

Ahead of the Curve

Unlocking the power of innovation
to turn New York State around

2006



The
Business Council
of New York State, Inc.

Introduction

A message from Linda S. Sanford



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It's worse than you think. Yet it could be so much better than you imagine.

That's the paradox confronting all of us who care about New York State and its future.

On the one hand, our state's economic performance is unacceptable, and has been for many years — a situation that profoundly jeopardizes the future of our families, our communities and our businesses.

New York State has still not made back the jobs we lost in the 2001 recession and the aftermath of 9/11.

Parts of Upstate are hemorrhaging jobs and people. The state as a whole is adding jobs at only a bit better than half the national rate. And as those of us in business have learned, if you lag behind your competitors year after year, huge gaps can open up before you know it. One example:

15 years ago, New York had a million more jobs than Texas. Today, Texas has a million more jobs than New York.

So it's worse than we would like to admit.

Yet the more important truth is that New York has a potential far greater than our dispirited, partisan public dialogue allows us to imagine.

Our state is perfectly positioned to get *Ahead of the Curve* in terms of the growth and prosperity now being unleashed by new technologies, new ideas and new opportunities in the global economy. Our workforce is in the top ranks globally — with our proportions of college graduates and graduate degrees well above the national average. Our business community is on the leading edge of invention — a key reason we rank second of all states in new patents each year. We have a superb system of public and private research universities. We've moved faster than

other states in reforming elementary and secondary education. New York City is the home base of the global economy, and the home address of the financing we need to put ideas into action. *Imagine what New York's future could be like, if we grasp the opportunities that flow from these strengths.*

The key to turning New York around is to unleash again the power that has driven our progress from the days of the Erie Canal, to the industrial age, to fiber optics — **the power of innovation.**

Innovation is the force that will define our competitiveness, drive our economic progress, improve our quality of life, and strengthen our ability to deal with our social problems.

So the Business Council's 2006 program approaches New York's problems, and opportunities, just as an innovator would.

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We propose quick and decisive action to resolve some long-lingering, no-brainer cost issues, such as workers' comp and the special burdens imposed on Upstate. And we propose moving boldly on a forward-thinking agenda that will strengthen our education system, our economic development programs and our research and development infrastructure, to give us the competitive edge we need.

Nor will we stop after 2006. Innovation is the long-term focus we must keep in the forefront in the years ahead, as we work to ensure that New York gets *Ahead of the Curve*.

We can. You know we can. It's time to get on with it.



Innovation

The capstone of a policy agenda that will get New York on the move again

We're a leader:

- ▶ New York ranks 5th in the nation — and almost one-third above the national average — in the percentage of our adult population holding advanced degrees.
- ▶ We're also above average in the percentage holding bachelors' degrees.
- ▶ Every year New York produces about 7,000 new patents — more than any foreign nation, except Japan and Germany, and (within the U.S.) second only to California.

And yet we're behind:

- ▶ We rank only 41st in the nation in private-sector job growth over the last 10 years.
- ▶ We're 32nd in the growth of high-tech employment.
- ▶ We're only 31st in growth in personal income.
- ▶ We rank 50th, worst in the nation, in the number of people moving out to other states — about 200,000 a year.

New Yorkers, like other Americans, hope and expect to have a standard of living second to none in the world. But as economic growth soars in China and elsewhere, we need to understand what that requires.

We won't achieve a high standard of living by closing our doors to the low-cost, high-quality goods and services coming from other countries. Nor will we do it by competing with China to get our pencils, say, on the shelves at Wal-Mart.

A high standard of living requires high productivity and high margins on the goods and services we produce. Which means, in turn, being *Ahead of the Curve* in terms of the quality and speed of the new thinking we introduce into our work and into the global marketplace. The best returns come on the goods and services that nobody else has thought of yet, that nobody else can produce, that yield the most growth in output with the least use of resources. That's why our future depends upon our success at **innovation** — the blend of invention, insight and entrepreneurship that launches growth industries, generates new value, and creates high-value jobs.

The Business Council's priority agenda for 2006, therefore, is built around two basic concepts we believe are critical, if New York is to compete and win in the global economy:

First, we must hone our **capacity to innovate**.

This means:

1. Ensuring that all our children get a strong, basic education to start.
2. Educating thousands of new, highly qualified teachers for science and math in our middle and high schools.

