A Review of the January 2001 Financial Plan For the City of New York for Fiscal Years 2002-2005

A Report of the
Citizens Budget Commission

March 29, 2001

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 City and New York State governments. This report was prepared under the auspices of the CBC's Budget Policy Committee, which I co-chair with Richard A. Levine. The other members of the Committee are: Lawrence B. Buttenwieser, Denis V. Curtin, Evan A. Davis, Stephen DeGroat, Cheryl Cohen Effron, Linda Fan, Bud H. Gibbs, Kenneth D. Gibbs, James F. Haddon, H. Dale Hemmerdinger, Lawrence S. Huntington, Peter C. Kornman, Robert Kurtter, John R. Miller, Lionel I. Pincus, Robert E. Poll, Carol Raphael, Edward L. Sadowsky, Barry F. Sullivan, Merryl H. Tisch, Stephen H. Weiss and David I. Weprin.

The Budget Policy Committee has responsibility for developing the Commission's positions on the New York City and New York State annual operating budgets. The City's Charter requires that the Mayor prepare a Preliminary Financial Plan each January that balances the budget for the upcoming fiscal year and projects revenues and expenses for the subsequent three years. This January Plan sets the stage for the release in April of the Mayor's Executive Budget, which is followed by City Council hearings and adoption of a final budget in June. This report presents the Commission's analysis of the Mayor's Plan and recommendations for its improvement before final adoption.

Charles Brecher, Director of Research, Douglas Offerman, Senior Research Associate, and Elizabeth Lynam, Senior Research Associate, researched and wrote this report. Kurt Richwerger, Research Consultant, and Amy Karwan, Research Associate, provided additional research support. Nicolette Macdonald, the Commission's Publications Coordinator, prepared this report for publication. An electronic version of the report is available on the CBC's website at <www.cbcny.org>.

Eugene J. Keilin
Chairman

March 29, 2001

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EXECUTIVE SUMMARY

The City of New York's finances are in transition, but the Financial Plan presented by Mayor Rudolph W. Giuliani in January 2001 does not adequately address the challenges posed by this transition. This report presents the Citizens Budget Commission's (CBC's) analysis of the Mayor's Preliminary Financial Plan and the Commission's recommendations for improvement.

The rapid growth in revenue caused by a period of unprecedented national prosperity is likely to slow and, in the event of a recession, even contract. At the same time, the Mayor and the legislative leaders responsible for local financial management are subject to term limits and reach the end of their tenure in the middle of the coming fiscal year. It is their successors who will have to live with the consequences of the decisions they make in the current budget cycle.

Instead of keeping spending in line with a slowed economy, the Mayor's Plan would raise the recurring costs of municipal government while reducing the recurring revenues available to meet these commitments. In addition, a number of one-time resources are being spent today, rather than reserved for the future or used to bolster the City's long-term fiscal condition. The result is extremely large budget gaps in future years, with a strong prospect that new leaders assuming office in January 2002 will have to make abrupt budgetary changes that disrupt and curtail services.

The Mayor himself has recognized the need for some adjustments to his January Plan. In late February agency heads were asked to develop spending reduction options for fiscal years 2001 and 2002. The nature of these cuts is not known at this time, and the magnitude appears relatively modest—$380 million in fiscal year 2002. However, this action suggests the Administration recognizes that the spending levels in the January Plan are too high.

Decisions that Significantly Increase the Cost of Municipal Government

Three decisions play a major role in inflating the cost of municipal government.

1. More Municipal Employees. During his first two years, Mayor Giuliani pared 11,514 positions from the municipal payroll. However, as the economy improved, the administration gave higher priority to adding workers than to obtaining greater productivity from them. From fiscal year 1996 to fiscal year 2000, fully 15,743 workers were added and the current year's budget adds nearly 5,000 more. At the end of this fiscal year, the total workforce of 255,669 will be larger than in any of the last 25 years, and the January Financial Plan would keep it near this level through 2005.

2. Higher Employee Compensation without Productivity Gains. Total employee compensation is rising even faster than headcount. The initial set of five-year contracts negotiated by Mayor Giuliani expired in 2000, and for the new round he initially pledged to give

raises only in the form of "merit pay" and to fund these raises through productivity enhancements. However, these productivity targets have been abandoned in recent actions.

During 2000, two agreements resulted in higher pension expenditures. In one, the Mayor agreed to support pension enhancements in exchange for a short-term reduction in the City's contributions to workers' pension funds. The package is estimated to cost the City $318 million annually or the equivalent of about a 2 percent wage increase. Additional State legislation passed in 2000, which the Mayor opposed, adds automatic inflation adjustments to pension benefits. Together the two measures, when fully phased in, carry a recurring annual cost of over $798 million, or the equivalent of a 5 percent pay increase.

In January 2001 the Mayor signed a Health Benefit Agreement with the Municipal Labor Committee (MLC), a coalition of unions, covering basic health insurance for City employees, retirees and their families and supplementary benefits obtained through union welfare funds. The Agreement obliges the City to provide health insurance without premium contributions from workers (which the Mayor had previously sought), and the guaranteed minimum benefits are expanded to include better mental health and prescription drug coverage. These new benefits cost about $40 million annually. The agreement also commits the City to pay $200 more annually per employee and retiree to union welfare funds, at a cost of $103 million annually.

