SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 25

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CAMPAIGN FOR FISCAL EQUITY, INC., et al.,	:	
Plaintiffs,	:	Index No. 111070/93
- against -	:	Hon. Leland DeGrasse
THE STATE OF NEW YORK, et al.,	:	Panel of Special Referees: John Feerick
Defendants.	:	E. Leo Milonas William Thompson

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TESTIMONY BY JOHN CAPE

1. I am First Deputy Budget Director of the New York State Division of the Budget, a position I have held since 2002, and I have worked in other capacities in the Division of Budget since 1980. As First Deputy Budget Director, I work at the direction of the Governor and the Budget Director, and I am responsible for overseeing New York State's entire Financial Plan.

Introduction

2. I am responding to the Special Referees' solicitation of testimony from the State regarding the following question:

#6: ....whether any of the measures [necessary to provide all New York City schoolchildren with the opportunity for a sound basic education] that should be implemented with respect to such operating funds or capital expenditures should be phased in over some period of time and, if so, what time period and in what increments

3. It should be noted that I did not participate in the development of the State's Plan or the calculation of the various funding amounts contained therein. Rather, my testimony is intended to assist the Referees in a factual understanding how the Governor's plan would be integrated into

the State's Financial Plan in the context of the proposed five-year phase-in and the State/local partnership with New York City that the plan assumes.

A Multi-Year Phase-In Promotes Better Planning, Implementation, and Accountability

4. A multi-year phase-in of major new funding commitments -- such as the $4.7 billion initiative contained in the State's Sound Basic Education Plan -- is a common practice at all levels of government. A multi-year approach clearly makes good sense for the planning, implementation and financing of the significant education reforms that are needed to ensure that all children in New York City have the opportunity for a sound basic education. Of equal importance, a multi-year phase-in permits the opportunity for periodic review of the effectiveness of the reforms in achieving the intended results. Such reviews are an essential part of the new accountability system contained as part of the State's Sound Basic Education plan.

5. A number of the education reforms that are contemplated by all parties involved in this litigation must, as a practical matter, be phased-in over a multi-year period. For example, a multi-year approval is appropriate for the phase-in of reforms that are the subject of collective bargaining -- including actions to ensure competitive teacher salaries and provide incentives for recruiting teachers to hard-to-staff schools throughout New York City.

A Multi-Year Phase-In Permits the State and the City an Opportunity to Provide Needed Resources While Minimizing the Need for Excessive Tax Increases/Program Cuts

6. The participants in financing New York City schools -- New York City, New York State, and the Federal Government -- all utilize a multi-year financial planning process. When any level of government contemplates making major program changes such as facility closures, implementation of collective bargaining agreements or completion of new capital projects they are

contemplated in a multi-year context. Aside from the need to ensure the appropriate program planning and accountability discussed above, phase-ins of significant changes in governmental financing, whether they be tax cuts or new expenditures, are necessary to avoid unacceptable budgetary shocks. The immediate need for significant tax increases negatively impact the state and/or local economy. Conversely, draconian budget cuts could devastate other critical programs that could result from implementing changes too rapidly. It should be noted that such program cuts could very well impact the very population of children sound basic education enhancements are designed to help.

7. An illustration of this concept can be seen in change in State school aid over the last 10 years. Spending has gradually increased from \$9.9 billion in 1994-95 to \$15.2 billion in the 2004-05 Enacted Budget, an increase of 53 percent. At the same time, growth in the State's entire General Fund budget was limited to 29 percent. Thus, the multi-year phase-in of increased State support for schools allowed school aid to comprise a much greater share of the State Budget -- an increase from 24 percent of the General Fund budget in 1994-95 to 30 percent in 2004-05 -- without the need for draconian budget cuts or excessive tax increases.

8. It is without dispute that the State currently has multi-billion dollar structural budget gaps. In the current fiscal year, the State has a deficit of approximately \$400 million which must be closed by March 31, 2005. Presuming the revenue increases and/or expenditure reductions that bring the current year into balance are recurring, the Division of Budget currently projects the shortfall between expected revenues and anticipated spending – at \$5.7 billion in 2005-06 and at \$7.2 billion in 2006-07. These gaps represent approximately 13 percent and 17 percent, respectively, of current total General Fund spending of \$43 billion.

9. The large budget gaps already assume that the State economy has emerged from the national recession and that there will be healthy revenue growth of roughly 5 percent to 6 percent each year. Moreover, the State's revenue forecast could be negatively impacted by a number of factors, including weaker performance in the financial community and higher energy prices.

10. Recognizing the chronic fiscal difficulty facing the State, the Governor concluded that it was not realistic to assume that new resources or the magnitude required for the State's plan could be provided entirely from current revenues. Accordingly, the Governor proposed dedicating all State receipts from the operation of Video Lottery Terminals (VLTs) to the implementation of the State's Sound Basic Education Plan. VLT revenue comprises over half of the direct State share of State's Sound Basic Education Plan.

11. The VLT program was created by Chapter 383 of the Laws of 2001. It has been amended several times since then. Under the current program, the Division of the Lottery (the Division) is authorized to license the operation of video lottery gaming at:

- Aqueduct
- Monticello
- Yonkers
- Finger Lakes
- Vernon Downs
- Batavia
- Buffalo
- Saratoga Raceway

The operation of VLTs are forbidden at:

- Belmont
- The Syracuse Fair
- Saratoga Flat track

12. The video lottery games must pay prizes that average no less than ninety percent of sales. The specific allocations for the balance of total revenue are specified in law:

- Education . . . . 61 percent
- Administrative Cost of the Lottery . . . . 10 percent
- Vendor Commission . . . . . . 29 percent

13 Any amount not need by the Division to operate VLTs is also required to be deposited in the Sound Basic Education Account.

14. The Governor put forth, as part of the 2004-05 Executive Budget, a proposal to expand the VLT program by authorizing the Division to award up to eight additional licenses for the operation of video lottery franchise gaming. That proposal was not enacted as part of the 2004-05 budget, and remains pending.

15. The revenues from VLTs will increase over a multi-year period as new facilities begin to open and, based on the combination of the eight facilities authorized in existing law and a new proposal to authorize up to another eight facilities, would grow from roughly $200 million in 2004-05 to $2 billion in additional school aid per year by 2009-10.

16. Similarly, New York City's fiscal pressures also require a multi-year phase-in to accommodate increased local funding to support necessary reforms. While I am not an expert on

New York City's finances, published reports released by New York City indicate that the City also has a difficult fiscal situation. In viewing the respective fiscal condition of the State and City, the I would note that:

- While the City is expecting to end its 2004-05 fiscal year in balance, like the State, the City faces projected outyear budget gaps. The City anticipates a budget shortfall of $3.7 billion in 2005-06 and $4.5 billion in 2006-07.
- The State's budget gaps are, respectively, 13 percent and 17 percent of current General Fund Spending of $43.0 billion. In contrast, the City's budget gaps are, respectively, 11 percent and 14 percent of current City-funded spending of $32.7 billion.

17. Thus, the budget pressures on both the State and New York City require a multi-year phase-in to ensure increased spending can be structured to match the ramp-up of new dedicated revenues and to avoid major disruptions in other critical services or tax increases that could negatively impact the State or local economy.