3. Increasing the number of students getting college and graduate educations in science, math and engineering.
4. Enhancing the ability of our universities to advance basic research.
5. Enacting growth-oriented tax incentives.
6. And redirecting the state's economic development investments toward those identified in concert with the private sector as most promising for each region's future.

Second, we must **break through the handicaps** that give New York an unnecessary disadvantage in the competition with other potentially high-innovation locations, particularly other states in the U.S. This, too, will require innovation — at the political, not just economic, level. Albany's culture must change from the can't-do mindset of perpetual gridlock, to a forward-looking, *can-do* approach that will at long last begin to shrink our state's excessively high cost of doing business, by:

1. Reining in debt, spending and taxes at the state and local government levels.
2. Reforming workers' comp.
3. Addressing the high cost of energy.
4. Restraining the growth in health-care costs, particularly employer-paid health insurance.
5. Reducing unnecessary liability costs.
6. And giving Upstate, where the structure of the economy is particularly vulnerable to New York's government-driven, high-cost habits, special opportunities to reduce those costs.

The best returns come on the products and services that nobody else has thought of yet — that nobody else can produce.

Learning comes first

Education — particularly in the sciences, math and engineering — will be key to a high standard of living in the 21st Century

The looming gap in science and math:

- ▶ The Bureau of Labor Statistics forecasts that U.S. demand for science and engineering workers will grow three times as fast as the nation's overall job base, in the decade ahead.
- ▶ Yet our educational output of new scientists is losing momentum. The number studying engineering, for example, has dropped 20 percent in the U.S. since 1985.
- ▶ South Korea, Germany, Australia, Singapore, Japan and Canada all produce a higher percentage of science and engineering graduates than the United States.
- ▶ New York is 19th among states in the proportion of its current jobs that are in science and engineering fields — yet only 26th in science and engineering degrees as a percentage of all degrees awarded by our colleges and universities.

The key competitive asset of New York's economy today is our workforce — among the most highly educated and productive in a nation which is, itself, the world leader in this respect.

But today this leadership is under challenge. Nations like South Korea are increasingly doing as well as, or better than, we are in giving a strong, basic education to their entire populations.

And our competitors in Asia are positioned to far outstrip the U.S. in terms of educating new scientists and engineers — the specialists most critical to innovation in products and services.

New York, once a leader in educating and employing scientists and engineers, is falling behind. This state is graduating fewer than 4,000 new engineers each year — about 1,000 fewer than if we matched the (inadequate) U.S. average. In fact, New York annually graduates about twice as many psychology majors as engineers.

In preparing our state for the economy of the future, our students must come first. What can we do for them?

For more than a decade, the business community in New York has given top priority to the drive to raise minimum standards in the schools — to ensure that a high-school diploma is meaningful. It's been a struggle, and the job is not finished. **We will continue to support high standards, and to resist any and all attempts to water down New York's high standards, or the assessments that undergird them.**

But focusing on minimums, alone, will not be enough to ensure that we produce the leaders needed to drive our success in the innovation economy.

Our nation urgently needs more graduates and advanced degrees in science, math and engineering. The Business Council has three proposals to address this need.

First, we need more and better science and math teachers at the middle- and high-school levels. In part because of stiff competition for new science graduates from the private sector, this is an area of chronic shortage in New York. Yet it is in these middle- and high-school years that too many of our students first get the idea that science isn't interesting or is "too hard." International comparisons show that U.S. students, including New Yorkers, are ahead of those in our peer nations through the fourth grade — but by the 12th grade, they are at or near the bottom in science and math. We need inspired and inspiring teachers to turn this around.

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The Business Council therefore proposes a ***Teach for the Future*** initiative, drawn from a model developed by the National Academies of the Sciences, to produce 500 new, highly qualified science teachers every year.

Under this plan, the state would fund 500 competitive scholarships each year, at up to \$20,000 per year for up to five years, for students who agree to earn a bachelor's degree in a science or math, as well as the master's degree needed for full teacher certification.

In return, the recipients would commit to teach science or math in New York public schools for a minimum of five years — with an extra \$10,000 bonus for those who agree to teach in inner-city or rural school districts.

Second, students in both the high-school and college years need more and better guidance about the career choices ahead of them — and about the educational requirements that fit with those choices. The Business Council will work with the Education and Labor departments to develop an information program to that end.

Third, to encourage our students to pursue critical skills after high school, we also propose a 50 percent tax credit for individual or corporate contributions to scholarships in math, science and engineering given to New York students attending New York colleges.

