MANAGING THE BUDGET IN THE BLOOMBERG ADMINISTRATION

A BACKGROUND PAPER PREPARED FOR THE
CITIZENS BUDGET COMMISSION CONFERENCE ON

"NEW YORK CITY'S CHANGING FISCAL OUTLOOK"

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FOREWORD

Founded in 1932, the Citizens Budget Commission (CBC) is a nonpartisan, nonprofit civic organization devoted to influencing constructive change in the finances and services of New York State and New York City governments. Careful research, presented in clear and easily understood reports, has been the major mechanism by which the Commission seeks to achieve these reforms.

However, on several occasions the CBC also has convened conferences in order to deepen understanding of important issues and help develop a broad consensus among opinion shapers on important policies. During the 1980s the CBC organized conferences to discuss annual volumes produced by the "Setting Municipal Priorities" project sponsored jointly by New York University and Columbia University. In January of 1989, with support from the NYNEX Foundation, the CBC commissioned five papers that were the basis for a day-long conference on "Future Shocks to New York," which considered the longer-run implications of issues such as changes in the financial services sector, the closing of landfills, and high rates of international immigration. In December of 1991 the Commission staff prepared background papers for an overnight conference it organized on "Restructuring New York City's Finances;" the objective was to help City officials develop fiscal policies to help sustain services during a difficult period of economic recession. In May of 1995 the Commission hosted another overnight conference as part of its "Budget 2000" project, with a goal of refining and broadening support for a set of "Guiding Principles for Changing Times" that the Trustees had formulated.

Early in 2001 the Commission's leadership foresaw a need for a conference to be held after the municipal elections. We recognized that the fiscal outlook was likely to change as the period of unprecedented national economic growth ended and the operating surplus generated in that period of prosperity was consumed by current expenses during the election year. The Charles H. Revson Foundation, the Nathan Cummings Foundation, and the Robert Sterling Clark Foundation generously agreed to help fund such a conference, and the CBC is grateful for their support. The tragic events of September 11, 2001 came after plans for the conference were underway, but added significantly to the importance of this event.

This background paper for the conference was developed with my guidance and under the direction of Diana Fortuna, President of the Commission. Marcia Van Wagner, Deputy Research Director, took the lead in preparing a first draft. She benefited from research support from Elizabeth Lynam, Senior Research Associate; Douglas Offerman, Senior Research Associate; Cynthia Searcy, Research Associate; and Ben Seigel, Research Consultant. Charles Brecher,

Director of Research, worked with Diana Fortuna and Marcia Van Wagner in the design of the paper, wrote portions of it, and helped edit the final product. The staff thanks three knowledgeable and devoted New Yorkers who took time to review a preliminary draft and made many helpful suggestions: Kathleen Grimm, Raymond D. Horton and Jeffrey Sommer. They bear no responsibility for any errors of fact or interpretation.

The background paper is available in electronic form on the CBC website at www.cbcny.org.

Eugene J. Keilin, Chairman
Citizens Budget Commission
November 29, 2001

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EXECUTIVE SUMMARY

The Citizens Budget Commission's conference on "New York City's Changing Fiscal Outlook" is intended to: (1) promote understanding of the nature and magnitude of the fiscal problems confronting the City of New York as its government changes hands at the end of 2001; (2) stimulate development of a consensus among opinion shapers on the strategies that are necessary to confront successfully these challenges.

This background paper is organized into four sections. The first describes the origins and size of the budget gap facing the incoming Bloomberg Administration. The second analyzes the ways in which three previous mayors—Edward I. Koch, David N. Dinkins, and Rudolph W. Giuliani—managed the City's operating and capital budgets. The third addresses City-State relations. The final section presents recommendations for reaching long-term goals of recurring budget balance and improving the economic competitiveness of New York City.

THE CHALLENGE TO THE BLOOMBERG ADMINISTRATION

Even before Michael Bloomberg takes office on January 1, 2002, he will be devoting much attention to the financial plan due within a month of inauguration. This plan will indicate how the administration will address a gap estimated at between $1.2 and $1.6 billion for the fiscal year 2002 and at least $4 billion for upcoming fiscal year 2003.

Why Are Things So Bad?

The obvious answer is the terrorist attacks of September 11. But this is a potentially misleading answer, because much of the problem derives from other sources.

The budget adopted for fiscal year 2002 in June 2001 contained one egregious fiscal policy error and one understandable misjudgment. The error was to allocate $2.5 billion of a $2.8 billion accumulated surplus, generated when revenues exceeded projections in a booming economy, to support operating expenditures during fiscal year 2002. By using the surplus to support ongoing expenses, City officials were creating a budget problem in the next year when the surplus was no longer available.

The misjudgment related to assumptions about the national and local economies. It assumed no national recession in 2001 or 2002. This scenario proved too optimistic; it now is known that the nation began a recession in March 2001. Even before the events of September 11, the City would have had to bring down its revenue projections in light of emerging national economic trends.

The magnitude of the revenue losses following September 11 is now being estimated and will not be certain for several months. Preliminary estimates by the City's Office of Management and Budget, the City Council, and the Independent Budget Office put the figure at between $569 million and $1,000 million for fiscal year 2002; and between $890 million and $1,800 million for

fiscal year 2003. Based on these estimates, the gap in the current fiscal year is at least $1,194 million and as much as $1,625 million. The range grows to $4,044 million to $4,954 million next year. It should be emphasized that up to half the shortfall in the current fiscal year and at least two-thirds of the gap in 2003 are due to events unrelated to the terrorist attacks.

Is This Worse Than What Other New Mayors Faced?

The current term “budget gap” did not exist when the fiscal crisis emerged in 1975. But if a budget gap had been calculated in fiscal year 1976, it would have been the largest on record. In that year the City borrowed $1.2 billion to support its operating budget, an amount equal to 19 percent of all City-funded expenditures.

By comparison, the fiscal year 2003 gap that Mayor Bloomberg faces represents 13 to 16 percent of projected City-funded expenditures. However, unlike Mayor Bloomberg, Mayor Beame did not have to close the larger gap by the start of the next fiscal year. Under the State legislation that governed the City’s finances, the operating budget did not have to be balanced until fiscal year 1982 and borrowing could be used in the interim.

The first financial plan that Mayor Koch prepared after his inauguration in 1978 revealed a gap of 8.6 percent of City-funded expenditures for fiscal year 1978 and a larger gap of 11.4 percent in the upcoming fiscal year 1979. But again, the target was a balanced budget in fiscal year 1982. The gap Mayor Koch closed in three years (one year early) was smaller than the one Mayor Bloomberg must close in less than one year.

Incoming Mayor Dinkins faced a serious fiscal challenge in fiscal year 1990, both an election year and a year when a deep recession began. That fiscal year, actual tax revenues turned out to be $780 million less than expected in the adopted budget. Mayor Dinkins was obliged to close this gap during the last half of the fiscal year, fighting a moving target in the form of a deteriorating economy. While formidable, the gaps Mayor Dinkins faced were smaller than those initially facing Mayor Koch and now facing Mayor Bloomberg.

When Mayor Giuliani took over in fiscal year 1994, he inherited a current year budget that was balanced, but a looming gap equal to 9.6 percent of City-funded expenditures for the next year and rising to 12.7 percent in the subsequent year. These gaps represented a serious challenge, but were smaller than those facing Mayor Bloomberg in January 2002.

MANAGING THE BUDGET: A TALE OF THREE MAYORS

An analysis of the experience of the last three mayors points to two basic conclusions.

- *The economic conditions during a mayor's administration strongly shape the basic fiscal policies of that administration*. There have been periods of boom and bust in the local economy. Not surprisingly, in good times the City's government grows and in bad times expenditures must be constrained. However, the expenditure growth often exceeds sustainable levels, and the contraction is imprudently delayed with fiscal gimmicks.

- *Within the broader economic constraints, a mayor can achieve selected policy objectives*. Spending need not rise or fall in an across-the-board fashion; mayors can and do focus on their favored services (and not all mayors favor the same services) for improvement in times of expansion and for protection in periods of cutbacks.

The Operating Budget

From an economic vantage, the city's bad times were the period during which Mayor Koch had to bring the budget into balance in the aftermath of the fiscal crisis, and the period during which Mayor Dinkins faced a deep recession. The city's economic good times were during Mayor Koch's second and third terms and during Mayor Giuliani's two terms.

Mayor Koch. In the time of contraction, overall operating expenditures in constant dollars fell 15 percent, real compensation per worker fell 7 percent, and the number of municipal workers fell 1 percent. This was reversed in the better times, when real spending eventually exceeded the 1978 level, real compensation per worker increased more than one-third to exceed earlier levels, and the number of workers increased nearly 47,000 to reach 243,090. In the time of contraction, public safety was cut at an above average rate, but during the period of expansion it and the public schools were favored while debt service declined and the "all other" category of services had very limited growth.

Mayor Dinkins. Mayor Dinkins reduced the number of municipal workers 3 percent and their average real compensation 6 percent. Mayor Dinkins and the City Council added taxes that generated more than $1.8 billion annually by the end of his term. Without these increases, constant-dollar tax revenues would have declined nearly 7 percent from fiscal year 1990 to fiscal year 1993. In his term, total expenditures in constant dollars rose 4 percent as debt service and social welfare obligations grew.

Mayor Giuliani. After constant dollar expenditure cuts of 2 percent during his first term, Mayor Giuliani and the Council increased real spending more than 11 percent in the second term. The number of City workers was reduced early in his first term but then increased to nearly 250,000 in fiscal year 2001, 6,600 more than when he took office. Adjusted for inflation, compensation per worker increased more than 6 percent in Mayor Giuliani's second term to reach a higher level than when Mayor Koch left office.

If Mayor Giuliani's overall fiscal policy followed the boom and bust pattern, his priorities for the use of resources were much more consistent. The Police Department and the Board of Education received favored treatment in both terms. In addition, Mayor Giuliani distinguished himself from his predecessors by seeking tax cuts worth more than $2.2 billion annually.

The Capital Budget

The mayors' management of the City's capital budget evidences the same two broad conclusions as their handling of the operating budget. Each mayor has had to accommodate the size of his capital program to the prevailing economic conditions. In the early years of the Koch Administration, borrowing was restrained due to the City's limited capital market access. In his second term, total constant dollar (2000) commitments rose to $11.0 billion. In his third term, the trend accelerated and total adjusted commitments jumped to $19.2 billion.

Mayor Dinkins could not sustain this high level of capital investment in the face of an economic downturn. He pared the capital budget in his early years, and total constant (2000) dollar commitments during his term fell from Mayor Koch's $19.2 billion to under $19.0 billion.

In his first term, Mayor Giuliani's capital budget, like the expense budget, showed real declines. However, as the economy improved, Mayor Giuliani expanded the capital budget as well as the operating budget during his second term. The four-year total of capital commitments are planned to jump to a constant (2000) dollar sum of $23.5 billion, exceeding that of Mayor Koch's third term and 27 percent above Mayor Giuliani's own first term.

The allocation of capital commitments changed as each Mayor shaped his legacy. During Mayor Koch's first two terms, commitments were driven largely by available intergovernmental aid in areas such as transportation and the water system. In his third term, Mayor Koch made a distinctive and pronounced priority of housing, increasing its share of the total capital program from 2 to 14 percent.

Under Mayor Dinkins, the capital priority was education. Between fiscal years 1991 and 1993, the annual capital commitment to education increased 71 percent and the share of the total capital program for education rose from 10 to 23 percent

The composition of the capital program in Mayor Giuliani's first term shifted toward environmental protection. In his second term, Mayor Giuliani continued to invest in environmental protection at a high level, and increased funding for education to nearly one-quarter of the capital program.

CITY-STATE RELATIONS

While mayors can assert priorities in the City's operating and capital budgets, they must always be attentive to possible interventions by State officials. The City of New York is legally a "creature of the State," and the State Legislature decides how the City operates in a wide variety of ways.

Although the range of possible actions is extensive, the two major conflicts between the City and State with large fiscal implications are: (1) obtaining a "fair share" of State aid for the City, especially education aid, and (2) reducing the amounts the City is "mandated" to spend for certain programs, notably Medicaid and pension contributions.

A Fair Share of Aid

The largest component of State aid is for the public schools. State education aid to the City of New York totaled $5.7 billion in fiscal year 2001, representing 71 percent of all State categorical aid and 44 percent of all intergovernmental aid. State education aid to the City of New York has also been increasing rapidly, more than doubling in constant dollars since 1978 and up 32 percent between fiscal years 1998 and 2001.

Despite the growth, there is a strong argument that New York City does not receive a fair share of the State's total education aid. Its current share is 37 percent. This is equal to the City's share of statewide public school enrollment, but much farther below the City's share of "need" as gauged by multiple indicators. For example, 84 percent of New York City public elementary school students qualify for free lunches compared to 48 percent statewide, and 16 percent of New York City students have limited English proficiency compared to 8 percent statewide.

For most of the last two decades the City made slow but steady progress in gaining a more equitable distribution of education aid. From fiscal year 1981 to 1990 its share of total State education aid rose from 30 to 38 percent. After a slight falloff in the early 1990s, the share reached a peak again at 38 percent in fiscal year 1995. Since then the share has fallen to 37 percent. The recent decline is due in part to passage of the State Tax Reduction (STAR) program, effective beginning in fiscal year 1999. This form of aid is allocated among districts not on the basis of educational needs, but on the basis of real estate values and the share of property taxes allocated to education. New York City's share of STAR payments has been 20–25 percent and will not exceed 27 percent at full implementation, well below the proportion given New York City under more traditional forms of school aid.

Mandate Relief

The clearest and largest example of the spending burden that New York State places on its local governments is Medicaid. Medicaid provides federal funds to aid states in purchasing medical care for the indigent. For New York, the federal matching rate is 50 percent. However, New York State is unusual in the way it finances the nonfederal share of Medicaid. It requires counties, including the City of New York, to pay half the nonfederal share for acute care services

and 10 percent for long-term care. Only about a dozen states require any local contribution, and none requires such a significant one. Consequently, New York City paid $3.1 billion for its share of Medicaid in fiscal year 2000. This meant that 11.5 percent of all City-fund revenue was used to meet this mandate.

Another large expenditure item that can be viewed as a mandate is pension fund contributions. While the mayor negotiates with unions over wages and most fringe benefits, pension benefits are set by State legislation and are protected by the State Constitution. The State Legislature can and does enhance pension benefits under pressure from unions, often outside of (or despite) the mayor's negotiated agreements. While the Legislature sets the benefits, the City must make the annual pension fund contributions that finance the retirees' benefits. In this way, legislated pension benefit enhancements are effectively a costly mandate upon the City.

GOALS FOR THE BLOOMBERG ADMINISTRATION

Mayor Bloomberg's challenge is not just to get through an initial troublesome period. The goal should be to weather this storm in a way that permits the City to be in a position four years from now to have a balanced budget, a competitive tax system, and services that satisfy residents. This requires basic changes in tax policy, operating expenditures, and capital investments.

These recommendations cannot be fully implemented in time to close the fiscal year 2003 budget gap. Necessary and painful interim steps could include service cuts, tax increases (temporary or otherwise), labor concessions, and extraordinary actions such as borrowing to cover an operating deficit. Municipal leaders should consider carefully what is in the City's long-term interest and should build a broad political consensus for the right balance among the options. Yet, unless progress is made in achieving the long-term goal stated above, the pattern of boom and bust characterizing mayoralties will persist and the City will again be ill-prepared when another crisis arises.

Tax Policy: Cutting and Sharing

The basic problem tax policy should address is that New York City imposes a tax burden on its residents and businesses that is higher than in nearly all other large U.S. cities. New Yorkers pay high taxes for two reasons. First, services are produced inefficiently. Second, New York City taxpayers are obliged to pay for services to others because of State mandates and restrictions.

In order to stop New York City taxpayers from having to pay for services to others, the City should again be granted authority to impose a commuter tax. This tax, at the modest rate of 0.45 percent that prevailed until 1999, would yield about $500 million annually.

The new administration should also pursue a four-year strategy to realign responsibility for financing Medicaid and public assistance in New York State. New York City families and businesses would pay their share, but it would be based on how much they earned (via the State

income tax) or spent (via the State sales tax), not on how many poor people lived in their municipality.

A farsighted administration will also look beyond the borders of New York State for opportunities to share the tax burden equitably. The rapid relocation of firms displaced by the attacks on the World Trade Center highlighted that for many purposes nearby parts of New Jersey serve as an adjunct to the Manhattan central business district. The problem is the artificial boundaries of tax jurisdictions, and they could be overcome. Tax sharing between parts of New Jersey and New York could be accomplished through a variety of mechanisms including special tax districts or a new combined entity to finance transportation facilities now in the separate hands of the Port Authority, New Jersey Transit and the Metropolitan Transportation Authority.

