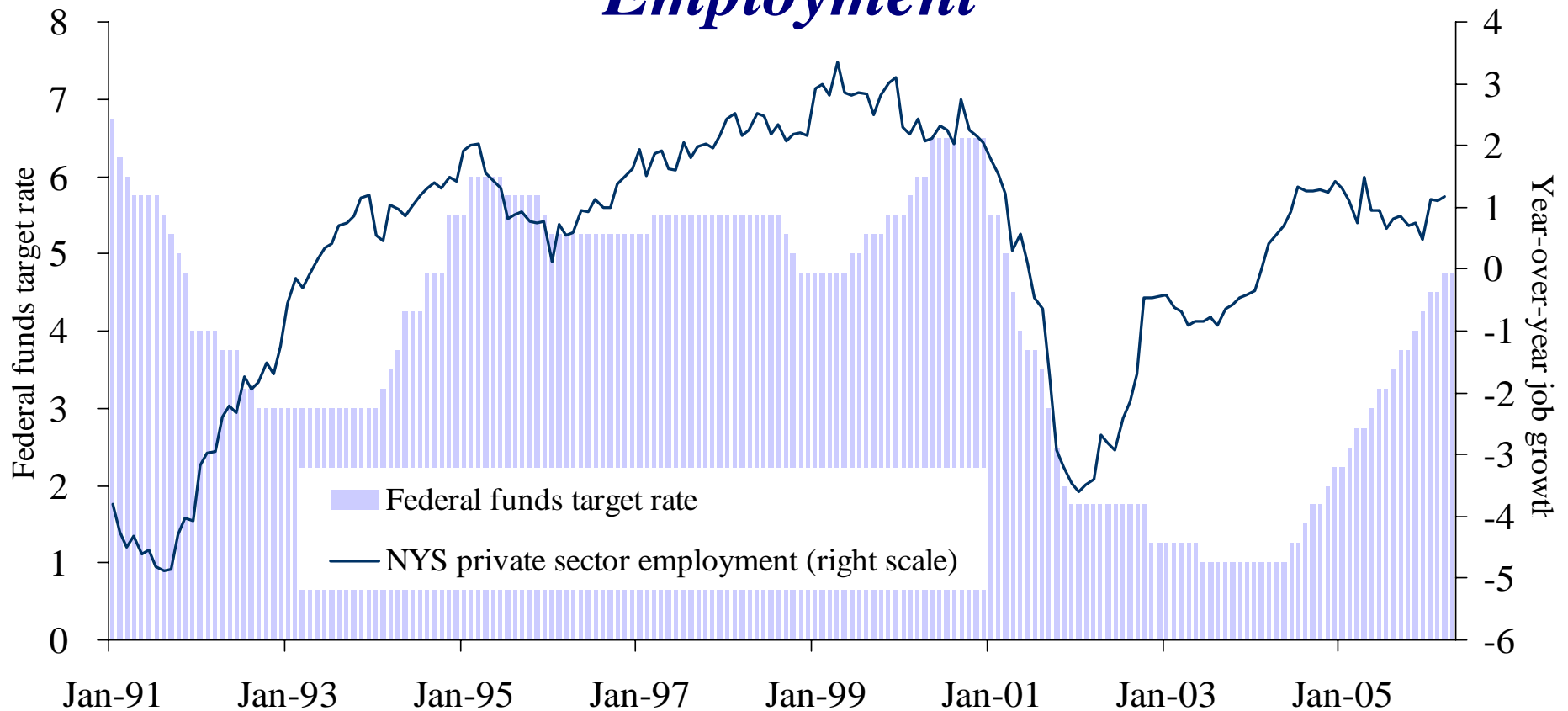


Note: Values for 2006 are SIA estimates. Bonus numbers are for the following fiscal year.

Source: Securities Industry Association; NYS Labor Department; DOB staff estimates.

- ❑ Securities industry profits have declined two years in a row; however, profits are expected to increase in 2006.
- ❑ DOB has raised its forecast for finance and insurance sector bonuses for SFY 2006-07 by \$1.1 billion since the Executive Budget forecast.

Impact of Federal Reserve Tightening on Employment



Source: Moody's Economy.com

- ❑ The Federal Reserve's 1994-95 tightening adversely affected the New York State labor market. This is chiefly due to New York's unique position as a global financial capital. The current pace of tightening continues to pose a risk to State employment growth for 2006.