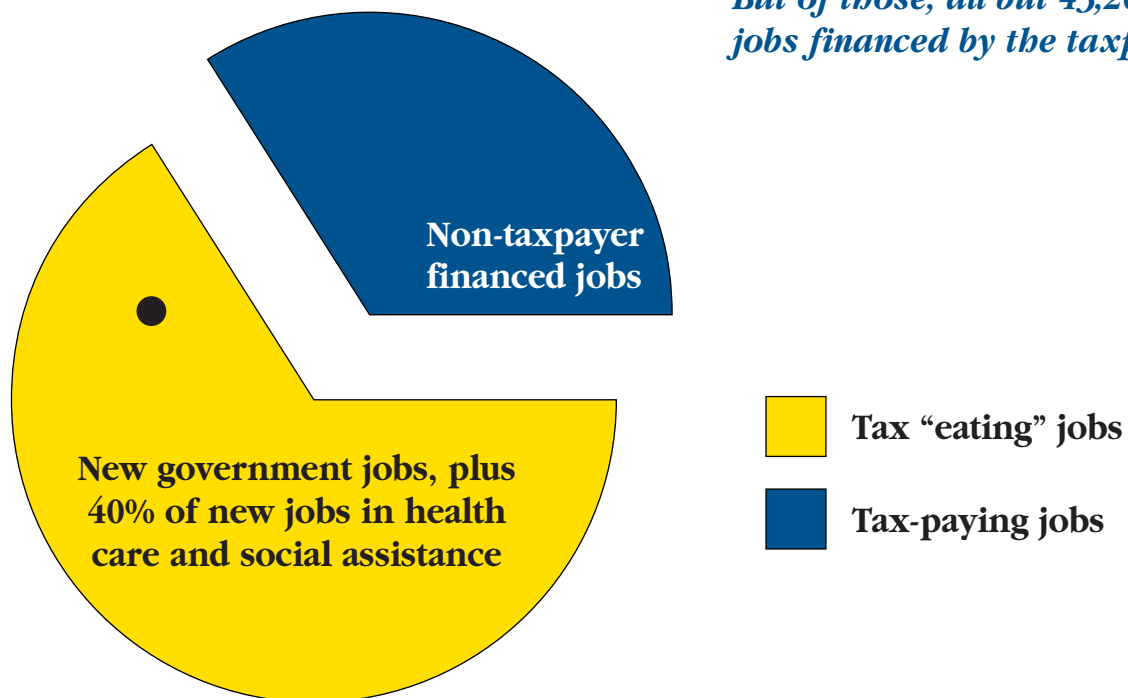
Economic development

It's time to get smart about investing — not just spending — to grow our economy

Net new jobs Upstate, 1990 - 2005

Upstate gained 129,200 jobs overall, from 1990 to 2005.

But of those, all but 43,200 are jobs financed by the taxpayers.



Source: U.S. BLS establishment data survey, annual averages, not seasonally adjusted.

For too long, Albany's favorite answer for New York State's economic troubles has been to take our money from us by way of taxes, and then send some of our tax money back to us, in hopes that this will somehow generate real economic activity.

Well, it isn't working. To understand why "spending our way to prosperity" doesn't work — and how we can do better — we have to look closely at how this policy unfolds now. It has two elements.

First, government in New York tries to create the appearance of economic growth by steadily increasing the number of jobs that are paid for by the taxpayers.

Many of these jobs are directly on government payrolls. New York State has about 1.35 million state and local government employees. (This number is about 133,000 higher than it would be if we matched the national average ratio of government jobs to all jobs — extra payroll that costs New York taxpayers at least \$5 billion a year.) In addition, tax dollars pay for 40 percent or more of all jobs in the health care and social assistance sector (which totals about 1.2 million jobs in New York).

This payroll-as-economic-development policy is so pervasive that *of 310,700 net new jobs created statewide between 1990 and 2005, 48 percent were "tax-eating" jobs funded by the taxpayers.* In Upstate New York during the same period, tax-eating jobs constituted two-thirds of all net new jobs created.

Any job is better than no job, of course, and at first these tax-funded jobs provide at least an illusion of progress. But ultimately they drive taxes up, which holds *down* the number of private-sector jobs, which *weakens* the tax base, making it ever harder to pay for the taxpayer-financed jobs without ever-higher taxes and ever-more strain on the *tax-paying* side of the economy.