Expenditure Policy: Productivity, Not Priorities

The often-repeated advice to chief executives facing difficult times is “set priorities.” The analysis of expenditure changes under three mayors showed that New York City's chief executives do set spending priorities. The tougher mayoral challenge is to oblige leaders in all agencies to focus on doing their job more productively. Previous research by the Citizens Budget Commission has identified five measures that would greatly enhance municipal productivity:

1. Set pay levels in response to labor market conditions. The basic strategy should be to divide civil service positions into three categories, each with a different wage policy.

a. Occupations with an abundant supply of applicants. The labor market signal for them is clear; higher real wages are not needed.

b. Shortages without wage disparities. In many cases, the issue is not primarily wages. For example, engineers appear to be hard to recruit primarily because of the City's hiring practices rather than low entry salaries. For this group, the City’s recruitment and hiring practices, and its working conditions, should be changed, but wages may need only to keep pace with inflation.

c. Shortages that require significant wage increases. A third group of positions has basic salaries clearly out of line with the private sector. These pay disparities are causing labor shortages, which, in turn, harm the quality of public services. In these instances, substantial real wage increases should be provided.

Some, but not all, public school teaching positions fall in the third category. Only about 17 percent of the Board’s nearly 80,000 teachers work in specific fields and schools that face a serious shortage. Most teachers are not in a shortage position and should not receive large raises in an “across the board” fashion. Outside of education, there are about 16,000 workers in the shortage category in 129 different job titles.

2. Change work processes to lower the unit cost of services. The wage policies recommended above would help bring the cost of labor into line with other places, but two additional steps should be taken to use labor more efficiently: (a) encourage more efficient work rules by sharing the savings from productivity initiatives with workers; (b) facilitate managerial initiatives to revise work processes.

3. Shift the emphasis in pay scales from longevity to performance by adding a merit pay component to wages. While the CBC encourages base wage increases for some shortage positions and in exchange for productivity initiatives, merit pay also should reward efforts by workers that lead to higher quality services.

4. Modernize the health insurance program for municipal workers and retirees. The municipal health insurance program is more expensive for the City and for workers than it needs to be. It has not kept pace with contemporary movements toward two key cost containment strategies: (a) premium cost-sharing; (b) price competition among insurance plans.

5. Restructure the pension system for newly employed workers to provide a defined contribution rather than a defined benefit. The current defined benefit pension system puts the City of New York at a financial disadvantage in both good and bad economic times, opens the door for abuses, and places the City at a disadvantage in today's job market. In order to promote the dual goals of becoming a more attractive employer to younger workers and of protecting itself from fiscal risks and abuses, the City should use collective bargaining to achieve two changes in its pension systems: (*a) For current employees, prohibit benefit enhancements outside of collective bargaining. (b) For newly hired workers, establish a new defined contribution plan.*

Capital Investments: A Smarter, Not a Larger, Capital Program

In encouraging greater labor productivity, enlightened managers urge that people "work smarter, not harder." A parallel philosophy should be applied to capital investments. The capital budget should be smarter, not necessarily bigger and more expensive.

One key element in this strategy is to create facilities that can be used more intensively. Businesses that seek to expand production do not seek first to build new plants; instead they operate existing ones for longer hours with extended and weekend shifts. The same logic can be applied in a smart and selective fashion to public facilities. The clearest example is schools, where overcrowding can be alleviated through scheduling educational activities on a year-round basis instead of just 180 days per year. Year-round schooling can make better use of existing and planned buildings, eliminating the need for some new school construction.

Another smart way to reduce the need for new capital spending is to maintain better existing facilities. The City's abysmal record of maintaining its capital assets, particularly during the 1960s and 1970s, contributed to the urgency of capital spending needs today. Regular and timely maintenance can delay and avoid substantially more expensive renovation or replacement.

Finally, smart capital planning is more likely to occur if there is a clear limit on the amount the City can borrow for capital projects. If borrowed funds are seen as a limitless resource, then projects will not be reviewed as carefully as they should be. A new State constitutional amendment is needed to place a clear, comprehensive and realistic limit on all municipal borrowing.

INTRODUCTION

The Citizens Budget Commission (CBC) has organized a conference on "New York City's Changing Fiscal Outlook." Its purposes are: (1) to promote understanding of the nature and magnitude of the fiscal problems confronting the City of New York as its government changes hands at the end of 2001; (2) to stimulate development of a consensus among opinion shapers on the strategies that are necessary to confront successfully these challenges. While the CBC planned this conference before the terrorist attacks of September 11, those horrific events intensified the need for thoughtful deliberation of the options available to maintain the City's fiscal health in the wake of those attacks and their aftershocks.

This paper has been prepared as background for the conference discussions. It is organized into four sections. The first describes the origins and size of the budget gap facing the incoming Bloomberg Administration and indicates why it is more serious than those faced by previous incoming mayors. The second analyzes the ways in which three previous mayors—Edward I. Koch, David N. Dinkins, and Rudolph W. Giuliani—managed the City's operating and capital budgets. The third addresses City-State relations with emphasis on the need for the Mayor to deal constructively with inequities in State education aid and the fiscal burden of mandated expenditures.

The final section presents the CBC's recommendations for reaching long-term goals of recurring budget balance and improving the economic competitiveness of New York City. These suggestions do not comprise a detailed plan for closing next year's budget gap, but rather are strategies that, if followed over the next four years, would put the City in a position of enduring fiscal strength. The CBC hopes the analysis and recommendations in this paper will inform and stimulate discussion among the participants at the conference.

THE CHALLENGE TO THE BLOOMBERG ADMINISTRATION

Even before Michael Bloomberg takes office on January 1, 2002, he will be devoting much attention to the preliminary budget and four-year financial plan due within a month of inauguration. This plan will indicate how the Bloomberg Administration will address a gap estimated in November 2001 at between $1.2 and $1.6 billion for the nearly half-completed current fiscal year 2002 and at least $4 billion for upcoming fiscal year 2003.

WHY ARE THINGS SO BAD?

An effective solution to a problem generally requires a good understanding of why it arose. In the case of municipal fiscal problems this is complicated by the fact that New York City financial plans typically project budget gaps, but in recent years they have been closed with seemingly little effort and no sacrifice from citizens. Why is the situation different now?

The obvious answer is the terrorist attacks of September 11. But this is a potentially misleading answer, because much of the problem derives from other sources. The terrorist attacks worsened a pre-existing problem. They are not exclusively, or even primarily, the cause of the current fiscal challenge.

The budget adopted for fiscal year 2002 by Mayor Giuliani and the City Council in June 2001 contained one egregious fiscal policy error and one understandable misjudgment. The error was to allocate $2.5 billion of a $2.8 billion accumulated surplus, generated when revenues exceed projections in a booming economy, to support operating expenditures during fiscal year 2002. This permitted planned expenditures to grow 3.9 percent and the municipal payroll to reach 250,000 employees in June 2001 and rise to 255,000 at the end of June 2002. A more prudent approach would have been to use the surplus for capital investments or other appropriate one-time objectives. By using the surplus to support ongoing expenses, City officials were creating a budget problem in the next year when the surplus was no longer available. As a result, the budget adopted in June was balanced for this fiscal year, but left a gap of nearly $2.8 billion in fiscal year 2003. (See Table 1.)

The misjudgment in the adopted budget related to assumptions about the trajectory of the national and local economies. It assumed no national recession in 2001 or 2002. The local economy was projected to slow in 2001 and to contract 0.8 percent in 2002. As a result, local tax revenue would fall 2 percent in fiscal year 2002. This scenario—considered reasonable when it was developed in the late spring—proved too optimistic. It subsequently became clear that the nation entered a recession in March. Even before the events of September 11, it is likely that the City would have had to bring down its revenue projections in light of emerging national economic trends.

Other developments also adversely affected the current and future years' budgets. Another "one-shot" revenue valued at $250 million that the City was relying on in fiscal year

2002, the sale of the Off Track Betting Corporation, became unlikely. Measures that the State was expected to approve, including restoration of aid to replace the stock transfer tax and other aid measures, did not materialize, creating another hole of nearly $240 million in this and succeeding years. Then the Mayor reached a collective bargaining agreement with several uniformed services unions that exceeded the amount in the labor reserve in the budget by $150 million annually.[1] Excluding revenue losses due to the deepening national recession, the actions taken prior to September 11 created a budget problem of about $625 million in the current year and more than $3.1 billion in fiscal year 2003.

Table 1
City of New York
Size and Sources of the Budget Gap, Fiscal Years 2002 and 2003
(dollars in millions)

	Fiscal Year	
	2002	**2003**
Adopted Budget, June 2001	**$0**	**$2,778**
Actions Before September 11	**$625**	**$376**
Loss of OTB Sale	250	0
Loss of Stock Transfer Aid	114	114
Loss of Other Budgeted Aid	145	145
Uniformed Labor Settlement	150	152
Expense Savings	(34)	(35)
Revenue Losses from Attacks and Recession	**$569 - $1,000**	**$890 - $1,800**
Total*	**$1,194 - $1,625**	**$4,044 - $4,954**

Sources: City of New York, Office of Management and Budget, *Financial Plan Update: Fiscal Implications of the September 11, 2001 Terrorist Attack,* October 9, 2001; City of New York, City Council Finance Division, *Budget Gap Analysis: Implications of September 11th, 2001*, October 31, 2001; and City of New York, Independent Budget Office, "Tax Revenue Update: City Faces Significant Shortfalls from Adopted Budget," *Fiscal Brief*, November 2001.
* Total does not reflect available resources of $200 million in the General Reserve for fiscal year 2002 and $345 million of unallocated prior-year surplus.

Then the hijacked airliners struck the World Trade Center towers, killing thousands of people. The immediate economic consequence was a closing of the New York Stock Exchange for four days, suspension of air travel and a collapse of the tourism industry, and the relocation of

[1] Fiscal monitors have identified additional revenue and spending assumptions in the City's current financial plan that may prove unrealistic, including higher airport rental payments and higher payments in lieu of taxes for the World Trade Center from the Port Authority. See State of New York, Office of the State Deputy Comptroller for the City of New York, *Review of the Four-Year Financial Plan for Fiscal Years 2002 Through 2005,* Report 4-2002, (July, 2001), and New York State Financial Control Board, *City in Transition: Staff Report,* July 11, 2001.

about 100,000 jobs from lower Manhattan.[2] The attacks and subsequent declaration of war on terrorist forces caused a loss of consumer and business confidence that accelerated the emerging national recession. The stock market declined rapidly, and the financial services sector, concentrated in New York City, suffered losses in employment and profits.

The magnitude of the revenue losses following September 11 is now being estimated and will not be certain for several months. Preliminary estimates by the City's Office of Management and Budget put the figure at $1 billion relative to the adopted budget for fiscal year 2002; the City Council estimates $645 million for fiscal year 2002 and $890 million for fiscal year 2003; and the City's Independent Budget Office projects between $569 and $925 million in fiscal year 2002, and between $1.0 and $1.8 billion in fiscal year 2003. Based on these estimates, the gap in the current fiscal year is at least $1,194 million and as much as $1,625 million. The range grows to $4,044 million to $4,954 million next year. It should be emphasized that up to half the shortfall in the current fiscal year and at least two-thirds of the gap in 2003 are due to events unrelated to the terrorist attacks.

The estimates summarized in Table 1 do not reflect substantial added expenditures related to the rescue, recovery, and clean-up work at the World Trade Center site, as well as new security measures undertaken since the attacks. The Office of Management and Budget has a preliminary estimate of $11.4 billion in combined operating and capital expenditures related to the attacks spanning fiscal years 2002 and 2003.[3] Federal officials have indicated that there will be federal reimbursement of all legitimate disaster-related costs, although the amount and timing of that reimbursement is not yet clear. It is reasonable to assume that due to federal aid these amounts will not add to current and future budget gaps, but there is a danger that disputes between the City and the federal agencies could leave some expenses unreimbursed.

IS THIS WORSE THAN WHAT OTHER NEW MAYORS FACED?

Michael Bloomberg is not the first mayor to face a serious fiscal problem on inauguration day. The CBC was founded in 1932 amidst a fiscal crisis arising when Mayor James Walker could not adjust the City's finances to an economic depression. He left office in a scandal, and in 1933 newly elected Mayor Fiorello H. LaGuardia inherited a fiscally distressed City that required him to impose "payless paydays" for municipal workers as well as other measures. Aggressive federal aid programs under the Roosevelt Administration and the economic stimulus of World War II eventually helped the City of New York to regain a solid financial footing.

New York City grew and prospered in the period of national growth that followed World War II. But as urban flight accelerated in the 1960s, in his third term Mayor Robert Wagner engaged in deficit borrowing and appointed a Temporary Commission on City Finances to

[2] New York City Partnership, "Working Together to Accelerate New York's Recovery: Economic Impact Analysis of the September 11th Attack on New York City," November 13, 2001; see also City of New York, Office of the Comptroller, *The Impact of the September 11th WTC Attack on NYC's Economy and City Revenues,* October 4, 2001.
[3] City of New York, Office of Management and Budget, *Financial Plan Update: Fiscal Implications of the September 11, 2001 Terrorist Attack*, October 9, 2001.

develop a strategy to restore the City to fiscal health. It was his successor, Mayor John Lindsay, who overcame the deficits by adopting many of the Commission's recommendations including a new municipal income tax. Then Lindsay himself engaged in borrowing to finance an expanding budget during the recession of the early 1970s.

Lindsay's successor, Mayor Abraham D. Beame, did not promptly face up to the problem he inherited. Instead he continued and expanded the practice of borrowing to meet operating deficits. After it became clear that Mayor Beame had no plan for achieving a balanced budget, lenders called a halt to the practice of unquestioned borrowing. After the credit markets closed to the City in March of 1975, the State created the Municipal Assistance Corporation to borrow on behalf of the City. Then in September of 1975 a Financial Control Board was established to oversee the development and implementation of a plan to curb the City's borrowing and bring its budget into balance.

From the fiscal crisis of 1975 to inauguration day on January 1, 1978, Mayor Beame, under pressure from the Financial Control Board, took dramatic steps to help bring the City's budget under control. Thousands of workers were laid off and positions were eliminated by attrition, fringe benefits were curbed, and obligations for funding the senior colleges of the City University, the courts and some welfare benefits were passed from the City to the State.

The current term "budget gap" did not exist when the fiscal crisis emerged. It was not until fiscal year 1978 that the City began keeping its books following generally accepted accounting principles and began preparing the periodically revised, four-year financial plans that indicate the size of future budget gaps. But if a budget gap had been calculated in fiscal year 1976, it would have been the largest on record. In that year the City borrowed $1.2 billion to support its operating budget, an amount equal to 19 percent of all City-funded expenditures.[4] By comparison, the fiscal year 2003 gap that Mayor Bloomberg faces represents a substantial, but smaller, 13 to 16 percent of projected City-funded expenditures. However, unlike Mayor Bloomberg, Mayor Beame did not have to close the enormous gap by the start of the next fiscal year. Under the State legislation that governed the City's finances, the operating budget did not have to be balanced until fiscal year 1982. The budget could be financed with borrowing for several years while a plan was developed to balance the budget in a sustainable way.

The first financial plan that Mayor Koch prepared after his inauguration in 1978 revealed a gap of $763 million or 8.6 percent of City-funded expenditures for fiscal year 1978 and a larger gap of 11.4 percent in the upcoming fiscal year 1979. (See Table 2.) But again, the target was a balanced budget in fiscal year 1982, when the projected gap was 9.3 percent. To his credit, Mayor Koch balanced the budget one year early, in fiscal year 1981. But it is important to keep in

[4] The City expense budget consists of items paid for with intergovernmental aid and items paid for with locally raised (or "City-funded") resources. Intergovernmental aid is paid by the State or federal government to cover specific items, so eliminating an intergovernmentally financed expense also sacrifices that revenue and does not help close a budget gap. Thus, it is most appropriate to measure the size of budget gaps relative to the City-funded portion of the expense budget. The fiscal year 1976 data are from Charles Brecher and Raymond D. Horton with Robert A. Cropf and Dean Michael Mead, *Power Failure: New York City Politics and Policy Since 1960* (New York: Oxford University Press, 1993), pp. 22–25.

mind that the gap Mayor Koch closed in three years was smaller than the one Mayor Bloomberg must close in less than one year.

After Koch balanced the budget, projected gaps still emerged, but these were small relative to those of the fiscal crisis, and they proved to be manageable in a time of relatively rapid economic growth. The gap for the coming year in the financial plan Mayor Koch prepared at the start of his second term was 7.6 percent of City-funded expenditures, and the comparable figure from the plan at the start of his third term was 3.7 percent.

Incoming Mayor Dinkins was the next to face a serious fiscal challenge. The data in Table 2 only partly reveal the magnitude of the problem arising in fiscal year 1990. That was both an election year and a year when a deep recession began. As the economic picture worsened, the budget had to be repeatedly revised to reflect the falling revenues. That fiscal year, the actual tax revenues turned out to be $780 million less than initially expected in the adopted budget. Dinkins was obliged to close this gap during the last half of the fiscal year, fighting a moving target in the form of a deteriorating economy. While formidable, the gaps Mayor Dinkins faced were smaller than those initially facing Mayor Koch and now facing Mayor Bloomberg.