Finally, the City made a substantial concession by agreeing to drop the productivity savings item in the City budget that would have saved $250 million in fiscal year 2001 and grow to $300 million in 2004 and beyond. In exchange for these benefits and concessions, the City gained no recurring savings, settling instead for "one-shot" revenues.

3. Higher Debt Service Burdens. The January Financial Plan includes a capital plan, covering fiscal years 2001 to 2004. Compared to last year's capital plan, commitments grow 20 percent, to $29.1 billion.

The growing capital program is financed largely by borrowing, which imposes future debt service costs. The plan requires $24.4 billion in new debt through 2004, pushing debt service spending to unprecedented levels. Debt service increases from $3,426 million in fiscal year 2000 to $5,051 million in fiscal year 2005, or 8.1 percent annually. Unlike more discretionary expenditures, debt service is difficult to reduce in hard times. If the City faced a sudden economic downturn, growing debt service would require cutbacks concentrated in other areas.

Short-sighted Revenue Decisions

In the Mayor's Financial Plan, the substantial new spending is financed with short-sighted revenue policies. For fiscal year 2002, the Mayor draws upon the current year's surplus and a variety of other "one-shot" sources. In subsequent years, the disappearance of these sources is compounded by a promise of tax cuts that are "backloaded."

1. Imprudent use of the surplus. In recent years, unexpectedly strong local economic performance generated an annual operating surplus for the City. This pattern is being repeated in fiscal year 2001. The January Plan projects a surplus of $2,267 million.

Fiscal prudence requires that nonrecurring resources, such as an operating surplus, be used to improve the long-run financial condition of a government. Instead, the Mayor's Plan proposes using $1,922 million of the fiscal year 2001 surplus to cover recurring expenses in fiscal year 2002, and $345 million for expenses generated in fiscal year 2003. This is postponing a problem, not solving it.

2. Heavy reliance on "one-shots." The Mayor's Plan for fiscal year 2002 relies heavily on one-shot revenues. In addition to the $2.3 billion prior-year surplus, the Mayor draws on almost $600 million from the sale of City-owned property and other one-time sources. Depending on these nonrecurring revenues to finance recurring expenses postpones the task of sizing municipal government to fit its revenue base.

3. "Backloaded" tax cuts not matched with spending cuts. Compounding the dependence on nonrecurring revenues is a multiyear tax cut program that is not matched with cuts in expenditures. The January Plan proposes phased-in tax cuts with a value of $405 million in fiscal year 2002 that grow to $1,249 million in fiscal year 2005. While additional tax cuts are important for improving New York City's competitiveness, the Mayor is proposing tax cuts without indicating how to make them affordable. If they are passed this year, his successor will have to answer the question of what services to sacrifice in order to balance the budget.

The Resulting Large Budget Gaps

Growing expenditures, disappearing one-shots and backloaded tax cuts leave the City with large future budget gaps. Moreover, the gaps are understated in the Mayor's Plan because of unrealistic assumptions.

The January Plan balances the coming year's budget, but not those of subsequent years. In fiscal years 2003 to 2005 the Mayor's estimate of the gap between revenues and expenditures ranges from $2.3 billion to almost $2.5 billion. A more cautious set of projections should consider three factors.

1. Unrealistic aid assumptions. The Mayor's Plan anticipates $350 million in unrealistic or nonrecurring intergovernmental aid. While such aid may be desirable, it is unlikely.

2. Additional costs of labor settlements. The January Plan assumes municipal employee wages will be frozen between 2003 and 2005. Adjusting wages for projected inflation would increase the gap by $514 million in 2003, rising to $1,426 million in 2005. If current wage negotiations result in a settlement that is higher than inflation, these future wage shortfalls would be even greater.

3. Revenue losses due to a less robust economy. If the current economic slowdown is more prolonged than the City's estimate, then the revenue impacts would be more severe. Under a scenario of no growth in the local economy for calendar years 2001 and 2002, and slow growth thereafter, the shortfall in tax collections from the Mayor's Plan would be $440 million in 2003, growing to $906 million in 2005. A recession would reduce revenues even further.

These adjustments have been combined to yield a low range and a high range estimate of future gaps. The low range allows for unrealistic aid and wage increases equal to inflation; it reveals a gap of $4.2 billion, or 10 percent of projected expenditures, in fiscal year 2005. The high range includes all the adjustments; it indicates a gap of $5.8 billion, or 13 percent of expenditures, in fiscal year 2005.

Better Budget Strategies

More far-sighted policies would respond to the challenges the City faces, and would leave a legacy of soundly balanced budgets. Four strategies should be pursued.

1. Use the surplus prudently. The current surplus should be used to provide long-lasting improvements to the City's fiscal health. More prudent uses of the surplus are:

- Reduce the City's $37 billion in outstanding debt by retiring bonds early, particularly the higher interest bonds.
- Lower future outstanding debt by financing some capital projects with the current surplus.
- Establish a rainy day fund to protect against future economic downturns.