Albany must stop thinking of taxpayer-financed payrolls as an economic development policy.

The second element in Albany's effort to spend our way to economic growth is somewhat more promising — but stands in need of improvement. This is the use of state spending for direct economic

development projects that are intended to spur private-sector investment and job growth. All told, New York State's government spends at least \$1 billion a year in efforts of this kind — with mixed results.

Albany Nanotech is a shining example of a New York State success in this area. Building on a UAlbany research strength, it got substantial state funding, which helped attract private-sector investments, which helped it stake out a lead position globally in the development of chip design and other nanotechnologies. We need a stronger Centers of Excellence program that replicates this success elsewhere.

Other state investments have not paid off as demonstrably. Many of them have been designed primarily to give the impression of a quick state response to some bad economic news, such as a plant closing.

The best bet, in our view, is to make major investments, focused on high-tech or high-concept innovations, tied as closely as possible to nearby research universities that will help provide the intellectual depth needed to make new ideas succeed. And we think the key to getting the state's investment choices right is to take politics *out* of it, and bring the regional business leadership *in*.

The Legislature took a step in the right direction in 2005, with enactment of the Foundation for Science, Technology and Innovation legislation that allows regional business groups to apply for certification to plan the use of state economic development monies in their own regions. The state has been slow to actually create the Foundation, however. We will press hard for quick action on this — and for a major, private-sector role in targeting the state's investments.

We also believe the state needs to invest in basic research efforts at our universities, including investments not directly tied to an immediate economic purpose.

To that end, **we support the State University's request for a three-year, \$122.6 million Excelsior Research Faculty Initiative.** The state should undertake a parallel initiative to bolster the independent sector's strong tradition of research excellence, as well.

The cost of government

**High taxes, spending and debt
impose a burden on our
competitiveness that we
can no longer afford**

High taxes R us:

- ▶ New York ranks 1st in the nation in the overall burden of state and local taxes per capita — 48 percent above the norm.
- ▶ Apologists claim we can afford high taxes because we have higher incomes. But Census figures show that New York's median household income is only 1.9 percent above the national average.
- ▶ Local property taxes per capita in New York are 44 percent above average, 5th highest in the nation.
- ▶ The Tax Foundation ranks New York's state business tax climate as next-to-worst in the country.
- ▶ Gasoline taxes per gallon are 5th in the nation, 38 percent above the national average.
- ▶ New York's state and local debt per capita also ranks 1st in the nation — more than \$10,000 for every man, woman and child in the state.

The most important governmental development in New York State in 2005 came not from Albany, but from the voters. Presented with a proposed Constitutional amendment that posed a real risk of more runaway spending and taxes, the voters turned it down by nearly a 65-35 margin. The message couldn't have been more clear. New Yorkers are fed up with state government's profligate ways. They want *real* change.

The change that will make a difference for our economy is to **rein in debt, restrain spending, and cut taxes.**

Doing so is essential to the growth of our economy. That's because high-growth states are reasonable-tax states. And it's time New York accepted the fact. Go to www.ppinys.org/reports/jtf.btm, for example, and compare taxes and job growth by state from 1993 through 2003 (the most recent period for which comprehensive tax burden data are available).

The top 10 job-growth states (Nevada, Arizona, Florida, Utah, Idaho, Colorado, Texas, Montana and Georgia) rank, respectively, as 24th, 36th, 34th, 39th, 43rd, 19th, 33rd, 47th, 28th and 23rd in

per-capita state and local taxes. If New York wants to get *on* the list of high-growth states, it must get *off* the list of high-tax states — it's just that simple.

Budget reform must start with **debt reform**, because it's Albany's free-wheeling way with debt that initially allows the Legislature to spend more each year than the state's tax base is producing.

Like a spendthrift with a credit card, New York State borrows each year to pay for a lifestyle it can't really afford. Then the next year it finds that the cost of the new lifestyle has gone up, there's no more real money to pay for it, and meanwhile there's the added cost of paying off the loans. It's a vicious cycle that stands to get the state in deep, deep trouble.

We must break the credit card habit. **We support Comptroller Hevesi's comprehensive proposals to reform debt and bring borrowing under control.**

The Legislature might also consider real, enforceable, Constitutional limits on state and local spending and taxes. If budget "reform" in 2006 includes real restraint on *how much* the state borrows, taxes and spends, The Business Council could also support measures that would give the Legislature more say over *what* the state spends the money on.