When Mayor Giuliani took over from Mayor Dinkins in fiscal year 1994, he inherited a current year budget that was balanced, but a looming gap equal to 9.6 percent of City-funded expenditures for the next year and rising to 12.7 percent in the subsequent year. These gaps reflected the still slow growing economy and Mayor Dinkins' heavy reliance on one-time revenue sources during the election year. These gaps represented a serious challenge, but are smaller than those facing Mayor Bloomberg this year.

By the start of Mayor Giuliani's second term the economy was reviving and tight control on expenditures had made future year gaps much more manageable. In January of 1998 the re-elected Mayor faced a gap for the coming year of a relatively modest 2.6 percent. As events unfolded, the economy outpaced expectations, and the gaps in the later years turned to surpluses.

In sum, a brief review of the budget gaps inherited by previous mayors reveals that the problem confronting Mayor Bloomberg is greater than any since the mid-1970s fiscal crisis under Mayor Beame. While the gap initially addressed by Mayor Koch was close in size to the current one, Mayor Koch had a longer period in which to close it. The gaps faced by subsequent new mayors were also large, but smaller than the current one.

Table 2
Preliminary Budget and Financial Plan in Inaugural Years, 1978 - 1998
(dollars in millions)

	Inaugural	Financial Plan Period			
	Year	Year 1	Year 2	Year 3	Year 4
Koch - First Term	1978	1979	1980	1981	1982
Planned Spending	$14,066	$14,217	$14,512	$14,750	$15,129
Planned City-fund Spending	8,836	8,935	9,023	9,091	9,259
Budget Gap	**($763)**	**($1,022)**	**($1,104)**	**($1,063)**	**($954)**
As a % of planned City-fund spending	**8.6%**	**11.4%**	**12.2%**	**11.7%**	**10.3%**
Actual Expenditures	$13,571	$12,892	$13,493	$13,758	$15,096
Koch - Second Term	1982	1983	1984	1985	1986
Planned Spending	$14,934	$15,913	$16,608	$17,227	$17,834
Planned City-fund Spending	10,064	11,183	11,828	12,340	12,838
Budget Gap	**$0**	**($854)**	**($1,022)**	**($870)**	**($735)**
As a % of planned City-fund spending	**0.0%**	**7.6%**	**8.6%**	**7.1%**	**5.7%**
Actual Expenditures	$15,096	$15,564	$16,992	$18,732	$20,155
Koch - Third Term	1986	1987	1988	1989	1990
Planned Spending	$20,418	$21,587	$22,813	$23,720	$24,520
Planned City-fund Spending	13,980	15,608	16,775	17,650	18,412
Budget Gap	**$0**	**($577)**	**($1,149)**	**($1,018)**	**($849)**
As a % of planned City-fund spending	**0.0%**	**3.7%**	**6.8%**	**5.8%**	**4.6%**
Actual Expenditures	$20,155	$21,239	$22,760	$24,295	$26,087
Dinkins	1990	1991	1992	1993	1994
Planned Spending	$26,583	$28,256	$29,825	$31,245	NA
Planned City-fund Spending	18,530	20,027	21,256	22,313	NA
Budget Gap	**($295)**	**($1,018)**	**($1,322)**	**($934)**	**NA**
As a % of planned City-fund spending	**1.6%**	**5.1%**	**6.2%**	**4.2%**	**NA**
Actual Expenditures	$26,087	$27,702	$28,474	$30,311	NA
Giuliani - First Term	1994	1995	1996	1997	1998
Planned Spending	$31,735	$33,006	$34,439	$35,389	$36,433
Planned City-fund Spending	21,906	23,586	24,887	25,709	26,619
Budget Gap	**$0**	**($2,261)**	**($3,167)**	**($3,253)**	**($3,316)**
As a % of planned City-fund spending	**0.0%**	**9.6%**	**12.7%**	**12.7%**	**12.5%**
Actual Expenditures	$31,688	$31,587	$31,908	$32,598	$34,271
Giuliani - Second Term	1998	1999	2000	2001	2002
Planned Spending	$34,980	$34,704	$36,801	$37,732	$38,337
Planned City-fund Spending	23,929	24,398	26,492	27,382	27,976
Budget Gap	**($122)**	**($642)**	**($2,070)**	**($2,173)**	**($1,867)**
As a % of planned City-fund spending	**0.5%**	**2.6%**	**7.8%**	**7.9%**	**6.7%**
Actual Expenditures	$34,271	$35,465	$37,520	$40,906	NA

Source: City of New York, Office of Management and Budget, *Preliminary Budget and Financial Plan,* January 20, 1978, January 15, 1982, January 6, 1986, February 1, 1990, February 2, 1994, and January 29, 1998.
Note: Planned spending figures are not adjusted for impact of surpluses. Actual expenditures are adjusted for the impact of operating surpluses and for Transitional Finance Authority and TSASC debt service.

MANAGING THE BUDGET: A TALE OF THREE MAYORS

An analysis of the experience of the last three mayors points to two basic conclusions.

- *The economic conditions during a mayor's administration strongly shape the basic fiscal policies of that administration*. There have been periods of boom and bust in the local economy. Not surprisingly, in good times the City's government grows and in bad times expenditures must be constrained. However, the expenditure growth often exceeds sustainable levels, and the contraction is imprudently delayed with fiscal gimmicks.

- *Within the broader economic constraints, a mayor can achieve selected policy objectives*. Spending need not rise or fall in an across-the-board fashion; mayors can and do focus on their favored services (and not all mayors favor the same services) for improvement in times of expansion and for protection in periods of cutbacks.

The sections below present the evidence for these conclusions, considering first the operating budget and then the capital budget.

THE OPERATING BUDGET

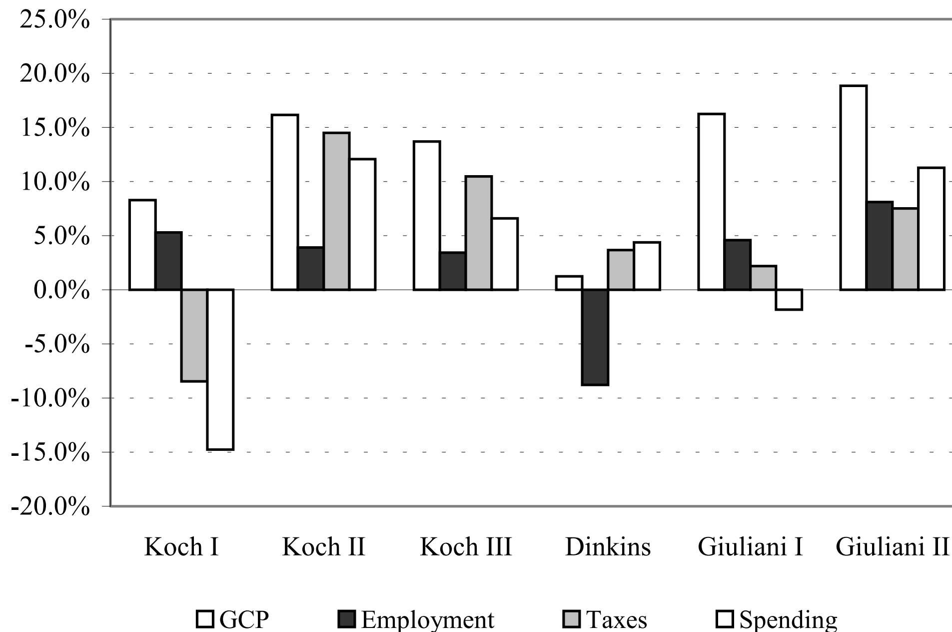
Figure 1 summarizes the cyclical pattern of New York City's operating budget. The city's bad times, at least from an economic vantage, were the period during which Mayor Koch had to bring the budget into balance in the aftermath of the fiscal crisis, and the period during which Mayor Dinkins faced a deep recession. In the first such period, Mayor Koch reduced constant dollar spending 15 percent. Mayor Dinkins imposed tax increases to help offset the economic losses, and even with these increases constant dollar spending grew only an historically modest 4 percent over the four years.

The city's economic good times were during Mayor Koch's second and third terms and during Mayor Giuliani's two terms. The second Koch term had relatively strong growth in real Gross City Product (GCP), and this continued but slowed in his third term. Mayor Giuliani experienced similarly strong growth in his first term and unprecedented growth in his second term. The prosperity was accompanied by nearly parallel growth in City expenditures, which grew in inflation adjusted terms 12 percent and 7 percent in Mayor Koch's second and third terms, respectively, and 11 percent in the first three years of Mayor Giuliani's second term. Mayor Giuliani's first term did not follow this pattern because of the cuts needed to adjust for the unsupportable expenditure growth under Mayor Dinkins.

Figure 1

Change in New York City Gross City Product, Employment, Tax Revenue and Spending by Mayoral Term

(inflation-adjusted)



Sources: U.S. Bureau of Economic Analysis; City of New York, Office of the Comptroller, *Comprehensive Annual Financial Report*, fiscal years 1979 to 2000 editions. Figures converted to constant dollars based on U.S. Department of Labor, Bureau of Labor Statistics, CPI for All Urban Consumers, NY-Northeastern NJ; All items.
Note: Data for Mayor Giuliani's second term is through fiscal year 2001.

The boom-bust budget pattern persists because of four factors. First, the City's revenues are volatile, primarily because of the disproportionate impact of the finance sector (especially the firms collectively known as "Wall Street") on tax collections. Second, the City has no true "rainy day" fund that allows or requires some resources to be reserved for use in times of genuine fiscal distress. Third, mayors significantly increase spending during good times, often building obligations into the budget that are difficult to undo. Fourth, mayors generally have cut the budget by reduced staffing that harms services rather than by reducing the unit costs of providing services. As a result, staff and spending cuts made during downturns tend to be restored during upswings. And, in a related point, mayors have typically underused the opportunities for implementing change that are afforded during downturns when pressure is on the budget and consensus for making changes can be easier to build.

Within this broad picture it is possible to trace more specifically for each mayor the economic context, the overall fiscal changes, and the particular expenditure priorities. In addition to total spending, key fiscal variables are the size of the municipal workforce and average payroll

expenses per worker. The payroll accounts for about half of the total operating budget. In terms of priorities, the analysis considers three functional areas—public schools, health and social services, and public safety—as well as debt service and all other activities.

Mayor Koch

Mayor Koch's 12 years in office spanned a period of fiscal bust, the first term, and boom, the next eight years. In the time of contraction, overall operating expenditures in constant dollars fell 15 percent, real compensation per worker fell 7 percent, and the number of municipal workers fell 1 percent. This was reversed in the better times, when real spending eventually exceeded the 1978 level, real compensation per worker increased more than one-third to exceed earlier levels, and the number of workers increased more than 45,000 to reach 243,090. In the time of contraction, public safety was cut at an above average rate, but during the period of expansion it and the public schools were favored while debt service declined and the "all other" category of services had very limited growth.

The Economic Context. In the 1970s, two national recessions merged in New York to form one protracted downturn, in which 610,000 jobs were lost from 1969 to 1977. In the face of shrinking resources and growing claims on city services, the budget had been mismanaged to bring New York to the brink of bankruptcy. When Mayor Koch entered office, planned spending was still far above a sustainable level, despite significant cuts enacted in the first years of the fiscal crisis.

During Mayor Koch's second term, from 1982 to 1986, the economy accelerated, with real output growth increasing from 2.7 percent per year during his first term, which ended during a mild recession, to 3.8 percent per year from 1982 to 1986.[5] Employment growth was more sluggish, lagging the nation, and the city's unemployment rate remained as high as 8 percent near the end of Mayor Koch's second term. Real output growth, however, was much closer to the national rate, and helped increase tax revenue collections. A personal income tax surcharge imposed from 1982 to 1984 also helped boost tax revenues.

With revenues rising and a backlog of demands, expenditures in Mayor Koch's second term rose 12 percent from $29.2 billion to $32.7 billion in constant (2000) dollars. In his second term, Mayor Koch was also able to generate and sustain surpluses that averaged $480 million annually, or about 5 percent of City-fund expenditures.

As Mayor Koch entered his third term, the city's economy gained momentum. While employment growth remained below the national pace, real GCP surged 4.9 percent in 1986, as Wall Street firms earned $5.4 billion in profits. In 1987, however, the stock market crashed and the firms' profits fell 80 percent to $1.1 billion. By 1989, growth in GCP had fallen to 0.5 percent

[5] Economic data is expressed in calendar years, while the City's fiscal year ends on June 30. Most non-property tax collections are driven by the economic activity that occurred in the calendar year that ends midway in a fiscal year. For example, economic activity in calendar year 2001 will account for most of the growth (or decline) in fiscal year 2002 tax revenues. Therefore, economic data for a mayoral term begins with the calendar year prior to the start of the term. (For example, for Mayor Koch's first term, economic data are for the calendar years 1977 through 1981.)

and employment growth had stalled. Tax revenues, adjusted for inflation, declined in 1988 and 1990.

In this environment, inflation-adjusted spending in Mayor Koch's third term grew at about half the pace of the second term. The annual surplus fell from a high of $567 million in fiscal year 1987 to $253 million in fiscal year 1990. Mayor Koch's last financial plan, covering fiscal years 1990 to 1993, balanced 1990's budget through a combination of tax increases, beneficial adjustments in pension contribution formulas, and one-shot revenues.[6] Partly as a result, it projected gaps approaching $700 million in fiscal years 1991 and 1992. During those years, expenditures for correction, education and debt service were projected to accelerate faster than the City's tax revenues. Debt service alone was projected to grow from 8 percent of expenditures in 1990 to 11 percent in 1993.

Koch's Spending Priorities. The Board of Education comprised over one-fifth of total operating expenditures in 1978. During his first term, Mayor Koch cut constant (2000) dollar spending at the Board $1.3 billion, or 18 percent.[7] (See Figure 2.) The number of employees fell a lower 1 percent, with all the reduction among non-pedagogical workers. As a consequence, despite an 11 percent fall in enrollment, real per pupil expenditures declined, but the ratio of pupils to teachers improved from about 16:1 to 14:1. (See Appendices A and B.)

In Mayor Koch's second term, spending at the Board increased in real terms $1.3 billion, or 23 percent, and it increased another $1.4 billion (19 percent) in his third term. These added funds permitted a 20 percent increase in the number of pedagogical employees, which, with enrollment nearly flat, further improved the ratio of pupils to teachers. (See Figure 3.) The number of non-teaching employees expanded more rapidly, 38 percent. The rising number of special education students partly drove the expenditure and staff increase, but other services also were expanded —schools stayed open longer, and new programs were launched for summer enrichment, students with limited English proficiency, dropout prevention, and class size reduction.

Health and human services accounted for $7.7 billion, or 30 percent of total expenditures, in fiscal year 1978. Mayor Koch cut constant-dollar spending in this area a relatively scant 1 percent during his first term, and the staff of the Department of Social Services was reduced as the average annual public assistance caseload fell 6 percent. During the remainder of Koch's tenure, rising homelessness, and the AIDS and crack epidemics, placed enormous demands on the City's health and human services. In response, from 1982 to 1990 real spending on these functions increased 25 percent, and the number of workers in the Department of Social Services increased more than 9,000, or 42 percent.

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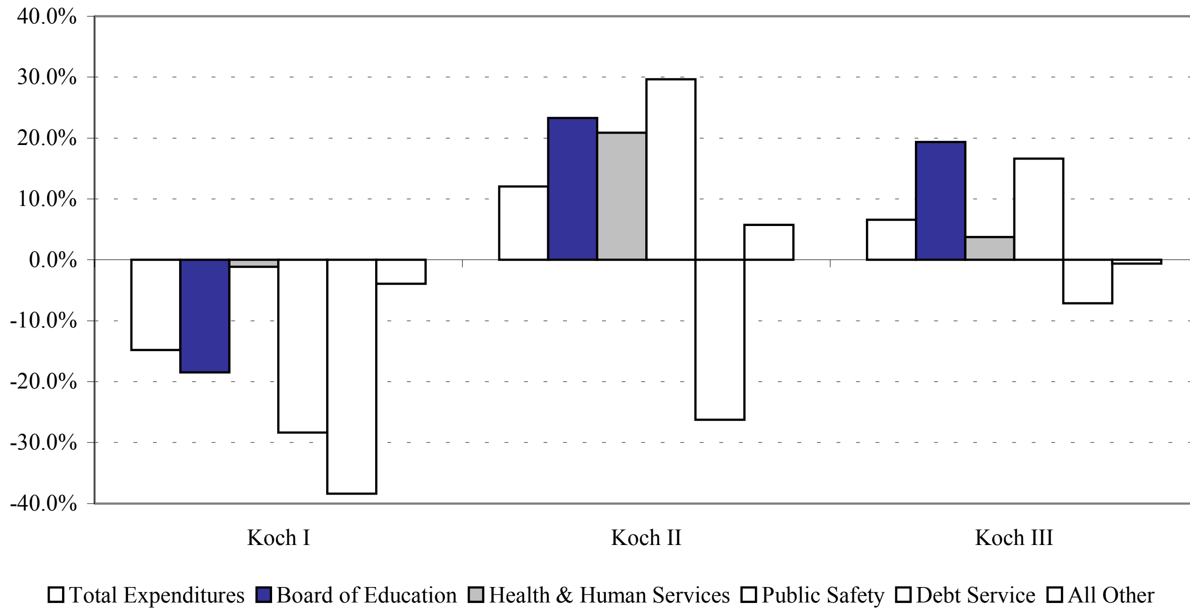
[6] City of New York, Office of Management and Budget, *Financial Plan, Fiscal Years 1990–1993*, Adopted Plan, June 1989.