2. Pursue labor agreements with large productivity gains. New York City's workforce should be smaller, better paid and more productive than is now the case. A more productive government would provide the same or better services at a lower cost. It is what we expect of the private sector, and it should be true of a modern municipal government.

Progress toward this goal will be possible only if the Mayor assigns it a high priority in his ongoing negotiations with the municipal employee unions. He should reconsider the provision of the Health Benefit Agreement that capitulates on including productivity gains in the Financial Plan, and he should develop a meaningful productivity agenda to pursue in the negotiations. Without this effort, future New Yorkers are destined to have to pay more in taxes for a government that produces less in services.

3. Focus on high-priority tax cuts, and drop others. New York City's taxes are too high. Reducing the local tax burden is vital, along with better services and infrastructure, to attracting and retaining businesses and residents.

While lower taxes are important, all tax cuts are not equally important. Those deserving the highest priority are cuts that bring taxes in line with the burdens imposed in competitive areas and those that help create a common playing field on which all businesses can compete, rather than favoring one firm or activity over another.

Some of the tax cuts proposed in the January Plan fit this strategy, and should be supported. These include eliminating the commercial rent tax, providing a personal income tax credit for "S" corporations, and lowering other business taxes. Other tax proposals are not critical to the City's competitiveness and should be dropped. These include repealing the $2 flat tax on hotel rooms, which is unnecessary in assisting the City's hotel and tourist industries, and extending the coop and condo abatement, which exacerbates rather than corrects the inequitable taxation of real property.

4. Design a smarter capital program. In encouraging greater labor productivity, enlightened managers urge that people "work smarter, not harder." A parallel philosophy should apply to capital investments. The capital budget should be smarter, not necessarily bigger. 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 will make workers more productive and services more efficient and convenient.

In order to do this, the City's capital program should include these measures.

- *Create facilities that can be used more intensively*. For example, using school buildings year round reduces the need for new school construction.
- *Maintain existing facilities better*. This extends the useful life of critical infrastructure and reduces capital spending needs.
- *Repeal of the Wicks Law*. The Mayor should continue his support for efforts that streamline capital construction and speed completion of projects.
- *Pursue a new State constitutional amendment that places a clear, comprehensive and realistic limit on municipal borrowing*. Such an amendment would ensure that municipal borrowing was affordable and would provide a clear incentive for capital planning that recognized the need to set priorities.

INTRODUCTION

The finances of the City of New York are in transition. Due to a changing national economy, the rapid growth in revenue caused by a period of unprecedented prosperity is likely to slow and, in the event of a recession, even contract. At the same time, the Mayor and legislative leaders who are responsible for local financial management are subject to term limits and reach the end of their tenure in the middle of the coming fiscal year. Their successors, rather than these incumbents, will have to live with the consequences of decisions made in the current budget cycle.

The Preliminary Financial Plan presented by Mayor Rudolph W. Giuliani in January 2001 does not adequately address these challenges. Instead of identifying policies that would help keep spending in line with a slowed economy, it raises the recurring costs of municipal government while reducing the recurring revenues available to meet these commitments. The result is extremely large budget gaps in future years, with a strong prospect that new leaders assuming office in January 2002 will have to make abrupt budgetary changes that disrupt and curtail services. The Mayor's Plan should be modified in the Executive Budget he presents in April and in the budget ultimately adopted in June.

The Mayor himself has recognized the need for some adjustments to his January Plan. In late February the Budget Director reported to agency heads that: "what appears to be a national slowdown in the economy may have an adverse effect on the City's economy…. [w]e are concerned that the economy may not be strong enough to produce the revenue growth that we have experienced in the past."[1] Accordingly, agency heads were asked to develop spending reduction options for fiscal years 2001 and 2002 for possible inclusion in the Mayor's Executive Budget in April. The nature of these cuts is not known at this time, and the magnitude appears relatively modest—$380 million in fiscal year 2002.[2] However, this action suggests the Administration recognizes that the spending levels in the January Plan are too high.

This report presents the Citizens Budget Commission's (CBC's) analysis of the Mayor's Preliminary Financial Plan and its recommendations for improvement. The first section identifies the decisions made in the current year and recommended for fiscal year 2002 that significantly raise the recurring cost of providing municipal services. The second section analyzes the decisions about how to finance this expenditure growth in the coming year with emphasis on the one-shot or short-run nature of the resources identified, and the consequent likely shortfalls in subsequent years. The third section presents estimates of the budget gaps the City might face in fiscal years 2003-05 as a result of the policies currently being pursued. The final section recommends alternative budget strategies that would lead to better fiscal prospects for the City under the newly elected leaders of 2002 and beyond.

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[1] City of New York, Office of Management and Budget, "Fiscal Year 2002 Executive Budget," memorandum from Adam Barsky to Agency Heads, February 20, 2001.
[2] David Andelman and Frank Lombardi, "Rudy Tells Agencies to Cut Back," *Daily News*, March 22, 2001.

DECISIONS THAT SIGNIFICANTLY INCREASE THE COST OF MUNICIPAL GOVERNMENT

Three decisions each play a major role in inflating the cost of municipal government: (1) increasing the number of City employees, (2) raising employee compensation without offsetting productivity gains, and (3) committing to an exceptionally large capital program that causes debt service to reach unprecedented levels. While these are the major factors driving higher spending, other decisions in the budget follow a similar pattern of making commitments today that will increase future costs.