Action to reduce state and local taxes need not await comprehensive budget reform, however. In addition to constraining the growth of taxpayer-financed payrolls (see previous section), we would give top priority to tax reduction efforts in two other areas.

First, reduce high local property taxes by easing costly mandates on localities. Start with reforms and flexibility in Medicaid — and with repeal of the Wicks Law.

Second, target new state tax reforms in ways that will get "the most bang for the buck" in attracting the investment, infrastructure and R&D activity New York needs for the innovation economy. Last year, for example, the Legislature took a step

forward by reforming our corporate tax to phase out the disadvantage long imposed on companies that operate in (as opposed to merely selling in) New York — and we believe the phase-out should be accelerated. Further important reforms would include:

- Phase out the 2.5 percent corporate **alternative minimum tax**, to strengthen the impact of our existing investment incentives.
- Immediately exempt the state's **R&D credit** from all minimum tax provisions.
- Exempt newly deployed **fiber optic** lines from local property taxes.
- And couple the state's **estate tax** to the federal tax, so that entrepreneurs will never find it a disadvantage to launch their start-ups in New York.

"We lost 14,000 more taxpayers, according to the Census Bureau. Why? Because of high taxes."

— Patrick Rauhen, *Williamsville Letter to The Buffalo News*

The cost of doing business

**It's taken far too long for
New York to cut some basic
costs of doing business**

New York's cost problems:

- ▶ New York's average cost of a workers' comp claim is 2nd highest in the nation — 40 percent above average.
- ▶ New York's average cost for employer-paid health insurance is 3rd highest in the nation — 10 percent above average.
- ▶ The average cost of commercial electricity in New York State is 43 percent above the national norm — 3rd highest in the country.
- ▶ We rank only 31st on the competitiveness index published by the Beacon Hill Institute (based on government fiscal policy, legal/regulatory system, infrastructure, labor force, technology, and finance).
- ▶ Overall, New York State ranks 9th highest on *Economy.com's* index of relative costs of doing business by state.

It's time for New York to have the brains to do the no-brainers. Putting it bluntly, that's the way a growing number of employers across New York State feel about Albany's inexplicable inability, year after year, to reform some of New York's outdated, self-destructive costs of doing business.

These issues — ranging from the “ladder law” to energy siting — are routinely referred to by business people, reporters and even many legislators as “no-brainers.”

As we try to position New York for the major leaps needed to get our people *Ahead of the Curve* in the new innovation economy, it's time to take care of these issues. New York doesn't have more years to waste. Let's just do it:

- **Workers' comp.** New York has a workers' comp system that somehow manages to combine high costs for employers (the average cost per claim is 40 percent above the national average) with relatively low benefits for workers.

Governor Pataki has proposed a sound, balanced reform package that addresses the needs of both workers and employers. It would raise the maximum weekly wage-replacement benefit from \$400 to \$500, or 25 percent, while cutting employers' costs by an estimated 15 percent. The Governor's reforms would, among other things, reduce the second injury fund assessment, authorize comprehensive fee schedules for medical costs, and create tiered benefit levels for injuries that are not currently “scheduled.”

The Governor's bill is a sound basis for Legislative action in 2006.

- **Energy costs.** New York needs to adopt a reasonable, cost-aware approach to issues that impact on energy costs — including power siting and environmental regulation. New York's half-finished policy on energy deregulation will not

be successful until the supply side of the energy equation is addressed. The state must also extend and reform its economic development power programs.

- **Health-care costs.** The soaring cost of the health insurance they purchase for their workers is the largest single concern of employers in New York.

A special state commission was created last year to consider ways of reducing excess capacity in the health-care system; if it is successful, that should hold down costs.

So should efforts to deliver improved information on which doctors, hospitals and procedures produce the best results. Increasingly, employers are using this data to design pay-for-performance systems that reward providers who deliver the

best care. Better care will also be bolstered if the state presses the initiative on “wiring the health-care system” — that is, creating electronic medical records, initiating electronic prescriptions and e-imaging — to speed the flow of information and reduce transaction costs.