[7] Part of this decline reflects a change in the way pension expenditures were reported between fiscal years 1978 and 1982. An effort to adjust the figures for this change yields a smaller 2 percent decline.

Figure 2
Koch Administration
Percent Change in Spending, by Function
(inflation-adjusted)



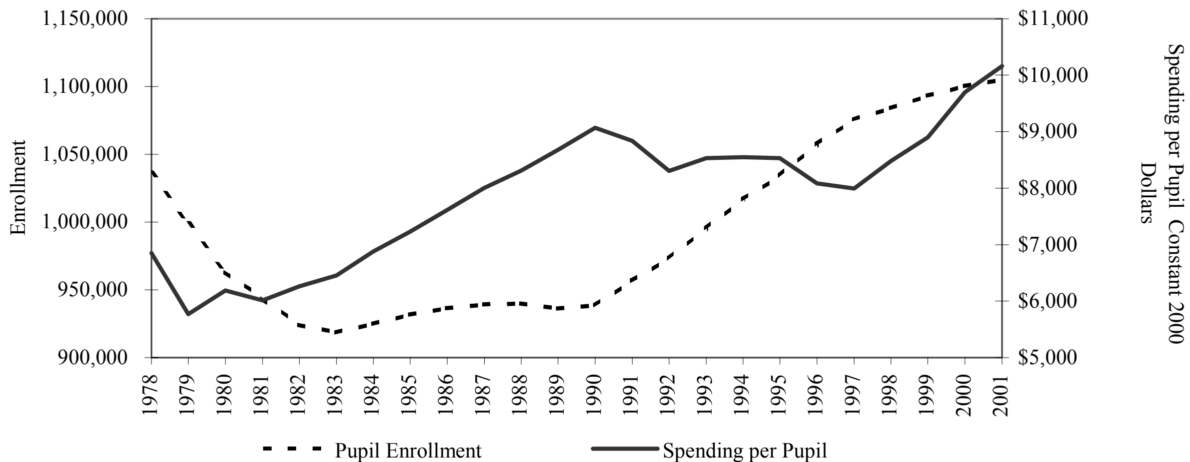
Source: See Appendix A.
Note: Fiscal year 1978 data have been adjusted to account for a change in the City's reporting of State and federal Medicaid expenditures.

Spending on public safety was cut sharply in Mayor Koch's first term, with constant (2000) dollar expenditures on these agencies (Police, Fire, Correction, Juvenile Justice, and Probation) declining $1.2 billion, or 28 percent. The heaviest of these cuts fell on the Police Department, where spending was reduced 35 percent.[8] The reductions in public safety, however, were achieved largely through non-personnel cuts. The Police Department saw a drop in uniformed employees while civilians increased.

From 1982 to 1990, real spending on public safety was restored and expanded. In this period, police expenditures (including the Housing and Transit Authority Police) increased 36 percent, and the number of personnel rose 16 percent. Real spending at the Department of Correction increased a dramatic 177 percent, as the City strove to fulfill federal mandates to reduce overcrowding and house a surging inmate population. The number of inmates rose from a daily average of 9,279 in fiscal year 1982 to 19,643 in 1990.[9]

[8] Part of this decline reflects a change in the way pension expenditures were reported between fiscal years 1978 and 1982. An effort to adjust the figures for this change yields a smaller 17 percent decline.
[9] City of New York, Mayor's Office of Operations, *Mayor's Management Report*, fiscal year 1982 and 1990 editions.

Figure 3
New York City Board of Education
Enrollment and Real Spending per Pupil
Fiscal Years 1978 to 2001
(in 2000 dollars)



Source: City of New York, Mayor's Office of Operations, *Mayor's Management Report*, Volume II: Citywide Indicators, fiscal year 1978 to 2001 editions.

In some cases increases in inflation-adjusted spending reflected expanded services, but enhanced compensation for workers also drove expenditures. After falling in Mayor Koch's first term, real personal service costs per worker (including wages, fringe benefits and pension contributions) grew 8 percent to reach $72,003 (in 2000 dollars) in fiscal year 1986 and another 2.2 percent to $73,586 in 1990. (See Table 3.) These amounts reflect wage and salary increases in excess of inflation, and rapidly rising fringe benefit costs, which grew 25 percent per worker in Mayor Koch's second term. Pension costs, after rising to onerous levels in the late 1970s and early 1980s to make up for past under-funding and low market returns, fell throughout Mayor Koch's second and third terms, helping to offset the rapidly rising costs of fringe benefits.

During Mayor Koch's second and third terms, sharply reduced debt service payments helped free resources for other priorities. In fiscal year 1978, debt service accounted for 16 percent of total expenditures. Because the capital program had been minimal during the fiscal crisis and its aftermath, the debt service share of expenditures dropped to 7.4 percent by fiscal year 1986 and to 6.5 percent by 1990.

Mayor Dinkins

Mayor Dinkins entered office at the beginning of a recession that lingered well into his term and caused continuous budget strains. In the face of this pressure, Mayor Dinkins reduced the number of municipal workers 3 percent and their average real compensation 6 percent. Despite these measures, total expenditures in constant dollars rose 4 percent as debt service and social welfare obligations grew. In the hard times, these priorities were made affordable through

significant tax increases and a reliance on one-time revenues that left Mayor Dinkins' successor a substantial budgetary challenge.

Table 3
Personal Service Expenditures for Full-Time Workers, Fiscal Years 1979 to 2001
(in 2000 dollars)

	Fiscal Year						
	1979	**1982**	**1986**	**1990**	**1994**	**1998**	**2001**
Total Expenditures (in millions)							
Personal Service - Full-Time	$14,158	$13,113	$15,861	$17,888	$16,808	$17,075	$18,699
Wages and Salaries	9,560	8,795	11,002	12,859	12,082	12,210	13,782
Fringe Benefits	1,373	1,488	2,095	2,679	3,168	3,319	3,734
Pension	3,258	2,832	2,764	2,350	1,558	1,546	1,184
Expenditures Per Full-Time Worker							
Personal Service - Full-Time	$71,641	$66,852	$72,003	$73,586	$71,294	$70,426	$74,848
Wages and Salaries	48,376	44,838	49,946	52,900	51,248	50,362	55,165
Fringe Benefits	6,946	7,585	9,510	11,020	13,436	13,688	14,945
Pension	16,487	14,440	12,547	9,667	6,610	6,376	4,738
Full-Time Workers	**197,618**	**196,151**	**220,276**	**243,090**	**235,752**	**242,448**	**249,824**

Source: See Appendix B.
Note: Personal Services totals and wages and salaries exclude part-time and seasonal expenses. Headcount totals are as of June 30 actuals. Fiscal year 1979 data is used because personal service expenditures were presented in component parts beginning in that year.

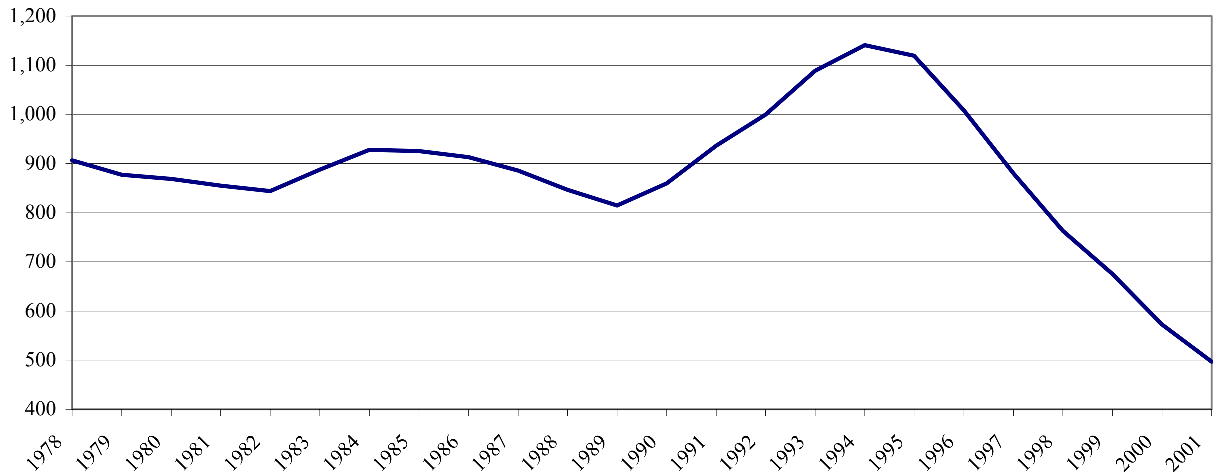
The Economic Context. When Mayor Dinkins took office in 1990, the city's economy had ground nearly to a halt, and the downturn was deepened when a national recession developed in 1991. The city lost 191,000 jobs in that year—a bigger drop than any single year during the 1970s—and real GCP fell 4.4 percent. Employment continued to fall in 1992.

As the economy was bottoming out, Wall Street revived, posting profits of $6 billion in 1991 and 1992, aiding a recovery of GCP growth. The rest of the economy, however, failed to follow suit. By the middle of Mayor Dinkins' term, the unemployment rate exceeded 11 percent and public assistance rolls had increased more than 30 percent since the beginning of his term, and would by 1994 grow 33 percent. (See Figure 4.)

An initial response to this sharp downturn was tax increases to help support ongoing expenditures. Mayor Dinkins and the City Council added taxes that generated more than $1.8 billion annually by the end of his term. (See Table 4.) Among the increases in 1991 were a 12.5 percent surcharge to the City's personal income tax and a higher real property tax rate. Additional increases in the personal income and real property taxes were enacted in 1992. Without these increases, constant-dollar tax revenues would have declined nearly 7 percent from fiscal year 1990 to fiscal year 1993.

At the same time, Mayor Dinkins sought savings through staff reductions. During his term 6,900 positions were eliminated. Despite these efforts, other decisions increased spending, and the City's constant-dollar expenditures grew 4 percent during the Dinkins administration.

Figure 4
Persons Receiving Public Assistance in New York City, Fiscal Years 1978 - 2001
(in thousands)



Source: City of New York, Mayor's Office of Operations, *Mayor's Management Report*, fiscal year 1979 to 2001 editions.

Dinkins' Spending Priorities. The clearest expenditure trend of the Dinkins Administration was the growth of health and human services. During a time when total real expenditures increased 4 percent, spending for these activities grew 15 percent. (See Figure 5.) The increased spending was tied to the deep recession, which pushed up the public assistance caseload, and to rapidly rising medical costs, which drove up the City's Medicaid obligation.

Under Mayor Dinkins, inflation-adjusted spending at the Board of Education increased 2 percent and the number of teachers grew 4 percent to 80,863. However, enrollment surged 8.3 percent to more than 1 million, after years of decline or little growth. Consequently, the modest increase did not preserve the earlier improvements in the ratio of pupils to teachers; it rose from 12.1 pupils per teacher in fiscal year 1990 to 12.6 in 1994. Constant (2000) dollar expenditures per pupil fell from $9,069 in 1990 to $8,555 in 1994.

A much-heralded priority of the Dinkins mayoralty was to expand aggressively the City's police force in order to control crime. With the help of dedicated tax revenues for the "Safe Streets, Safe City" program, more than 5,000 officers were added to the force from fiscal year 1990 to 1994, surpassing for the first time the pre-fiscal crisis number of police officers. This increase in personnel was accomplished despite a 3 percent decline in inflation-adjusted spending on the Police Department, partly because of a reduction in overtime. The Fire and Correction Departments, in contrast, experienced deeper spending cuts of 11 percent and 13 percent, respectively.

Table 4
Impact of Tax Policy Changes on Tax Revenues by Mayoral Administration
Annual Value in Final Fiscal Year of Term
(dollars in millions)

	Koch (post 1984)		Dinkins		Giuliani	
	Initiated by		Initiated by		Initiated by	
Tax	**State**	**City**	**State**	**City**	**State**	**City**
Real Property	-	-	-	$867	($127)	($200)
Personal Income	-	($91)	-	711	(1,078)	(1,100)
General Sales	$15	5	$32	129	(96)	(264)
General Corporation	-	14	-	-	(138)	(100)
Financial Corporation	-	-	-	-	(1)	-
Unincorp. Business	-	(17)	-	-	63	(89)
Commercial Rent	-	(7)	-	(3)	-	(439)
Mortgage Recording	-	5	-	44	9	-
Real Property Transfer	-	59	-	-	7	(2)
Utility	-	12	-	71	(44)	(6)
Hotel Occupancy	-	88	-	12	-	(27)
Commercial Motor Vehicle Tax	-	13	-	-	-	-
Coin Operated Amusement Devices	-	1	-	-	-	-
Other Taxes	-	-	-	-	-	(8)
Total	$15	$82	$32	$1,832	($1,405)	($2,236)
Grand Total	**$97**		**$1,864**		**($3,641)**	
Grand Total in 2000 Dollars	**$129**		**$2,142**		**($3,451)**	

Source: City of New York, Office of Management and Budget, *Forecast Documentation, Adopted Budget FY 2001-2005* , June 2001.
Comparable data not available for fiscal years prior to 1985.

Rising debt service costs, a legacy of the rapid increase in capital commitments during Mayor Koch's third term, contributed to the spending increase during the Dinkins administration. Debt service in constant dollars rose 38 percent from fiscal year 1990 to 1994, and claimed an increasing share of the budget that approached 9 percent in Dinkins' last year.

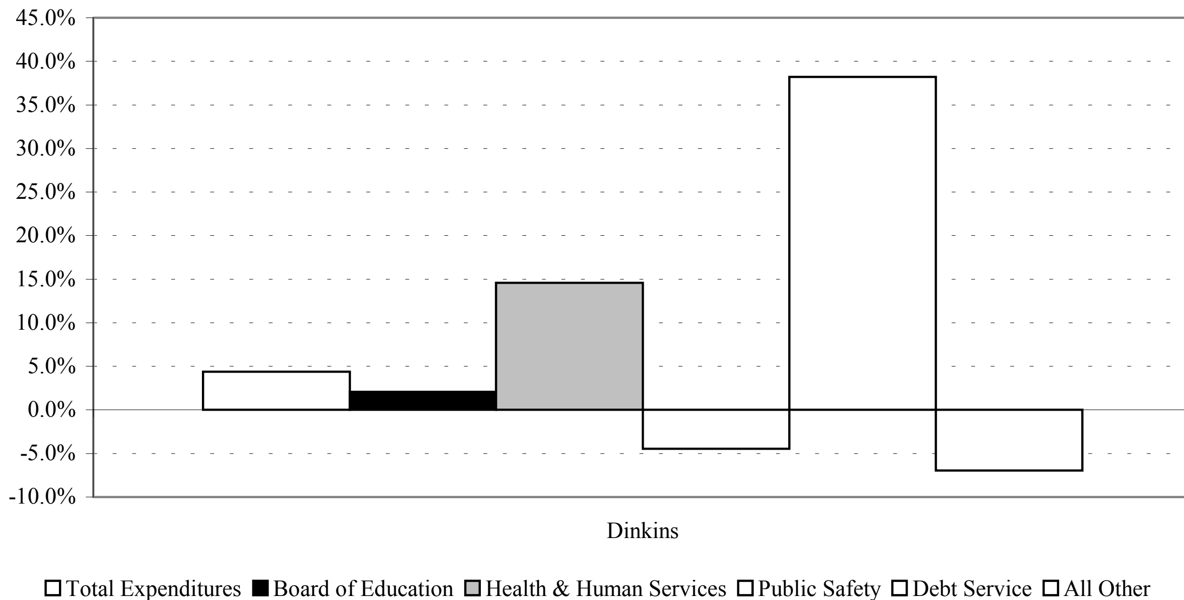
The inflation-adjusted cost of the municipal payroll fell 6 percent in the Dinkins years because the number of workers decreased and costs per worker fell. The number of City workers was 243,090 in fiscal year 1990, rose to 253,000 in 1991, but was then reduced to 235,752 by fiscal year 1994. Real compensation per worker fell 3 percent during Mayor Dinkins' term, largely reflecting the decline in the average wage and salary per worker. Real pension costs per worker fell 32 percent, but these savings were offset by a simultaneous escalation in fringe benefits costs of 22 percent, due primarily to rapidly rising health insurance costs.

Mayor Giuliani

Like his two predecessors, Mayor Rudolph W. Giuliani initially faced a budget in need of retrenchment. However, an unexpectedly robust economy soon yielded new resources and permitted fiscal expansion. After constant dollar expenditure cuts of 2 percent during his first term, Mayor Giuliani and the Council increased real spending more than 11 percent in the second term. The number of City workers increased to nearly 250,000 in fiscal year 2001, 6,600 more

than when he took office. Constant dollar (2000) compensation per worker increased more than 6 percent in Mayor Giuliani's second term to reach $74,848—higher than when Mayor Koch left office.