More municipal employees

More than half the City's budget is devoted to employee compensation. At the beginning of his administration, Mayor Giuliani promised to focus on "reinventing" government. During his first two years the Mayor pared 11,514 positions from the municipal payroll. (See Figure 1.) However, as the economy improved and more revenue became available, the administration gave higher priority to adding employees than to obtaining greater productivity from them. From a low point in fiscal year 1996 to fiscal year 2000, fully 15,743 workers were added. The current year's budget continues the trend with nearly 5,000 new workers. At the end of this fiscal year, the total workforce of 255,669 will be larger than in any of the last 25 years. The January Financial Plan would reduce municipal employment slightly in fiscal year 2002, but it would remain near today's level through 2005.

Higher employee compensation

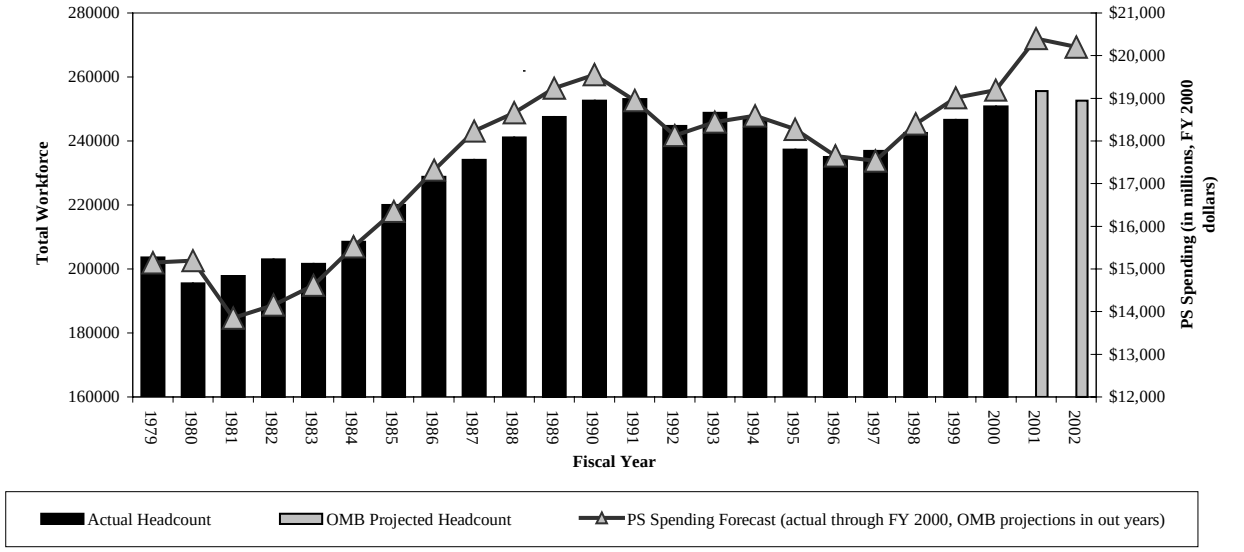
In addition to the number of employees, a key factor driving municipal expenditures is the rate at which these workers are paid. As Figure 1 shows, total employee compensation is rising even faster than headcount. Most elements of compensation are determined through collective bargaining, and Mayor Giuliani reached five-year contract agreements with most municipal employee unions during his first term. The general pattern of these settlements was a cumulative five-year base pay increase in excess of 12 percent plus significant fringe benefit enhancements. When allowance is made for seniority increases as well as the base pay changes, most employees benefited from pay increases that exceeded the rate of inflation during this contract period. For example, a firefighter starting work in January 1995 received annual increases averaging 10.9 percent over the next five years, and an entering correction officer's pay rose an average of 12.5 percent annually over the period.[3]

The previous contracts expired during calendar year 2000, and currently all municipal employees are working without a contract. They continue to be paid under the terms of the old contract, but it is highly likely that the new contracts will apply retroactively, and the City is now

[3] See *The Citizens' Stakes in Collective Bargaining: Recommendations for the Current Negotiations with the Municipal Employee Unions* (NY: Citizens Budget Commission, December 2000).

incurring costs that should be budgeted. The budget adopted for fiscal year 2001 included a labor reserve of $325 million that was intended to reflect the cost of a new merit pay component of compensation. The Mayor sought no "automatic" raises, only merit pay. The cost of this added pay was to be partly offset by productivity gains targeted at $250 million annually.[4]

Figure 1
City of New York
Headcount and Personal Service Spending Growth
Fiscal Years 1979 to 2002



Sources: City of New York, *Comprehensive Annual Financial Report of the Comptroller* , fiscal years 1979 through 2000 editions. Personal Service spending and headcount estimates for fiscal years 2001 and 2002 are from City of New York, Office of Management and Budget, *Financial Plan, Fiscal Years 2001-2005, Volume 1* (NY: Office of Management and Budget, January 25, 2001). Total headcount for fiscal year 2001 is projected for June 30, 2001.