We continue to support lower-cost Freedom Health Plans that would make it easier for employers to provide health insurance to their workers. Another way for New York to make a major dent in health-care costs is to **reform the tort laws applying to medical malpractice and to pharmaceutical liability.**

- **The scaffold law.** Section 240/241 of the Labor Law, sometimes known as “the ladder law” or “the scaffold law,” imposes absolute liability for work-site injuries, regardless of whether the employer was negligent. New York is the only state with such a provision, and it significantly drives up construction costs. **This law should be reformed this year.**

*“I grew up here. I like it here.
It just became too difficult
to do business here.”*

— *Western New York business owner Jay Klein, announcing he was moving his construction company out of New York*

Let Upstate be Upstate

Upstate's economy is being smothered by dictates from a Downstate political culture that thinks costs don't matter

Facing the facts about Upstate New York:

- ▶ Over the last 15 years Upstate has grown jobs only one-fourth as fast as the nation — and less than half as fast as comparable states like Ohio and Michigan.
- ▶ In the 2000 Census results, Upstate's population grew more slowly than all but two states, North Dakota and West Virginia. And 30 percent of Upstate's "new residents" during the period were prisoners.
- ▶ Between 1990 and 2000, Upstate's population between the ages of 20 and 34 dropped by almost one-quarter — a loss of 377,800 in this crucial age group.
- ▶ Upstaters pay about \$5 billion more each year in state and local taxes than they would if taxes per capita matched the national average. Yet average Upstate personal income is about 11 percent below the national average.

The connection between Upstate and Downstate has always been one of the joys of life in New York. A professional woman from Greenwich Village could visit the Finger Lakes in the fall, a father from Voorheesville could take his kids to Yankee Stadium — and both would feel, in some sense, at home. And the connection has been more than merely sentimental. Upstate businesses found their proximity to New York City's capital markets and specialized professionals a significant asset, while Downstate corporations found Upstate a good place to locate factories, back offices and R&D centers.

But in recent years the relationship has frayed, as Upstate's economy has lagged far behind Downstate, behind the U.S. overall, and even behind other "Rustbelt" states with similar economies, demographics, and weather. Third-quarter 2005 jobs numbers, for example, showed that employment in New York City and its suburbs had grown by 1.2 percent over the year before — compared to only four-tenths of a percent for Upstate.

What explains the gap? As the Public Policy Institute first observed in 2004, **the cost of doing business Upstate is heavily impacted by decisions flowing from the union-dominated and often anti-business politics of Downstate** — which controls two-thirds of the seats in the Legislature.

With its role at the center of the global economy, the New York City metropolitan area has less to fear from high costs. Upstate, on the other hand, is in the mix with Michigan and Virginia and other competitive places, and is forced to swim uphill against the burden of the unnecessarily high costs imposed by the Downstate political culture. Upstate is competing with states that have lower workers' comp costs, lower energy costs, lower taxes, less union domination of governmental policy, more reasonable Medicaid programs — all factors in which state government policy is tilted by Downstate political considerations. When downstate legislators can, for example, dictate the labor arrangements for the construction of a hotel project 245 miles away in Syracuse, Upstaters are tempted to think there is something vaguely colonial about the state's governmental process.

What to do? First, Upstate's economic troubles make it all the more important that New York State get its act together in the building blocks needed for the high-tech, innovation-driven economy of the future. Better schools, more math and science, and more intelligent economic development investments based largely on local decision-making — all these are even more important for Upstate than for the state as a whole.

Second, Upstate's vulnerability to high costs makes it all the more urgent that New York act to restrain the cost of state and local government. State spending and tax restraint, debt reform, and reforms in costly mandates on local governments (such as Medicaid, binding arbitration and the Wicks law) are all especially important to Upstate's chances for revival.

Third, reforming the "no-brainer" cost issues like workers' comp, energy, health care and 240/241 would have special value to the Upstate economy.

Truth to tell, Downstate, as well as Upstate, would benefit from action on all these fronts. But **if the Legislature persists in its refusal or inability to reform these matters statewide**, it should at least endeavor to find ways to "Let Upstate Be Upstate" — to apply policies Upstate that are more appropriate to its economic circumstances.

Upstate counties should be given the right to test alternative delivery mechanisms for Medicaid, as recently proposed by Chemung County. Counties and other local governments should be given the right to opt out of state mandates such as the Wicks law, and the binding arbitration provisions that now limit consideration of the localities' ability to pay in union contract disputes.

And employers Upstate would benefit if state policies on workers' comp, the scaffold law, brownfields, health care and energy were reformulated to take into account the special economic problems and the different cost environment of Upstate New York.

It's time for Albany to give Upstate a fighting chance to make its comeback.



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