Figure 5
Dinkins Administration
Percent Change in Spending by Function
(inflation-adjusted)



Source: See Appendix A.

While Mayor Giuliani's overall fiscal policy followed the boom and bust pattern, his priorities for the use of resources were consistent. The Police Department and the Board of Education received favored treatment in both terms. During the first term, when overall expenditures fell in real terms, the Police Department's real expenditures grew 5 percent; in the second term their 18 percent increase outpaced the overall growth of 11 percent. The Board of Education received an increase of 6 percent during the first term and 22 percent in the second term. In addition, Mayor Giuliani distinguished himself from his predecessors by seeking tax cuts. By the end of his second term he had initiated cuts worth more than $2.2 billion annually; when combined with local tax cuts initiated by the State, the total tax reductions during Mayor Giuliani's tenure exceed $3.6 billion annually.

The Economic Context. In January of 1994, when Mayor Giuliani prepared his first Financial Plan, the local recession had ended yet the economy remained weak. New York City stopped hemorrhaging jobs in 1992, and employment increased slightly in 1993. Even though Wall Street bounced back strongly in 1993, the lack of a broader economic recovery left tax revenues in fiscal year 1994 virtually unchanged from the previous year.

The outlook for fiscal year 1995 was dim, with revenues projected to decrease 3 percent, but expenditures expanding 4 percent. A slump in the financial sector reduced revenues further during the year, and the City was in a continuous scramble to end the fiscal year with a balanced budget. Ultimately, fiscal year 1995 spending was reduced by 2.7 percent, after adjusting for inflation, while revenues were temporarily bolstered with asset sales.

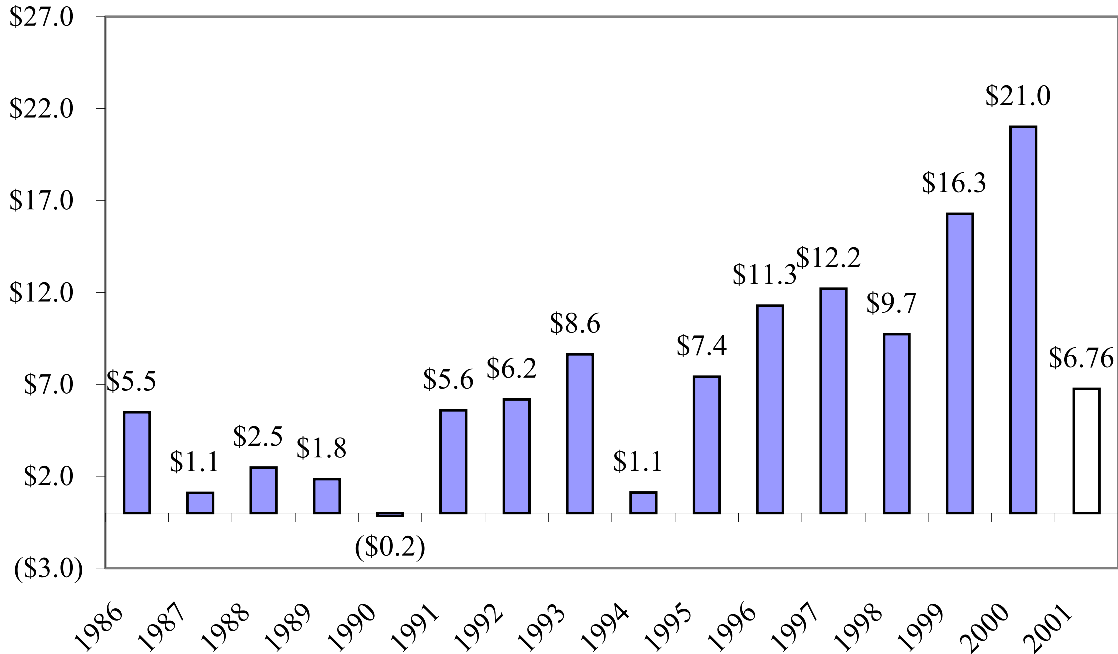
Wall Street recovered from the 1994–1995 economic setback, and posted record profits in 1996 and 1997. As the local economy gained momentum, Mayor Giuliani continued to reduce inflation-adjusted spending in fiscal years 1996 and 1997. The rising tax revenues enabled Mayor Giuliani to implement tax reductions and create a growing surplus. In fiscal year 1996, the surplus was $224 million, and it grew to nearly $1.4 billion the following year.

The surpluses continued to accumulate in Mayor Giuliani's second term as a result of two factors. First, the Mayor followed a policy of conservative economic and tax revenue forecasts, in order to have a cushion in case the economy softened. Second, beginning in 1997, the economy exceeded all expectations at the national and local levels. Real GDP growth averaged over 4 percent per year, and real GCP growth neared 6 percent. Growth was spurred by a speculative boom in the technology sector that led locally to astronomical profits on Wall Street ($21.0 billion in 2000) and a boom in employment in business and professional services and retail trade. (See Figure 6.)

As the economic boom continued in his second term, Mayor Giuliani reversed expenditure policy and began to expand municipal government. Real expenditures increased an average of 3.5 percent annually from fiscal year 1998 to fiscal year 2001—a total increase of over $4 billion in constant (2000) dollars. In the fiscal year 2002 Adopted Budget, expenditures were projected to increase 1.4 percent in fiscal year 2002, while revenues declined 3.6 percent; the difference was filled by drawing down virtually the entire surplus accumulated in the late 1990s boom. The combination of spending increases and using the surplus in fiscal year 2002 set the stage for the unusually large fiscal year 2003 budget gap.

Giuliani's Spending Priorities. Public safety, and especially police, has been a high priority of Mayor Giuliani during both terms. Inflation-adjusted public safety spending increased 6 percent in Mayor Giuliani's first term and 11 percent in the second. (See Figure 7.) The increase was concentrated in the Police Department. In the first term, real spending on the Police Department increased 5 percent. In this period, federal funding became available for police expansion and the Transit Authority and the Housing Authority police forces were merged into the Police Department. As a consequence of these measures, the Police Department's uniformed force expanded by 7,200, although the total number of uniformed officers actually declined slightly after allowance is made for the mergers.

Figure 6
Profits of New York Stock Exchange Member Firms
Calendar Years 1986 to 2001
(dollars in billions)

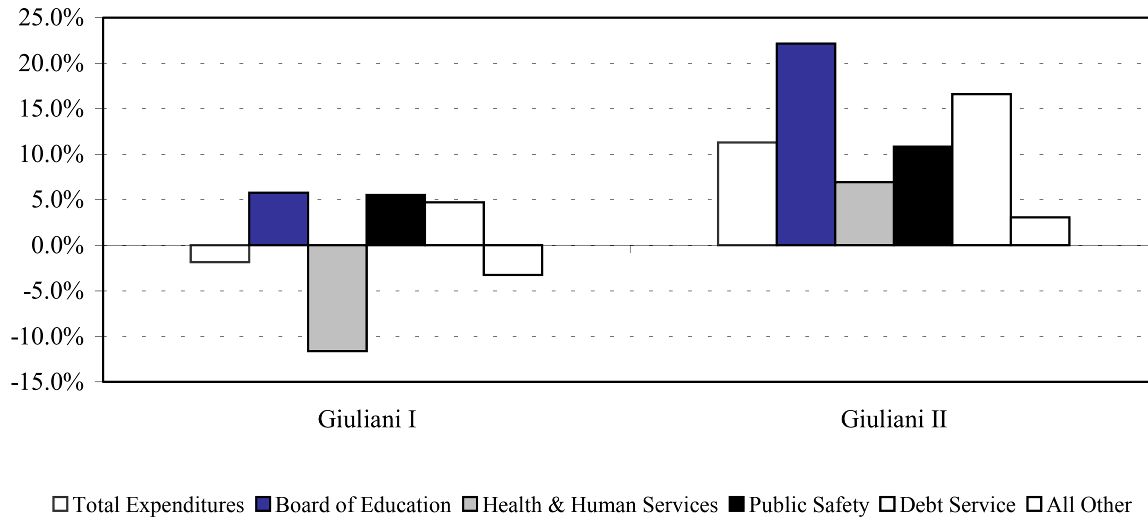


Sources: Data for 1986 to 2000 are from the New York Stock Exchange; 2001 figure is an estimate from the Securities Industry Association for three quarters only.

In the second term, the Police Department's real expenditures rose 18 percent by fiscal year 2001. However, the staff increase was not proportional. The number of uniformed officers grew 500 and civilians 600. Instead, spending increases supported special programs, such as Operation Condor, that relied on overtime. From fiscal year 1998 to 2001, police overtime rose 115 percent to $328 million in constant (2000) dollars.

The Board of Education is another favored agency under Mayor Giuliani. During his first term, there was a conflict with the Chancellor and initial cuts, but by the end of Mayor Giuliani's first term, the Board had a real increase of nearly 6 percent. However, enrollment increased at a slightly faster pace in these years, so constant (2000) dollar per pupil expenditures fell from $8,555 in fiscal year 1994 to $8,487 in fiscal year 1998. At the same time, the Mayor sought administrative reforms. Consequently, the number of teachers rose 7 percent to more than 86,000, while the number of administrators fell 8 percent from fiscal year 1994 to 1998. As a result the ratio of pupils to teachers held steady even though real spending per pupil declined.

Figure 7
Giuliani Administration
Percent Change in Spending by Function
(inflation-adjusted)



Sources: See Appendix A.

The priority for education was more apparent in the second term. Enrollment growth tapered off to about 2 percent during the fiscal year 1998–2001 period, and a statewide movement to raise standards for promotion and graduation led to intensified demands to improve school performance. In this context, the Mayor increased real spending at the Board 22 percent from fiscal year 1998 to 2001. This financed a 10 percent increase in personnel, as about 9,000 teachers and 1,000 administrators were added to the payroll. The ratio of pupils to teachers improved to 11.7, likely the lowest ever, and constant (2000) dollar per pupil spending leaped from $8,487 to $10,177.

Health and human services have not been an expenditure priority in the Giuliani Administration. In the first term, real spending for this purpose was cut more sharply than overall spending (12 percent versus 2 percent), and in the second term this function grew 7 percent compared to an overall increase of over 11 percent. The first term reductions were implemented as an improved economy and welfare reform reduced public assistance rolls one-third, and as national and state health care cost containment efforts tempered rapid inflation in medical costs. The public assistance caseloads continued to drop dramatically in the second term, but other social welfare initiatives and renewed inflation in health care absorbed the real increase.

Personal service spending under Mayor Giuliani mirrors total spending—real reductions in the first term, followed by increases in the second. Real compensation per worker fell 1.2 percent in Mayor Giuliani's first four years, but rose 6 percent in the second term. Real wages and salaries grew nearly 10 percent from fiscal year 1998 to 2001, the largest per worker increase

since Mayor Koch's second term. Growth in fringe benefits, in contrast, has been moderate since fiscal year 1994. In Mayor Giuliani's first term, an agreement with health insurance providers to freeze premiums kept growth in fringe benefit spending per worker under 2 percent, compared to rates that ranged from 16 percent to 25 percent per term for Mayor Giuliani's predecessors. In Mayor Giuliani's second term, fringe benefit spending grew 9 percent per worker through fiscal year 2001 as health insurance costs again rose.

Total compensation per worker under Mayor Giuliani would have grown even more if there had not been reductions in necessary pension fund contributions. These contributions declined due to the favorable performance of the funds' investments. In fiscal year 2000, Mayor Giuliani agreed to increase pension benefits for municipal workers if union leaders agreed to accelerate the recognition of higher-than-expected returns on the City's investments. This reduced necessary City contributions to the pension funds $800 million in fiscal years 2000 and 2001, but will raise the necessary contributions in future years.

Another area of real spending increase during Mayor Giuliani's tenure is debt service. It grew nearly 5 percent in the first term and 17 percent in the second term. In addition to the City's general obligation debt and the remaining Municipal Assistance Corporation debt, the City now also pays debt service through the Transitional Finance Authority and the Tobacco Settlement Asset Securitization Corporation—two agencies created at Giuliani's initiative to expand the City's debt capacity.

Since taking office in 1994, Mayor Giuliani has made tax reduction a high priority, viewing it as an economic stimulus. (Refer to Table 4.) Due to fiscal pressures, the cuts were modest in Mayor Giuliani's early years, targeting small but unique New York City taxes such as the vault tax and the tax on coin-operated amusement devices. As the economy improved, the tax reduction program became more ambitious. It eventually included a large reduction in the commercial rent tax, the elimination of the sales tax on clothing costing less than $110, the elimination of the Dinkins-era 12.5 percent personal income tax surcharge and, most recently, a reduction in the 14 percent personal income tax surcharge. The combined impact of Mayor Giuliani's tax cuts is over $2.2 billion annually by the end of his second term.

Under Mayor Giuliani, State initiatives also reduced local taxes. The STAR program lowers City property and personal income taxes. Other State-initiated tax reductions lowered sales and corporation taxes, and eliminated the commuter income tax. Together these State actions lowered taxes about $1.4 billion by fiscal year 2002, bringing the combined value of the cuts in Mayor Giuliani's two terms to $3.6 billion annually.

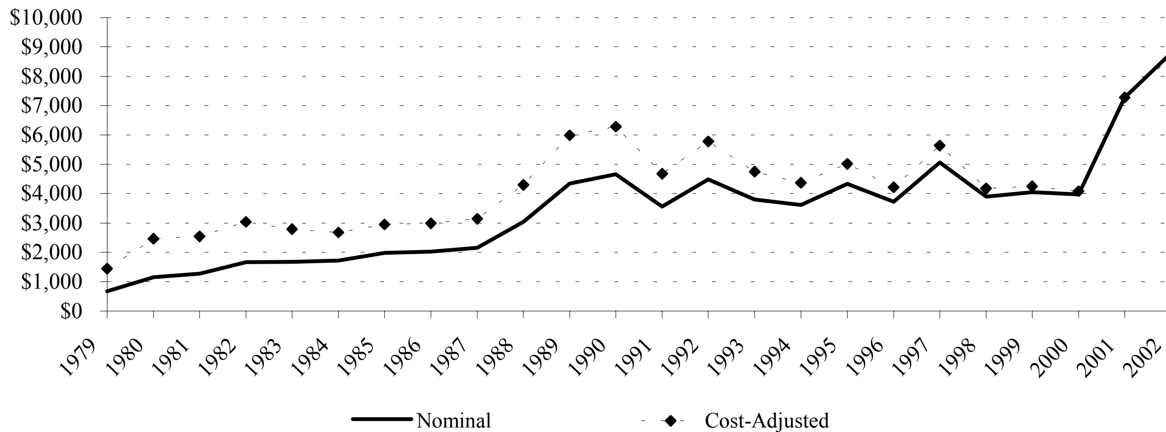
THE CAPITAL BUDGET

The mayors' management of the City's capital budget evidences the same two broad conclusions as their handling of the operating budget. First, the size of the capital budget expands and contracts along with economic conditions, with commitments reaching unsustainable levels

at the end of a boom. Second, within the economic constraints, different mayors are able to assert different functional priorities, placing their stamp on the mix of commitments.

Fluctuations in Capital Commitments. Each mayor has had to accommodate the size of his capital program to the prevailing economic conditions. (See Figure 8.) In the early years of the Koch Administration, borrowing was constrained due to the City's limited access to capital markets. The only capital spending was that funded by intergovernmental aid and by federally guaranteed borrowing. Accordingly, Mayor Koch's total first-term capital commitments were limited to under $8.9 billion in constant (2000) dollars.

Figure 8
City of New York Capital Commitments
Fiscal Years 1979 to 2002
(dollars in millions)



Sources: City of New York, Office of Management and Budget, *Executive Budget, Message of the Mayor*, Fiscal Years 1980 to 2002. Constant dollar calculations based on the construction cost index compiled by *Engineering News Record.*
Note: The fiscal years 2001 and 2002 numbers shown are the commitment plan totals minus the budgeted reserves for unattained commitments.

In his second term, Mayor Koch helped the City regain market access for its general obligation bonds and with approval of the State Legislature created a Water Finance Authority to borrow to support investments in the water supply system. The Authority's bonds were backed by earmarked water and sewer charges, and the new authority achieved easy market access. As a result, total constant dollar (2000) commitments in Mayor Koch's second term rose to $11.0 billion. In his third term, the trend accelerated and total adjusted commitments jumped to $19.2 billion.

Mayor Dinkins could not sustain this high level of capital investment in the face of an economic downturn. He pared the capital budget in his early years, and total constant (2000) dollar commitments during his term fell from Mayor Koch's $19.2 billion to under $19.0 billion.

In his first term, Mayor Giuliani's capital budget, like his expense budget, showed real declines. The constant (2000) dollar commitments fell to $18.6 billion. Mayor Giuliani's lowest

annual level of real capital spending, less than $4.1 billion in fiscal year 1998, was nearly one-third below Mayor Koch's high level of more than $6.1 billion in fiscal year 1990.