Note: PS spending is in FY 2000 dollars converted using the "Consumer Price Index for All Urban Consumers (CPI-U) in the New York-New Jersey Area". PS spending includes payments made to the Housing and Transit Authority police departments and for Emergency Medical Services personnel. The cost of Emergency Medical Services is estimated based on an average salary per worker.

Linking pay to performance and funding raises with productivity savings are policies the CBC strongly endorses.[5] However, the Mayor deviated from this strategy in the spring of 2000. As part of a deal struck with the leadership of the Municipal Labor Committee (MLC), a coalition of unions, the Mayor joined in supporting State legislation that enhanced workers' pension benefits. The nature of the enhancements varies among the five pension systems and among the tiers within each system, but the overall package is estimated to cost the City $318 million annually or the equivalent of about a 2 percent wage increase.[6] In exchange, the Mayor

[4] City of New York, Office of the Comptroller, *The Comptroller's Comments on the November Financial Plan for Fiscal Years 2001-2004*, December 2000.
[5] For a more complete discussion, see *Budget 2000 Project: Restructuring Government Services* (NY: CBC, December 1996), and Diana Fortuna and Charles Brecher, "He is locking in big gains," *Daily News*, February 7, 2000.
[6] City of New York, Office of Management and Budget, *Financial Plan, Fiscal Years 2001-2004*, November 17, 2000.

obtained union approval for a "restart" in the valuation of pension assets. This change had the effect of accelerating the recognition of increased market values of pension funds' holdings and thereby reduced, in the short run only, necessary City contributions to the pension funds. In addition, the impact of the recent downturn in the stock market on the coming years' contributions will be greater than would have been the case without the restart. Additional State legislation passed in 2000, which the Mayor opposed, made the pension systems more generous by adding automatic inflation adjustments to pension benefits. Together the two pension enhancements, when fully phased in, carry a recurring annual cost of over $798 million, or the equivalent of a 5 percent pay increase.[7]

In January 2001 the Mayor reached another agreement with the MLC. The Health Benefit Agreement relates to basic health insurance for City employees, retirees and their families and to supplementary benefits obtained through union welfare funds. Although the Mayor had previously endorsed, and the CBC recommends, structural changes in the health insurance program that would require employee contributions toward premiums and other cost-saving measures, the new agreement does not include such provisions.[8] Instead, the City pledges to continue to provide the same insurance choices without co-payments, and the guaranteed minimum benefits are enhanced to include better mental health and prescription drug coverage. These benefit enhancements are estimated to cost about $40 million annually.[9] The Agreement also requires the City to increase its contributions to union welfare funds $200 per employee and retiree in 2003 and beyond. The annual cost in 2003 is about $103 million.[10]

A third, and quite substantial, concession made by the Mayor in the Agreement is to drop the productivity savings item in the City budget that had been intended to save $250 million in fiscal year 2001, $265 million in 2002, $280 in 2003 and $300 million in 2004 and beyond.

In exchange for these costly new benefits and other concessions, the Mayor gained nothing in recurring savings. Instead he settled for some "one-shot" revenues. As described more fully below, the City is drawing on reserves in a Health Insurance Stabilization Reserve Fund that the unions partly control. In addition, the MLC pledges to work with the City to identify savings in health insurance costs of $100 million in fiscal years 2003 and 2004, but these measures remain unidentified and there is no penalty if they are not achieved.

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[7] The annual expense for the automatic cost of living adjustment was estimated at $480 million in State of New York, Financial Control Board, *Staff Report: Financial Strength and Fiscal Challenges*, July 18, 2000; additional enhancements supported by the Mayor will cost $318 million annually, as per City of New York, Office of Management and Budget, *Financial Plan, Fiscal Years 2001-2004*, November 17, 2000.

[8] See *The Citizens' Stakes in Collective Bargaining: Recommendations for the Current Negotiations with the Municipal Employee Unions* (NY: CBC, December 2000), and *Modernizing the Municipal Employee Health Insurance Program* (NY: CBC, April 1995).

[9] State of New York, Office of the State Deputy Comptroller for the City of New York, *Review of the Financial Plan for the City of New York: Fiscal Years 2001-2005*, Report 9-2001, March 2001, p. 28.

[10] The City contributes an average of $1,280 per worker and retiree to union welfare funds, for a total expense of $662 million in fiscal year 2000. Based on these figures, an increase of $200 or 15.6 percent would raise the total annual contributions to union welfare funds by $103 million.

While pension, health insurance and other fringe benefits have been negotiated with the MLC, contracts relating to wages and other working conditions remain to be settled with each of the municipal unions. The January Financial Plan provides a reserve of $395 million in fiscal year 2001, $814 million in fiscal year 2002, $861 million in fiscal year 2003, and $857 million in fiscal years 2004 and 2005. This implies an average wage increase of about 2.5 percent annually in fiscal years 2001 and 2002, and a wage freeze in subsequent years. These reserves will prove inadequate if the settlements for 2001 and 2002, now being negotiated, exceed 2.5 percent annually and if any pay increases are granted for after fiscal year 2002.