However, as the economy improved, Mayor Giuliani expanded the capital budget as well as the operating budget during his second term. The four-year total of capital commitments for the second term is planned to jump to a constant (2000) dollar sum of $23.5 billion, exceeding that of Mayor Koch's third term and 27 percent above Mayor Giuliani's own first term. Before the terrorist attacks of September 11, 2001, the boom in capital spending had been more than fully revived.

Shifting Capital Priorities. The allocation of capital commitments changed as each Mayor shaped his legacy. (See Table 5.) During Mayor Koch's first two terms, commitments were driven largely by available intergovernmental aid. Transportation, which benefits from State and federal aid, comprised 42 percent of Mayor Koch's total program in the first term and 21 percent in the second term. In the second term, as the Water Finance Authority began raising funds, the water system increased from 25 to 31 percent of the total program. Most other functions also experienced small percentage increases as Mayor Koch expanded investments in his second term.

In his third term, Mayor Koch made a distinctive and pronounced priority of housing in his capital program. Housing commitments in constant (2000) dollars jumped tenfold from $218 million to $2.7 billion. Housing's share of the total capital program leaped from 2 to 14 percent.

Under Mayor Dinkins, the capital priority was education. In constant (2000) dollars total commitments for the Board of Education doubled from $2.1 billion in Mayor Koch's final term to $4.2 billion. Between fiscal years 1991 and 1993, the annual capital commitment to education increased 71 percent and the share of the total capital program for education rose from 10 to 23 percent. During the same years the share dedicated to housing diminished, from 14 to 11 percent.

The composition of the capital program in Mayor Giuliani's first term shifted toward environmental protection. The City had to meet federal watershed protection and filtration avoidance mandates. These environmental projects consumed 24 percent of Mayor Giuliani's first term capital program, compared to 19 percent under Mayor Dinkins. The commitment to education established under Mayor Dinkins eroded somewhat in Mayor Giuliani's first term; the latter's allocation to education fell from $4.3 billion to $3.9 billion in constant (2000) dollars. Housing commitments continued to shrink, comprising just 6.1 percent of the program.

In his second term, Mayor Giuliani continued to invest in environmental protection at a high level, and increased funding for education to $5.8 billion in constant (2000) dollars or nearly one-quarter of the capital program. In contrast, transportation commitments were cut in constant dollars and as a share of the total program. Housing commitments stabilized and remain near 6 percent of the total program. The "other" category, which includes libraries, cultural institutions and stadium projects, roughly doubled in constant dollars and as a share of the entire program from 8 to 15 percent.

Table 5
City of New York Capital Commitments by Administration and Function
(constant 2000 dollars in millions)

Function	Amount					
	Koch I	Koch II	Koch III	Dinkins	Giuliani I	Giuliani II
Environmental Protection	$2,209	$3,388	$3,449	$3,550	$4,421	$5,461
Transportation	3,707	2,307	4,237	3,983	3,898	3,152
Education	770	827	2,039	4,285	3,883	5,813
Hospitals	267	491	972	770	229	255
Housing	85	218	2,739	2,083	1,136	1,365
Economic Development	177	384	508	251	614	800
Public Protection	323	765	1,382	1,127	1,183	1,157
Sanitation	430	973	1,144	687	593	857
Parks & Public Buildings	508	848	1,129	840	1,199	1,267
Other	380	838	1,650	1,402	1,427	3,416
TOTAL	**$8,857**	**$11,040**	**$19,250**	**$18,977**	**$18,582**	**$23,542**

Function	Share of Total Commitments					
Environmental Protection	24.9%	30.7%	17.9%	18.7%	23.8%	23.2%
Transportation	41.9%	20.9%	22.0%	21.0%	21.0%	13.4%
Education	8.7%	7.5%	10.6%	22.6%	20.9%	24.7%
Hospitals	3.0%	4.4%	5.1%	4.1%	1.2%	1.1%
Housing	1.0%	2.0%	14.2%	11.0%	6.1%	5.8%
Economic Development	2.0%	3.5%	2.6%	1.3%	3.3%	3.4%
Public Protection	3.6%	6.9%	7.2%	5.9%	6.4%	4.9%
Sanitation	4.9%	8.8%	5.9%	3.6%	3.2%	3.6%
Parks & Public Buildings	5.7%	7.7%	5.9%	4.4%	6.5%	5.4%
Other	4.3%	7.6%	8.6%	7.4%	7.7%	14.5%

Sources: City of New York, Office of Management and Budget, *Executive Budget, Message of the Mayor*, Fiscal Years 1980 to 2002. The fiscal year 2001 and 2002 numbers are the commitment plan totals minus the budgeted reserve for unattained commitments. The reserves have been allocated to functional areas based on historical spending patterns for each agency. Constant dollar calculations based on the construction cost index compiled by *Engineering News Record*.

Note: Giuliani II totals reflect actual commitments for fiscal years 1999 and 2000 only. Fiscal years 2001 and 2002 are estimated based on historical relations between planned and actual commitments.

CITY-STATE RELATIONS

While mayors can assert priorities in the City's operating and capital budgets, they must always be attentive to possible interventions by State officials. The City of New York is legally a "creature of the State," and the State Legislature may decide how the City operates in a wide variety of ways. As the previous discussion of tax changes indicated, more than $1.4 billion of local tax cuts in recent years were initiated by the State as opposed to the City. Similarly, the State refused to permit the City to adopt tax cuts authorized by the City Council including a refundable earned income tax credit under the municipal income tax and elimination of the local sales tax on clothing items costing more than $110.

Another important area of State control is public education. The State Legislature has rejected proposals to change the governance of public schools despite repeated pleas from mayors to give more direct mayoral control of the Board than is now the case under the 1970 law that gives borough presidents five Board appointees compared to the mayor's two.

Of course, the State also has been helpful to the City in a number of ways. It created new authorities, notably the Municipal Assistance Corporation, the Water Finance Authority and the Transitional Finance Authority, that enhanced access to credit markets and enabled the City to circumvent limits in the State Constitution on its borrowing. Change in the division of responsibility between the City and State, enacted during the fiscal crisis, also benefited the municipal treasury. The State increased its share of the operating costs of the City University of New York (CUNY) senior colleges from 50 to 100 percent between 1978 and 1982. In the current State fiscal year, the value of this budget relief to the City is about $600 million.[10] In the same period, the State also took over the operating costs of courts previously financed by the City. Most importantly, between 1984 and 1987 the State decreased the local match for the long-term care components of Medicaid from 25 to 10 percent and relieved localities of their financial responsibilities for medical services to persons with mental disabilities. In 1987, when these measures were fully phased-in, they provided the City with $620 million in relief.[11]

However, similar beneficial proposals have not been enacted in more recent years. In fact, recently New York State excluded the City from fiscal relief it gave most local governments, in large part because the City's economic condition was stronger than much of upstate. Last year, in State fiscal year 2000–01, New York City was excluded from a statewide increase in revenue sharing, representing a loss of $30 million for the City.[12]

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[10] State of New York, Division of the Budget, *2001–02 New York State Executive Budget*, Appendix I (NY: Division of the Budget, January 2001); and State of New York, Senate Finance Committee, *Staff Report on the SFY 2001–02 Adopted Budget* (NY: Senate Finance Committee, August 2001).
[11] Cynthia B. Green and Paul D. Moore, "Public Finance," in Gerald Benjamin and Charles Brecher, editors, *The Two New Yorks* (NY: Russell Sage Foundation, 1988).
[12] City of New York, Office of Management and Budget, *Executive Budget, Fiscal Year 2002*, Message of the Mayor (NY: OMB, April 2001).

Although the range of possible actions is extensive, the two major conflicts between the City and State with large fiscal implications are (1) obtaining a "fair share" of State aid for the City, especially education aid, and (2) reducing the amounts the City is "mandated" to spend for certain programs, notably Medicaid, public assistance and pension contributions. In each case, Mayor Bloomberg will be stepping into a battle with a long history and that is complicated by Albany's own fiscal problems in light of the recession and September 11. However, it is important to set these goals for the next four years because there is a potentially huge payoff for successful initiatives.

A FAIR SHARE OF AID

The City relies on intergovernmental aid for many municipal services. The largest component of State aid is for the public schools. As shown in Table 6, State education aid totaled $5.7 billion in fiscal year 2001, representing 71 percent of all State categorical aid and 44 percent of all intergovernmental aid including federal aid. State education aid has also been increasing rapidly, more than doubling in constant dollars since 1978 and up 32 percent between fiscal years 1998 and 2001.

Despite the growth, there is a strong argument that New York City does not receive a fair share of State education aid. Its current share is 37 percent. (See Table 7.) This is equal to the City's share of statewide public school enrollment, but much farther below the City's share of "need" as gauged by multiple indicators. The New York City public schools are among the neediest districts identified by the State Education Department using indicators such as the share of students in poverty or eligible for federally subsidized meal programs, the share of students not speaking English, and the share of students with other special instructional needs. For example, 84 percent of New York City public elementary school students qualify for free lunches compared to 48 percent statewide, and 16 percent of New York City students have limited English proficiency compared to 8 percent statewide.[13]

A frequent counter argument to the City's case for more State education aid is that the City will not use all the money to help students. That is, the City may reduce the amount it provides (or otherwise would have provided) from local funds as State aid grows, undermining the State's intention to provide needy students with more resources. The record with respect to this concern has been mixed over time. As noted earlier, in difficult fiscal times the City has reduced its education expenditures. During the 1980s, City funds for public schools did not grow as quickly as State funds did, but the reverse was true in the 1990s.

[13] Data from New York State Education Department.

Table 6
Intergovernmental Aid to the City of New York
Fiscal Years 1978 to 2001
(constant 2000 dollars in millions)

	Fiscal Year						
Type of Aid	**1978**	**1982**	**1986**	**1990**	**1994**	**1998**	**2001**
State Categorical	**$5,376**	**$5,226**	**$6,066**	**$6,917**	**$6,783**	**$6,646**	**$8,022**
Education	2,335	2,491	3,164	4,108	3,884	4,320	5,714 [a]
Social Services and Health	2,272	1,802	2,451	2,337	2,442	1,912	1,892
City University	600	692	149 [b]	148	154	130	118
Other	169	240	302	324	303	283	299
Federal	**$4,968**	**$4,412**	**$4,230**	**$3,843**	**$4,550**	**$4,477**	**$4,412**
Unrestricted	**$2,712**	**$1,557**	**$1,460**	**$919**	**$766**	**$648**	**$615**
TOTAL	**$13,056**	**$11,195**	**$11,757**	**$11,678**	**$12,099**	**$11,771**	**$13,050**

Sources: City of New York, Office of the Comptroller, *Comprehensive Annual Financial Report*, fiscal year 1978 to 2001 editions; the value of STAR aid to the City in fiscal year 2001 is from City of New York, Office of Management and Budget, *Executive Budget, Fiscal Year 2002*, Message of the Mayor, April 25, 2001. Amounts shown for fiscal year 1978 are adjusted to be consistent with the accounting for State and federal Medicaid aid in subsequent years.

Note: [a] Education figure for 2001 includes STAR aid.

[b] State aid for City University dropped between fiscal year 1982 and 1986 because the State took over the operating costs associated with the senior colleges.

For most of the last two decades the City made slow but steady progress in gaining a more equitable distribution of education aid. From fiscal year 1981 to 1990 its share of total State education aid rose from 29.7 to 38.3 percent. After a slight falloff in the early 1990s, the share reached a peak again at 38.5 percent in fiscal year 1995. Since then the share has fallen to 36.8 percent. The recent decline is due in part to passage of the State Tax Reduction (STAR) program, effective beginning in fiscal year 1999. This form of aid is allocated among districts not on the basis of educational needs, but on the basis of real estate values and the portion of property taxes devoted to schools. New York City's share of STAR payments has been 20–25 percent and will not exceed 27 percent at full implementation, well below the proportion given New York City under more traditional forms of school aid.

A recent court case seeks to address the issue of equity in school financing by establishing a minimal per pupil amount that the public schools must spend. If the case is upheld on appeal, a State judge will set a minimally acceptable per pupil expenditure level, and the State Legislature will decide how this financial responsibility should be divided between the State and City. While many interested parties in New York City hope the outcome would be greater State aid, it is also possible that the Legislature would mandate greater education spending by the City from its own tax revenues.

Table 7
New York City's Share of Total State School Aid
1980-81 to 1999-00

Year [a]	New York City	Total	NYC Share
1980-81	$1,174,932	$3,957,794	29.7%
1981-82	1,287,219	4,272,493	30.1%
1982-83	1,391,939	4,644,808	30.0%
1983-84	1,503,735	4,876,659	30.8%
1984-85	1,747,572	5,483,139	31.9%
1985-86	1,958,322	6,001,342	32.6%
1986-87	2,229,245	6,663,867	33.5%
1987-88	2,473,325	7,391,573	33.5%
1988-89	2,791,575	8,095,694	34.5%
1989-90	3,077,542	8,036,520	38.3%
1990-91	3,261,116	8,982,872	36.3%
1991-92	3,104,655	8,659,401	35.9%
1992-93	3,310,443	8,817,919	37.5%
1993-94	3,402,423	9,065,209	37.5%
1994-95	3,788,300	9,832,201	38.5%
1995-96	3,753,877	10,188,856	36.8%
1996-97	3,915,129	10,401,326	37.6%
1997-98	4,155,089	10,964,334	37.9%
1998-99 [b]	4,585,658	12,538,457	36.6%
1999-00 [b]	5,127,336	13,951,000	36.8%

Sources: State of New York, State Education Department, Fiscal Analysis and Research Unit, *Analysis of School Finances in New York State School Districts, 1998-99* , February 2001; and, City of New York, Office of the Comptroller, *Comprehensive Annual Financial Report* , fiscal year 1980 to 2001 editions. Total school aid for 1999-00 is estimated by the New York State Education Department.

Notes: [a] New York State school aid sums are school year (September to August) totals. New York City aid sums are fiscal year (July to June) totals.

[b] Total and New York City school aid includes the School Tax Relief Program (STAR) which began in 1998-99.

MANDATE RELIEF

New York State requires its local governments to pay for a disproportionate share of state and local services. Based on fiscal indicators, only four states place more responsibility on their local governments.[14]

The clearest and largest example of the spending burden that New York State places on its local governments is Medicaid. Medicaid provides federal funds to aid states in purchasing

[14] Citizens Budget Commission, *An Affordable Debt Policy for New York State and New York City* (NY: CBC, October 2000).

medical care for the indigent. For New York, the federal matching rate is 50 percent. However, New York State is unusual in the way it finances the nonfederal share of Medicaid. It requires counties, including the City of New York, to pay half the nonfederal share for acute care services and 10 percent for long-term care. Only about a dozen states require any local contribution, and none requires such a significant one. Consequently, New York City paid $3.1 billion for its share of Medicaid in fiscal year 2000. This meant that 11.5 percent of all City-fund revenue was used to meet this mandate. [15]

New York State chooses to provide relatively generous benefits to its Medicaid recipients. In 1998 New York State's average Medicaid payments per beneficiary were $7,907, more than twice the national average of $3,501.[16] Since the State controls Medicaid reimbursement rates and policies, the City is not in a position to control its expenditures; it merely pays its share of the bill.

Another large expenditure item that can be viewed as a mandate is pension fund contributions. While the mayor negotiates with unions over wages and most fringe benefits, pension benefits are set by State legislation and are protected by the State Constitution. The State Legislature can and does enhance pension benefits under pressure from unions, often outside of (or despite) the mayor's negotiated agreements. While the Legislature sets the benefits, the City must make the annual pension fund contributions that finance the retirees' benefits. In this way, legislated pension benefit enhancements are effectively a costly mandate upon the City.

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[15] Data provided by the New York City Office of Management and Budget. In fiscal year 2000, City-fund revenues were $26,893 million. Locally financed Medicaid expenditures in New York City in calendar year 2000 were $3,092 million.

[16] U.S. Congress, House of Representatives, Ways and Means Committee, *The 2000 Green Book*, <http://aspe.hhs.gov/2000gb/sec15.txt> (November 27, 2001).

GOALS FOR THE BLOOMBERG ADMINISTRATION

Like mayors before him, Michael Bloomberg faces a serious fiscal problem as he assumes office. As in the past, this problem is partly attributable to unsustainable spending policies adopted by his predecessor, and partly attributable to a downturn in the national and local economies that is proving to be sharper and deeper than forecasters anticipated, especially after September 11.

The challenge is not simply to get through this initial troublesome period and go through another boom-bust cycle. The long-term goal should be to weather this storm in a way that permits the City to be in a position four years from now to have a balanced budget, a competitive tax system, and services that satisfy residents. The four-year plan that guides the new administration should bring revenues and expenses into balance in a way that sustains services at a competitive cost. This requires basic changes in tax policy, operating expenditures, and capital investments.

The following recommendations, even if broadly accepted, could not be fully implemented in time to close the fiscal year 2003 budget gap. That difficult task will be undertaken by the city's new mayor and the City Council. Necessary and painful interim steps could include service cuts, tax increases (temporary or otherwise), labor concessions, and extraordinary actions such as borrowing to cover an operating deficit. Municipal leaders should consider carefully what is in the City's long-term interest and should build a broad political consensus for the right balance among the options. Yet, unless progress is made in achieving the long-term goal stated above, the pattern of boom and bust characterizing mayoralties will persist and the City will again be ill-prepared when another crisis arises.

TAX POLICY: CUTTING AND SHARING

The basic problem tax policy should address is that New York City imposes a tax burden on its residents and businesses that is higher than in nearly all other large U.S. cities. This has been documented in numerous studies, including those by the Citizens Budget Commission. As part of its *Budget 2000 Project,* the Commission analyzed the effective tax rates on a variety of manufacturing and service businesses in New York City and compared them to those in other large states.[17] In every case, a New York City location imposed a tax burden that reduced firms' rates of return by between 3 and 18 percentage points from what could have been earned at a location in other states such as Connecticut, New Jersey, Texas and Florida. The New York City tax burdens were also significantly higher than those in other parts of New York State. While

[17] The analysis was initially presented in Donald Boyd and James Barrese, "New York's State and Local Tax System," A Background Paper Prepared for the Citizens Budget Commission, (December 1995). A summary of the findings was published in Citizens Budget Commission, *Budget 2000 Project: Tax Policy* (New York: CBC, December 1996), pp. 3–4.

significant tax cuts have been enacted in recent years, other jurisdictions have also made reductions and the burdens still are likely to be higher in New York City.

New York City imposes high burdens on residents as well as businesses. An annual survey of the largest city in each state documents New York's continued high state and local tax burden for middle and high income families. As shown in Table 8, while more favorable for lower income families, New York City's tax burden for families with incomes above $50,000 annually is higher than in all large cities except Philadelphia. The added tax burden for a family making $100,000 in New York City over a similar family in the average large U.S. city is nearly $4,000.

Table 8
State and Local Tax Burdens of Large U.S. Cities, 2000

	Annual Income for a Family of Four			
City	**$25,000**	**$50,000**	**$75,000**	**$100,000**
Philadelphia	$3,020	$6,713	$9,959	$12,944
New York	**2,013**	**5,244**	**9,161**	**12,920**
Detroit	2,330	4,587	7,264	9,728
Boston	2,041	4,569	7,300	9,781
Washington, D.C.	2,146	4,335	7,455	10,459
Los Angeles	2,288	4,175	7,543	11,122
Chicago	2,110	4,016	6,386	8,403
Phoenix	1,478	2,594	4,438	6,329
Houston	1,707	2,584	4,040	5,202
51 City Average	**$2,003**	**$4,019**	**$6,584**	**$8,982**

Source: Government of the District of Columbia, Office of Research & Analysis, *Tax Rates and Tax Burdens In the District of Columbia - A Nationwide Comparison,* August 2001. This report presents data for the largest city in each state and the District of Columbia.

Paying higher taxes might be justified if residents were getting a better package of local services. But few argue this is the case in New York City, where the schools are widely criticized and the roads and bridges are poorly maintained. Rather, New Yorkers pay high taxes for two reasons. First, services are produced inefficiently. It takes more workers, often paid more money, to deliver a public service in New York City than in most other local jurisdictions.[18]

Second, New York City taxpayers are obliged to pay for services to others because of State mandates and restrictions. Each workday a million or more nonresidents enter the city to fill jobs and conduct business. Municipal workers protect them from crime and fire, clean the rubbish they discard, rush them to a hospital when they get sick, and otherwise care for them in

[18] This point is developed and documented in Citizens Budget Commission, *Budget 2000 Project: Restructuring Government Services,* (NY: CBC, December 1996).

numerous ways. Yet the City was limited in the tax it could impose on commuters for many years, and is now prohibited from taxing commuters by the State. Residents must pay for services to commuters.

Similarly, New York City workers and employers pay high taxes because many of their neighbors are poor. The federal and State governments have established a substantial and expensive “safety net” of minimal income and medical care through the public assistance and Medicaid programs. In most states, the combined resources of the state and federal governments finance these programs. But in New York State, counties and the City of New York must pay an unusually large share of the cost of these safety net programs. Because New York City is home to a disproportionately large number of indigent families, the City pays a disproportionately large share of the cost of the public assistance and Medicaid programs operated by New York State. With about 40 percent of the state’s population and jobs, the City is required to pay about two-thirds of the local portion of social welfare expenditures. If New York City taxpayers were asked to pay the former, more reasonable, share of the bill, then their taxes would be cut by about $1.3 billion annually.[19]

The two different causes of high taxes in New York City require two different strategies to reduce them. In order to reduce the cost of producing services, the City needs a new set of expenditure policies, and these are discussed below in the next section. Once expenditure requirements are reduced, specific taxes can be lowered.

In order to stop New York City taxpayers from having to pay for services to others, the City should again be granted authority to impose a commuter tax. This tax, at the modest rate of 0.45 percent that prevailed until 1999, would yield about $500 million annually.

The new administration should also pursue a four-year strategy to realign responsibility for financing social welfare programs in New York State. Medicaid and public assistance should become a State responsibility by fiscal year 2005. New York City families and businesses would pay their share, but it would be based on how much they earned (via the state income tax) or spent (via the state sales tax), not on how many poor people lived in their municipality. This is a more equitable basis for financing these services and would enable the City to become more competitive. All state residents would benefit from having the economic core of the state made more competitive.

A farsighted administration will also look beyond the borders of New York State for opportunities to share the tax burden equitably. The rapid relocation of firms displaced by the attacks on the World Trade Center highlighted that for many purposes the west bank of the Hudson River in Jersey City and Hoboken serves as an adjunct to the Manhattan central business district, as well linked to it as downtown Brooklyn or western Queens. Firms that locate in this part of New Jersey need not be viewed as traitors to New York; they remain tied to the essential core of activities that makes New York a business center and keep the entire area well served by

[19] The combined City share of Medicaid and public assistance was approximately $3.3 billion in fiscal year 2001. This represents about two-thirds of the statewide local portion; if the City’s share were reduced to 40 percent, then the amount would be under $2.0 billion for a reduction of $1.3 billion.

the benefits of agglomeration. The problem is the artificial boundaries of tax jurisdictions, and they could be overcome. Tax sharing between parts of New Jersey and New York could be accomplished through a variety of mechanisms including special tax districts or a new combined entity to finance transportation facilities now in the separate hands of the Port Authority, New Jersey Transit and the Metropolitan Transportation Authority. With some imagination, new financing mechanisms could be designed to help spread the cost of maintaining and enhancing a regional transportation network to include the New Jersey jurisdictions that are now growing because of their proximity to Manhattan.

EXPENDITURE POLICY: PRODUCTIVITY, NOT PRIORITIES

The often repeated advice to chief executives facing difficult times is "set priorities." The basic assumption is that hard choices must be made, favoring one activity (such as police) over another (such as parks). The earlier analysis of expenditure changes under three mayors showed that New York City's chief executives do set spending priorities. Such choices prove inevitable and in New York City the tougher mayoral challenge is to oblige leaders in all agencies to focus on doing their job more productively. Every agency, with no special treatment for some over others, should be obliged to redesign its work processes and labor relations in order to reduce the unit cost of service delivery.

Previous research by the Citizens Budget Commission has identified five measures that would greatly enhance municipal productivity.[20] Mayor Bloomberg should pursue them as he approaches the municipal employee unions in the round of negotiations that is still open for the police and teachers, and that will be approaching anew in 2002 for others.

1. **Set pay levels in response to labor market conditions, with shortage occupations receiving greater wage increases than those occupations where abundant applicants are available.**

The past practice of across-the-board increases of a similar percentage for numerous different job titles represented by municipal employee unions has led to counterproductive results. Some jobs cannot be filled because the wage is well below what is paid for comparable work in the private sector; as a result, services are provided poorly or inefficiently. At the same time, other municipal jobs offer salaries and benefits that far exceed the pay of private jobs requiring similar backgrounds; as a result, these positions draw numerous qualified applicants for each position and taxpayers pay more than is necessary. The basic strategy should be to divide civil service positions into three categories, each with a different wage policy.

a. **Occupations with an abundant supply of applicants.** One group is positions that draw an abundant pool of qualified applicants. The labor market signal for them is clear; higher real wages are not needed. This group includes the uniformed agencies. Recently the ratio

[20] These recommendations are developed with supporting information in two recent reports: *Using Collective Bargaining to Improve Public Education* (August 31, 2000) and *The Citizens Stakes' in Collective Bargaining* (December 13, 2000).

of *qualified* applicants for each vacancy has been 74:1 for entry sanitation workers, 12:1 for firefighters, 9:1 for correction officers, and 6:1 for police officers. [21]

b. **Shortages without wage disparities.** In the recent tight labor market, some municipal positions became difficult to fill. However, the perceived shortages should be analyzed to identify their root cause. In many cases, the issue is not primarily wages. For example, engineers appear to be hard to recruit primarily because of the City's hiring practices rather than low entry salaries. For this group of positions, the City's recruitment and hiring practices, and its working conditions, should be changed, but wages may need only to keep pace with inflation.

c. **Shortages that require significant wage increases.** A third group of positions has basic salaries clearly out of line with the private sector. These pay disparities are causing labor shortages, which, in turn, harm the quality of public services. In these instances, substantial real wage increases should be provided.

Some, but not all, public school teaching positions fall in the third category. The Board of Education does not have a single job classification of "teacher." Rather it hires people in 225 separate titles that are specific types of teachers such as high school social studies and bilingual Spanish elementary school. Only about 17 percent of the Board's nearly 80,000 teachers work in specific fields and schools that face a serious shortage. Those meeting the conditions should receive increases in the range of 20–25 percent in order to overcome the shortages. But most teachers, including the large number (nearly 29,000) working as "common branch" or elementary school teachers are not in a shortage and should not receive such large raises in an "across the board" fashion.

Outside of education, there are about 16,000 workers in the shortage category in 129 different job titles. Examples include social service workers, computer specialists and tax auditors. Municipal wages lag those in the local labor market by 10 percent or more for these titles. The cost of well-targeted, one-time "catch-up" raises for these shortage occupations would be approximately $150 million annually.

2. Change work processes to lower the unit cost of services.

New York City's historically high costs for public services, and the accompanying high tax burdens, make the City less economically competitive. High unit costs result from a combination of wages that are higher than in other places and of using more labor to produce the service. The wage policies recommended above would help bring the cost of labor into line with other places, but two additional steps should be taken to use labor more efficiently.

a. **Encourage more efficient work rules by sharing the savings from productivity initiatives with workers.** Workers are more likely to cooperate with, and even help

[21] It is not clear how the events of September 11 and the local recession will affect the number of applicants for police officer and firefighter positions. The situation should be carefully monitored to determine if there continues to be an adequate number of applicants.

identify, productivity initiatives if they share in the savings. Inefficiencies in the use of labor that could be reduced in this way include excessive overtime, use of more highly paid workers than is necessary for a task, and higher ratios of supervisors to workers than is necessary.

b. **Facilitate managerial initiatives to revise work processes.** In addition to removing currently cumbersome work rules, the new contracts should facilitate new managerial initiatives that permit services to be produced more efficiently. Two such strategies are the introduction of competition and the application of technology. New contracts should make it easier and quicker for the City to competitively bid services now produced internally, and they should facilitate the introduction of new technology by expanding management's work assignment flexibility and, as appropriate, providing for worker training in the use of new technology.

3. **Shift the emphasis in pay scales from longevity to performance by adding a merit pay component to wages.**

While the CBC would, as noted above, encourage base wage increases for some shortage positions and in exchange for productivity initiatives, merit pay also should reward efforts by workers that lead to higher quality services. For teachers, two types of merit pay should be made available. The first type rewards individual efforts such as achieving specific developmental goals or taking on added responsibilities. The second type rewards work groups that achieve service outcomes that exceed predetermined norms, such as better than expected gains in standardized test scores.

In services other than education there are fewer opportunities for individual merit pay, but there are numerous opportunities for bonuses to work groups that perform well. Teams of workers in agencies could be offered incentives. For example, agencies that process business permits could be rewarded for shortening permit-processing time, and customer service staff could be rewarded for shorter client queues. Such incentives have great promise for increasing municipal agencies' responsiveness to the public and stimulating improvements in public services.

Performance pay need not be financed with additional funding. The current salary structures have differential payments for longevity. These longevity payments could be eliminated for newly hired workers and reduced for incumbents in order to shift the emphasis in rewards from seniority to job performance. Since the current rewards for longevity are substantial, shifting the funding could provide a significant incentive for better job performance.

4. **Modernize the health insurance program for municipal workers and retirees.**

The municipal health insurance program is more expensive for the City and for workers than it needs to be; it has not kept pace with trends in private industry or with other governments in the implementation of two key cost containment strategies.

a. **Premium cost-sharing.** The City should follow the premium cost-sharing strategy now widespread among public and private employers. Among large private employers nationally, 69 percent require employees to contribute to the cost of individual coverage, and 80 percent require contributions toward the cost of family coverage. Of the 42 percent of private employers that offer retiree health benefits, 90 percent require some co-payment toward the premium.[22] Among state and local governments, 51 percent require contributions to the cost of individual coverage and 75 percent require contributions to the cost of family coverage.[23]

   The City should require cost-sharing of 10 percent toward individual coverage and 20 percent for family coverage for employees, should drop reimbursement of Medicare Part B premiums for retirees, and require a 50 percent contribution from retirees toward premiums for non-Medicare benefits. The direct savings would be over $500 million annually. In addition, there are likely to be substantial future indirect savings as workers and retirees become more cost conscious and work with the City to seek benefits changes and other measures that might control growing costs.

b. **Price competition among insurance plans.** Increasingly, large private, and a few public, employers are using their significant purchasing power to generate competition for their health insurance business. Large employers need not accept high premiums and substantial annual increases as inevitable. A preferable alternative would be to ask the multiple plans seeking to insure municipal workers and their families to compete by offering lower prices. If this strategy kept health insurance costs at current levels, then the City would save about $247 million from the projected costs in fiscal year 2004.

5. Restructure the pension system for newly employed workers to provide a defined contribution rather than a defined benefit.

Pension systems fall into two categories—defined benefit plans and defined contribution plans. New York City's systems are defined benefit plans. They guarantee workers an income during retirement based on retirement age, years of service, and final year or years' average salary. Defined contribution plans give workers a fixed employer contribution during each year of employment, with retirement income drawing on the accrued value of these contributions. For defined contribution plans, the employer's payment is a fixed annual amount or percentage of salary per worker; for defined benefit plans, the employer's annual payment varies due to changes in the returns on investments and changed actuarial assumptions about workers future average earnings, life span after retirement and other factors.

The current defined benefit pension system puts the City of New York at a financial disadvantage in both good and bad economic times, opens the door for abuses, and places the City at a disadvantage in today's job market. In hard times, when investment performance is weak, the City must make a larger pension fund contribution. During good economic times,

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[22] U.S. Department of Labor, Bureau of Labor Statistics, *Employee Benefits in Medium and Large Private Establishments, 1997,* < www.bls.gov/ncs/ebs/sp/ebbl0017.pdf > (27 November 2001).
[23] U.S. Department of Labor, Bureau of Labor Statistics, *Employee Benefits in State and Local Governments, 1998*, <www.bls.gov/ncs/ebs/sp/ebbl0018.pdf> (27 November 2001).

including recent years, the City's required pension contributions fall, but unions quickly take advantage of the situation to pursue legislative changes outside of collective bargaining that make significant, permanent pension benefit enhancements. Pension enhancements added in 2000 alone outside of collective bargaining will cost the City $798 million in recurring annual expenses, equivalent to a 5 percent pay raise.

The current defined benefit pension system also opens the door to abuse. Most systems count overtime in the final year or years as part of an employee's base pay for purposes of calculating pension benefits. A resulting frequent practice is to favor workers near retirement in the assignment of overtime, thereby inflating the future pension benefit.

Also, the City's pension plans lack the portability sought by today's younger workforce. Its plans reward workers who spend their entire career with one employer, but are less generous to those who change jobs. The benefits are not vested until after a five-year period, and the benefit formulas disproportionately favor longevity beyond 20 years.

In order to promote the dual goals of becoming a more attractive employer to younger workers and of protecting itself from fiscal risks and abuses, the City should use collective bargaining to achieve two changes in its pension systems.

a. **For current employees, prohibit benefit enhancements outside of collective bargaining.** The freedom for unions to do expensive legislative "end-runs" around collective bargaining should be ended. Just as salary, health insurance and welfare fund contributions are negotiated between the City and unions, pension benefits should be negotiated and set only in the context of negotiations. In the next contracts, the unions should commit to ending all legislative initiatives for pension enhancements not agreed to as part of the contract and supported by the City. The agreements should include serious and enforceable penalties.

b. **For newly hired workers, establish a new defined contribution plan.** The defined contribution model makes sense for the City and its workers. The City would incur a relatively fixed and predictable expense each year. Fluctuating annual liabilities, which are typically counter-cyclical and thus fiscally stressing, would be avoided in the future. Moreover, switching to a defined contribution plan would sharply diminish opportunities for altering pension benefits outside collective bargaining. Both parties could confront directly the tradeoffs between pension contributions and other compensation.