Another element of compensation policy that contributes to the high cost of municipal government is relying heavily on overtime, especially for the uniformed services. Overtime spending at the Police Department between 1995 and 2000 grew from $96 million to $237 million, or 20 percent annually. Spending on overtime at the Fire Department over the same period grew 7 percent annually, to $106 million. Overtime is not only costly in the year in which it is accrued; by adding to the average final salary of an employee nearing retirement, it obliges the City to pay permanently higher pension benefits for that employee.

Greater capital spending and debt service

The January Financial Plan includes a four-year capital commitment plan, covering fiscal years 2001 to 2004. Compared to last year's four-year plan, capital commitments grow 20 percent, to $29.1 billion from $24.2 billion last year.

New York City continues to have many compelling capital needs, including bringing critical infrastructure to a "state of good repair" and making federally mandated improvements in its water and sewer systems. The new four-year plan addresses some of these needs. Among the notable changes in the new capital program are:

- Spending on water mains and related facilities increases 88 percent, to $2.1 billion. This includes funding for a new filtration plant for water from the Croton watershed.
- Economic development funding increases 64 percent, to $1.4 billion. These funds support proposed biotech buildings, as well as the City's business development activities.
- Hospital spending grows 153 percent, to $593 million. These funds include construction of a DNA lab at Bellevue Hospital.
- Housing spending grows 20 percent, to $338 million. The Mayor's housing initiative includes rehabilitating and selling City-owned housing, subsidizing new owners of tax-delinquent properties, and subsidizing the construction of low and moderate income housing.

Other services are assigned a lower priority. For instance, education spending grows only 3 percent, or approximately $184 million.

The enlarged capital program is financed largely by borrowing, which imposes future debt service costs. The plan requires $24.4 billion in new debt through 2004. In contrast, there is little pay-as-you-go financing, only $932 million of the total $29.1 billion.

As a result of the substantial new borrowing, debt service spending will grow to unprecedented levels. As shown in Table 1, debt service increases from $3,426 million in fiscal year 2000 to $5,051 million in fiscal year 2005—or 8.1 percent annually. Unlike more discretionary expenditures, debt service is extremely difficult to reduce in hard times. If the City faced a sudden economic downturn, debt service would continue to be paid, requiring that cutbacks be concentrated in other areas.[11]

Table 1
City of New York
Debt Outstanding and Debt Service, Fiscal Years 2000-05
(dollars in millions)

	2000	2001	2002	2003	2004	2005
Net City Debt Outstanding	**$36,519**	**$39,084**	**$41,563**	**$43,630**	**$45,542**	**$47,187**
Debt Service (adjusted for prepayments)	**$3,426**	**$3,938**	**$4,236**	**$4,618**	**$4,869**	**$5,051**

Sources: Estimate of net City debt outstanding is based on combined net City debt, including general obligation, Municipal Assistance Corporation, Transitional Finance Authority, Tobacco Settlement Asset Securitization Corporation, and Samurai Finance Corporation debt, from City of New York, Office of the Comptroller, *Comprehensive Annual Financial Report of the Comptroller for the Fiscal Year Ended June 30, 2000* (NY: Office of the Comptroller), City of New York, Office of Management and Budget, *Statement of Debt Affordability* (NY: OMB, April 18, 2000), City of New York, Transitional Finance Authority, *Financial Statements and Report of Independent Certified Public Accountants*, June 30 1999 to June 30 2000 (NY: OMB, February 2001), and City of New York, TSASC Inc., *Financial Statements and Report of Independent Certified Public Accountants*, June 30, 2000 (NY: OMB, February 2001). Debt service, adjusted for prepayments, from City of New York, Office of the Comptroller, *Comprehensive Annual Financial Report of the Comptroller for the Fiscal Year Ended June 30, 2000* (NY: Office of the Comptroller), and City of New York, Office of Management and Budget, *Financial Plan: Fiscal Years 2001-2005* (NY: OMB, January 25, 2001).

Note: Net City debt outstanding and debt service exclude the debt and debt service of the New York City Municipal Water Finance Authority.

In addition to higher long-term capital and debt service expenses, other policy decisions made by the Mayor saddle the City with high recurring costs. The Mayor's plan for solid waste disposal is one example of such a policy. Beginning in March 2001, Staten Island's Fresh Kills landfill ceased accepting residential solid waste. Instead, this waste is being exported to landfills and incinerators as far away as South Carolina and Ohio.

Closing the landfill requires that the waste is exported to other jurisdictions, and exporting is much more expensive than burial at Fresh Kills. The cost for disposal at Fresh Kills was $43 per ton. Under interim contracts with exporters, the City pays an average of $63 per ton, and these costs likely will increase when the contracts begin expiring in July 2002. Largely due to greater reliance on exporting, the Department of Sanitation's budget grew 41 percent from $591 million in 1995 to $838 million in 2000. By 2004, the budget for the Department is projected to be $980 million, a 17 percent increase over fiscal year 2000.[12]

[11] For a complete discussion of the City's debt burden and debt service expenditures, see Citizens Budget Commission, *An Affordable Debt Policy for New York State and New York City* (NY: CBC, October 2000).
[12] City of New York, Independent Budget Office, "Closing Fresh Kills Means Mounting Costs to Dispose of New York City's Garbage," *Inside the Budget*, Number 77, February 5, 2001.

SHORT-SIGHTED REVENUE DECISIONS

In the Mayor's January Financial plan, the substantial new spending commitments are financed with short-sighted revenue policies. For fiscal year 2002, the Mayor draws upon the current year's surplus and a variety of other "one-shot" sources. In subsequent years, the disappearance of these sources is compounded by a promise of tax cuts that are "backloaded."

Imprudent use of the current surplus

In recent years, unexpectedly strong local economic performance has generated an annual operating surplus for the City. This pattern is being repeated in fiscal year 2001. The January Plan projects a surplus of $2,267 million, almost $1.4 billion more than the surplus anticipated when the budget was adopted.

The tremendous growth is largely due to unanticipated revenues. (See Table 2.) The Plan anticipates $950 million in additional taxes above the adopted budget, with almost 40 percent ($352 million) from higher personal income tax collections. An additional 26 percent ($235 million) and 25 percent ($225 million) result from growth in anticipated sales taxes and general corporate taxes, respectively. Another significant source of higher tax revenue is the defeat in the State legislature of tax cut proposals that it was assumed would be enacted when the budget was adopted. The failure to enact these tax cuts provides the City with $331 million that it had not anticipated.

The surplus would be even larger this year, but higher spending offset some of the unexpected revenues. The January Plan recognizes increases in Police Department expenses, including overtime ($144 million), pension costs ($132 million) and labor settlement costs ($250 million). These are only partially offset by agency savings ($215 million) and one-shot revenues from the Health Benefit Agreement.

Fiscal prudence requires that nonrecurring resources be used in ways that improve the long-run financial condition of a government. The surplus is a nonrecurring resource. Some ways of improving the long-run financial condition of New York City include reducing outstanding debt, funding one-time commitments that provide multi-year benefits (such as pay-as-you-go capital spending or targeted early retirement incentive programs for workers), or holding the surplus in a rainy day fund for use during an economic downturn.

Unfortunately, the City does not use its surplus for any of these fiscally prudent purposes. Instead, the Mayor's Plan proposes using the fiscal year 2001 surplus primarily to balance the expense budget in fiscal year 2002. The $2,267 million is allocated to prepaying fiscal year 2002 debt service ($1,779 million for general obligation and lease-purchase debt service, and $488 million for Municipal Assistance Corporation debt service). The vast majority ($1,922 million) of the fiscal year 2002 savings related to the prepaid debt service is, in effect, used to help

balance that year's budget and support its increased operating expenses. However, $345 million is reserved for use in helping to balance the fiscal year 2003 budget.

Table 2
City of New York
Sources and Uses of the Surplus
Fiscal Year 2001
(dollars in millions)

Sources of the Surplus	**$2,267**
Planned Surplus at the Start of the Year	**$905**
Changes Year to Date	
Revenue Increases	**$1,412**
Personal income tax collections	352
Other tax and revenue increases	729
Tax reductions not enacted/revised downward	331
Spending Reductions/(Increases)	**($191)**
Labor reserve	(250)
Health insurance costs/benefits bargaining	120
Pension costs	(132)
Police Department expenses, including overtime	(144)
Agency programs & other spending changes	215
General Reserve	**$141**
Uses of the Surplus	**$2,267**
Gap reduction in fiscal year 2002	1,922
Gap reduction in fiscal year 2003	345

Sources: City of New York, Office of Management and Budget, *Financial Plan Fiscal Years 1999-2003*, Volume 1 (NY: OMB, January 28, 1999), p. 3 and City of New York, Office of Management and Budget, *Executive Budget Fiscal Year 2000*, Message of the Mayor (NY: OMB, April 22, 1999).

Prepaying debt service is not a prudent use of the City's surplus. It is a device, permissible under generally accepted accounting principles, for transferring one year's revenues to the next year. In effect, it pays expenses incurred in 2002 with revenue earned in 2001. This is postponing a problem, not solving it.

Heavy reliance on "one-shot" revenues in 2002

"One-shot" revenues are nonrecurring resources. In addition to coming from operating surpluses, they arise in a variety of ways—from selling public assets such as buildings, from drawing down reserve funds, or from specific new funds made available by the state or federal governments. Depending on one-shot revenues to finance recurring expenses is short-sighted and postpones the task of sizing municipal government to fit its recurring revenue base.

The Mayor's Plan for 2002 relies heavily on one-shot revenues. In addition to the $2.3 billion prior-year surplus, the Mayor draws on almost $600 million in one-shots. (See Table 3.) All of these are imprudent, and many are also unrealistic.

Table 3
City of New York
Financial Plan, Fiscal Year 2002
One-Shot Revenues
(dollars in millions)

2001 Budget Surplus	**$2,267**
Asset Sales	**$397**
Privatization of OTB	250
HPD revenue from real property disposition	56
HPD mortage sales	50
Sale of United Nations Development Corp. property	41
Miscellaneous	**$200**
Health benefits agreement	45
State reimbursement of landfill closure costs	75
Alternative funding sources for Economic Development Corporation	27
Other miscellaneous revenues	54
Total	**$2,864**

Source: City of New York, Office of Management and Budget, *Financial Plan Fiscal Years 2001-2004*, Volume 2 (NY: OMB, January 25, 2001).
Note: Totals may not add due to rounding.