A defined contribution plan also would help the City to recruit qualified, younger workers, because this type of system better matches the expectations of today's workforce. Employees who change jobs before completing five or more years of service would not forego the employer contribution to their retirement fund. In addition, employees would control how their retirement funds are invested and could personalize their investments according to their own risk tolerance and investment horizon.

In a report prepared in December 2000, the CBC estimated that implementing these five recommendations over four years would yield net savings at the end of the period of about $1.4 billion annually. The productivity initiatives can reasonably be expected to provide savings amounting to about 4 percent annually for the uniformed services and 2 percent annually for other workers. The health insurance modernization would save nearly $800 million annually. Returning one-third of the productivity gains to workers through gainsharing and funding targeted raises as well as a merit pay program reduces these gross savings to the approximately $1.4 billion annually.

CAPITAL INVESTMENTS: A SMARTER, NOT A LARGER, CAPITAL PROGRAM

In encouraging greater labor productivity, enlightened managers urge that people "work smarter, not harder." A parallel philosophy should be applied to capital investments. The capital budget should be smarter, not necessarily bigger and more expensive. The goal should not be to rebuild old facilities in exactly the same place and style as their initial design, but to design new infrastructure and buildings that make better use of available capital funds. New facilities and equipment should be sought that will make workers more productive and services more efficient and convenient.

One key element in this strategy is to create facilities that can be used more intensively. Businesses that seek to expand production do not seek first to build new plants; instead they operate existing ones for longer hours with extended and weekend shifts. The same logic can be applied in a smart and selective fashion to public facilities. The clearest example is schools, where overcrowding can be alleviated through scheduling educational activities on a year-round basis instead of just 180 days per year.[24] Year-round schooling can make better use of existing and planned buildings, eliminating the need for some new school construction. The same approach should be considered in planning other departments' capital programs.

Another smart way to reduce the need for new capital spending is to better maintain existing facilities. The City's abysmal record of maintaining its capital assets, particularly during the 1960s and 1970s, contributed to the urgency of capital spending needs today. The City should not impose the same burden on future residents by neglecting maintenance. Regular and timely maintenance can delay and avoid substantially more expensive renovation or replacement.

When new construction is necessary, it should be accomplished as efficiently as possible. Yet a State law, the Wicks Law, mandates inefficient and costly practices in the City's capital program. It requires that public entities act as their own general contractors by hiring multiple subcontractors for projects costing more than $50,000. While originally meant to combat corruption, the effect today is to raise the cost of capital projects and add substantial delays. Last

[24] See Citizens Budget Commission, *School Buildings for the Next Century: An Affordable Strategy for Repairing and Modernizing New York City's School Facilities* (NY: CBC, September 1996) and The Year-Round Education Task Force, *You're Blocking My View!: A Report on Year-Round Education and the Crisis of Overcrowding* (NY: Board of Education, October 4, 2000).

year the City estimated that the Wicks Law raises capital project costs by 14 percent.[25] It should be repealed, and Mayor Bloomberg should redouble his predecessor's support for such efforts.

Finally, smart capital planning is more likely to occur if there is a clear limit on the amount the City can borrow for capital projects. If borrowed funds are seen as a limitless resource, then projects will not be reviewed as carefully as they should be. In recent years, the City has circumvented State constitutional limits on its general obligation borrowing by successfully petitioning the State to create new borrowing entities such as the Transitional Financing Authority and the Tobacco Settlement Asset Securitization Corporation. A new State constitutional amendment is needed to place a clear, comprehensive and realistic limit on all municipal borrowing. The CBC, in its October 2000 report on *An Affordable Debt Policy for New York State and New York City,* identified a suitable method for setting state and local debt limits and recommended a constitutional amendment to implement this approach. Adopting such an amendment would ensure that municipal borrowing stayed within affordable limits and would provide a clear incentive for capital planning that recognized the need to set priorities.

[25] City of New York, Office of Management and Budget, *Financial Plan, Fiscal Years 2000–2004,* January 27, 2000.

APPENDICES

Appendix A
City of New York
Major Service Expenditures in Constant 2000 Dollars
(dollars in millions, except where indicated)

	Fiscal Year							
	1978[a]	1982	1986	1990	1994	1998	2001[b]	2002[b]
Total - All Functions								
Adjusted Expenditures	$34,270	$29,206	$32,730	$34,890	$36,417	$35,747	$39,782	$40,321
Percentage Change	na	-14.8%	12.1%	6.6%	4.4%	-1.8%	11.3%	12.8%
Expenditure Components								
City Funds Expenditures	21,200	19,571	22,433	24,130	25,083	24,623	27,803	28,584
Percentage Change	na	-7.7%	14.6%	7.6%	3.9%	-1.8%	12.9%	16.1%
Federal Categorical Aid	6,786	4,411	4,230	3,842	4,551	4,477	4,425	4,211
Percentage Change	na	-35.0%	-4.1%	-9.2%	18.4%	-1.6%	-1.2%	-6.0%
State Categorical Aid	6,284	5,224	6,067	6,917	6,784	6,647	7,554	7,527
Percentage Change	na	-16.9%	16.1%	14.0%	-1.9%	-2.0%	13.7%	13.2%
Headcount[c]	202,394	201,539	226,804	249,632	243,196	242,448	249,824	255,477
Percentage Change	na	-0.4%	12.5%	10.1%	-2.6%	-0.3%	3.0%	5.4%
Board of Education								
Expenditures	$7,097	$5,783	$7,131	$8,513	$8,689	$9,192	$11,228	$10,921
Percentage Change	na	-18.5%	23.3%	19.4%	2.1%	5.8%	22.1%	18.8%
Agency Expenditures as % of Total	20.7%	19.8%	21.8%	24.4%	23.9%	25.7%	28.2%	27.1%
Headcount	71,734	70,891	79,760	86,224	88,639	93,365	102,583	103,175
Pedagogues	63,690	64,751	72,034	77,780	80,863	86,179	94,397	95,306
Non-Pedagogues	8,044	6,140	7,726	8,444	7,776	7,186	8,186	7,869
Total Headcount as % of City Total	35.4%	35.2%	35.2%	34.5%	36.4%	38.5%	41.1%	40.4%
Pedagogical Headcount as % of City Total	31.5%	32.1%	31.8%	31.2%	33.3%	35.5%	37.8%	37.3%
Enrollment	1,036,243	924,145	936,231	938,645	1,015,756	1,083,058	1,103,245	na
Percentage Change	na	-10.8%	1.3%	0.3%	8.2%	6.6%	1.9%	na
Expenditures per Pupil (dollars)	$6,849	$6,257	$7,616	$9,069	$8,555	$8,487	$10,177	na
Pupil Enrollment to Pedagogues	16.3	14.3	13.0	12.1	12.6	12.6	11.7	na
Health & Human Services[d]								
Combined Agency Expenditures[e]	$7,667	$7,581	$9,163	$9,505	$10,891	$9,625	$10,295	$10,299
Percentage Change	na	-1.1%	20.9%	3.7%	14.6%	-11.6%	7.0%	7.0%
Combined Expenditures as % of Total	22.4%	26.0%	28.0%	27.2%	29.9%	26.9%	25.9%	25.5%
Department of Social Services[f]								
Expenditures	$7,847	$6,286	$7,423	$7,516	$8,855	$7,820	$8,166	$8,140
Percentage Change	na	-19.9%	18.1%	1.3%	17.8%	-11.7%	4.4%	4.1%
Agency Expenditures as % of Total	22.9%	21.5%	22.7%	21.5%	24.3%	21.9%	20.5%	20.2%
Headcount	23,021	22,190	24,759	31,491	26,013	22,952	21,309	22,165
Percentage Change	na	-3.6%	11.6%	27.2%	-17.4%	-11.8%	-7.2%	-3.4%
Department of Social Services	23,021	22,190	24,759	31,491	22,966	13,641	12,624	7,619
Department of Homeless Services	na	na	na	na	3,047	2,140	1,564	1,570
Department of Children's Services	na	na	na	na	na	7,171	7,121	7,619
Agency Headcount as % of Total	11.4%	11.0%	10.9%	12.6%	10.7%	9.5%	8.5%	8.7%

Appendix A - Continued
City of New York
Major Service Expenditures in Constant 2000 Dollars
(dollars in millions, except where indicated)

	Fiscal Year							
	1978[a]	1982	1986	1990	1994	1998	2001[b]	2002[b]
Public Safety Services[g]								
Combined Agency Expenditures	$4,317	$3,093	$4,010	$4,676	$4,467	$4,713	$5,224	$5,100
Percentage Change	na	-28.4%	29.7%	16.6%	-4.5%	5.5%	10.8%	8.2%
Combined Expenditures as % of Total	12.6%	10.6%	12.3%	13.4%	12.3%	13.2%	13.1%	12.6%
Police Department[h]								
Expenditures	$2,875	$1,872	$2,395	$2,545	$2,578	$2,705	$3,183	$3,036
Percentage Change	na	-34.9%	28.0%	6.2%	1.3%	4.9%	17.7%	12.2%
Department Expenditures as % of Total	8.4%	6.4%	7.3%	7.3%	7.1%	7.6%	8.0%	7.5%
Total Headcount	34,099	34,971	39,197	39,518	45,452	46,864	48,004	49,296
NYPD Total	29,378	29,583	32,669	32,976	38,008	46,864	48,004	49,296
Uniform	24,879	23,961	26,490	25,909	30,927	38,144	38,630	40,710
Civilian	4,499	5,622	6,179	7,067	7,081	8,720	9,374	8,586
Transit Authority & Housing Authority Police	4,721	5,388	6,528	6,542	7,444	na	na	na
Total Police Headcount as % of Total	16.8%	17.4%	17.3%	15.8%	18.7%	19.3%	19.2%	19.3%
NYPD Uniformed Headcount as % of Total	12.3%	11.9%	11.7%	10.4%	12.7%	15.7%	15.5%	15.9%
Debt Service - Adjusted for Prepayments								
Total Expenditure	$5,358	$3,301	$2,436	$2,262	$3,127	$3,275	$3,819	$3,852
Percentage Change	na	-38.4%	-26.2%	-7.1%	38.2%	4.7%	16.6%	17.6%
Debt Service as % of Total Expenditures	15.6%	11.3%	7.4%	6.5%	8.6%	9.2%	9.6%	9.6%
Components of Debt Service								
General Obligation[i]	$4,334	$2,543	$2,055	$1,524	$2,720	$2,941	$2,936	$2,863
Municipal Assistance Corporation	$1,023	$758	$381	$738	$407	$317	$439	$463
Transitional Finance Authority	na	na	na	na	na	$17	$396	$477
TSASC	na	na	na	na	na	na	$49	$49
All Other Functions								
Expenditures	$9,832	$9,448	$9,990	$9,933	$9,244	$8,942	$9,217	$10,150
Percentage Change	na	-3.9%	5.7%	-0.6%	-6.9%	-3.3%	3.1%	13.5%
All Other as % of Total	28.7%	32.4%	30.5%	28.5%	25.4%	25.0%	23.2%	25.2%
Components of All Other Functions:								
Fringe Benefits	na	$1,488	$2,095	$2,679	$3,168	$3,319	$3,734	na
Pensions	na	$2,832	$2,764	$2,350	$1,558	$1,546	$1,184	$1,293
Other Expenditures	na	$5,128	$5,132	$4,904	$4,518	$4,077	$4,300	na
Percentage Change	na	na	0.1%	-4.4%	-7.9%	-9.8%	5.5%	na

Appendix A - Sources and Notes

Sources: Fiscal years 1978 through 2001 expenditure data are from City of New York, Office of the Comptroller, *Comprehensive Annual Financial Report of the Comptroller* , fiscal year 1978 to 2001 editions. Fiscal year 2002 expenditure data are from City of New York, Office of Management and Budget, *Financial Plan, Fiscal Years 2001-2005,* Adopted Plan, June 7, 2001. Headcount data are supplied by City of New York, Office of Management and Budget. Other indicators from City of New York, Mayor's Office of Operations, *Mayor's Management Report* , fiscal year 1979 to 2001 editions. Constant dollar adjustment based on consumer price index series from U.S. Department of Labor, Bureau of Labor Statistics, CPI for All Urban Consumers (CPI-U), NY-Northeastern, NJ; All items. Inflation for fiscal year 2002 based on assumptions in City of New York, Office of Management and Budget *Fiscal Year 2002 Adopted Budget* .

Notes: a. In fiscal year 1978 pension costs for selected agencies were reported differently than in years after 1980. The effect of this change is to make reductions for these agencies (notably Police, Fire and Education) greater than would be the case if data were reported consistently.

b. Percentage change for fiscal years 2001 and 2002 are the change from fiscal year 1998. Expenditure and headcount figures for fiscal year 2002 are as projected in the *Fiscal Year 2002 Adopted Budget* .

c. Total headcount includes Transit Police and Housing Police prior to 1995, but excludes Emergency Medical Services prior to 1996.

d. Health and human services agencies include: Department of Social Services, Administration for Children's Services, Department of Homeless Services, City payments to the Health and Hospitals Corporation, Department of Health, Department of Mental Health, and Department for the Aging.

e. Health and human services expenditure for fiscal year 1978 reduced $2,759 (constant 2000 dollars) to account for change in reporting of State and federal Medicaid expenses. This expense was divided between the Department of Social Services and the Health and Hospitals Corporation payment.

f. Department of Social Services includes Department of Homeless Services for fiscal years 1994 - 2002 and Administration for Children's Services for fiscal years 1998 - 2002.

g. Public safety includes the Police Department, Fire Department, Department of Correction, Department of Juvenile Justice and Department of Probation.

h. NYPD expenditures include spending on Transit Authority and Housing Authority Police Departments prior to 1995, but exclude traffic enforcement personnel prior to 1997.

i. General obligation debt service includes lease purchase obligations.

na - Not applicable.

Appendix B
City of New York
Headcount and Personal Service Expenditures in Constant 2000 Dollars
(dollars in millions, except where indicated)

	Fiscal Year							
	1978	1982	1986	1990	1994	1998	2001a	2002a
New York City Total								
Adjusted Expenditures	$34,270	$29,206	$32,730	$34,890	$36,417	$35,747	$39,782	$40,321
Percentage Change	na	-14.8%	12.1%	6.6%	4.4%	-1.8%	11.3%	12.8%
Headcount[b]	197,673	196,151	220,276	243,090	235,752	242,448	249,824	255,477
Percentage Change	na	-0.8%	12.3%	10.4%	-3.0%	2.8%	3.0%	5.4%
Personal Service Expenditures								
Total Personal Service Expenditures	na	$13,113	$15,861	$17,888	$16,808	$17,075	$18,699	na
Percentage Change	na	na	21.0%	12.8%	-6.0%	1.6%	9.5%	na
Personal Services Expenditures as % of Total	na	44.9%	48.5%	51.3%	46.2%	47.8%	47.0%	na
Personal Service Expense per Worker (dollars)	na	$66,852	$72,003	$73,586	$71,294	$70,426	$74,848	na
Percentage Change	na	na	7.7%	2.2%	-3.1%	-1.2%	6.3%	na
Wage and Salary Expenditures[c]	na	$8,795	$11,002	$12,859	$12,082	$12,210	$13,782	na
Percentage Change	na	na	25.1%	16.9%	-6.0%	1.1%	12.9%	na
Wage Expense per Worker (dollars)	na	$44,838	$49,946	$52,900	$51,248	$50,362	$55,165	na
Percentage Change	na	na	11.4%	5.9%	-3.1%	-1.7%	9.5%	na
Fringe Benefit Expenditures	na	$1,488	$2,095	$2,679	$3,168	$3,319	$3,734	na
Percentage Change	na	na	40.8%	27.9%	18.2%	4.8%	12.5%	na
Fringe Benefit Expense per Worker (dollars)	na	$7,585	$9,510	$11,020	$13,436	$13,688	$14,945	na
Percentage Change	na	na	25.4%	15.9%	21.9%	1.9%	9.2%	na
Pension Fund Contributions	na	$2,832	$2,764	$2,350	$1,558	$1,546	$1,184	$1,293
Percentage Change	na	na	-2.4%	-15.0%	-33.7%	-0.8%	-23.4%	-16.4%
Pension Contribution per Worker (dollars)	na	$14,440	$12,547	$9,667	$6,610	$6,376	$4,738	$5,060
Percentage Change	na	na	-13.1%	-23.0%	-31.6%	-3.5%	-25.7%	-20.6%

Sources: See Appendix A.

Notes: a. Percentages for fiscal year 2001 and 2002 are the change from fiscal year 1998. Expenditure and headcount figures for fiscal year 2002 are as projected in the *Fiscal Year 2002 Adopted Budget* .

b. Total headcount excludes Transit Police and Housing Police prior to 1995, and Emergency Medical Services prior to 1996.

c. Personal service and wage and salary expenditures exclude part time and seasonal wages in order to reflect accurately compensation for full time employees included in the headcount.

na - Not available.