Fully $397 million of the one-shots are asset sales. This includes $250 million anticipated from the sale of the Off Track Betting Corporation, $106 million from sales of property and mortgages owned by the Department of Housing Preservation and Development, and $41 million from the sale of property owned by the United Nations Development Corporation. Proceeds from the sale of real assets should not be diverted to supporting operations; instead they should be converted to other fixed assets (by capital investments) or used to reduce liabilities (by paying off debt). The net effect on the City's balance sheet should be neutral rather than negative.

The Health Benefit Agreement, described earlier, is another source of one-shot revenues. In exchange for a commitment to pay for greater health insurance and other fringe benefits, a recurring operating expense, the City is able to draw $165 million from its Health Insurance Stabilization Reserve Fund. Most of this is used in fiscal year 2001 (thereby increasing the surplus to be shifted to 2002), and $45 million is used directly in fiscal year 2002.

"Backloaded" tax cuts are not matched with spending cuts

High local taxes are a major drag on the competitiveness of New York City. In 1996, as part of its *Budget 2000 Project*, the Citizens Budget Commission presented a list of high-priority tax cuts that would enhance the city's attractiveness to residents and businesses. This included a substantial reduction in the personal income tax and elimination of some unique municipal taxes such as the commercial rent tax and unincorporated business tax.

Since entering office, Mayor Giuliani and the City Council have taken significant steps to lower taxes. Tax cuts enacted since 1995 reduced New York City tax collections by more than $3.1 billion in 2001. (See Table 4.) That is, current year taxes are about 12 percent less than they would have been without actions taken since 1995. Most of these cuts have been phased in over several years, and will continue to grow in value. By 2005 they will be worth nearly $4.1 billion, representing a 13.5 percent cut.

Table 4
City of New York
Impact of Tax Cuts Enacted and Proposed Since FY 1995
(dollars in millions)

	Fiscal Year Impact										
Fiscal Year Enacted	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
1995	$29	$102	$193	$216	$212	$253	$275	$273	$281	$285	$289
1996	0	87	167	277	352	214	223	231	236	243	244
1997	0	0	38	84	109	129	149	152	156	163	165
1998	0	0	0	97	258	566	945	1,206	1,271	1,302	1,332
1999	0	0	0	0	219	806	814	819	863	918	970
2000	0	0	0	0	0	738	640	456	490	529	566
2001	0	0	0	0	0	0	93	219	277	366	491
2002 *(proposed)*	0	0	0	0	0	0	8	405	721	1,017	1,249
Total Enacted Tax Cuts	**$29**	**$189**	**$398**	**$674**	**$1,150**	**$2,706**	**$3,139**	**$3,356**	**$3,574**	**$3,805**	**$4,056**
Grand Total (Enacted & Proposed)	**$29**	**$189**	**$398**	**$674**	**$1,150**	**$2,706**	**$3,147**	**$3,761**	**$4,295**	**$4,822**	**$5,305**
Tax Revenue Base 1995 Tax Law	**$17,628**	**$18,215**	**$19,583**	**$20,986**	**$22,469**	**$24,838**	**$25,751**	**$26,046**	**$27,326**	**$28,707**	**$30,082**
Reduction in Tax Collections	**0.2%**	**1.0%**	**2.0%**	**3.2%**	**5.1%**	**10.9%**	**12.2%**	**14.4%**	**15.7%**	**16.8%**	**17.6%**

Source: City of New York, Office of Management and Budget, *Financial Plan FY 2001-2005, Forecast Documentation* (NY: OMB, January 2001).
Note: Includes State tax reductions that flow through to the City's tax base, STAR, and the commuter tax repeal.

Many of these cuts are consistent with the CBC's priority of promoting competitiveness. They include elimination of a personal income tax surcharge, lower commercial rent taxes, and reduced unincorporated business taxes. However, a major item already implemented was inconsistent with CBC's strategy and not a priority cut; that was the elimination of the 0.45 percent commuter income tax authorized by the State legislature in 2000. It represents $475 million in fiscal year 2001 or about 14 percent of the total cuts. Mayor Giuliani and the City Council strongly opposed this change.

In the January Plan the Mayor proposes additional tax cuts. As explained in the final section of this report, four of the seven proposals, totaling $894 million in fiscal year 2005, would increase the City's competitiveness. (See Table 5.) The remaining three proposals, totaling $355 million in fiscal year 2005, are either low priority or misguided tax cuts.

The tax cuts are heavily "backloaded" with a value of $405 million in fiscal year 2002 that grows to $1,249 million in fiscal year 2005. However, the most fiscally relevant point about the Mayor's latest tax proposals is that they are not matched with expenditure reductions. As will be discussed more fully below, the Plan has substantial gaps in fiscal years 2003 and beyond, and the tax cut proposals help create these gaps. The Mayor is proposing tax cuts without indicating

how to make them affordable. If they are passed this year, his successor will have to answer the question of what services to sacrifice in order to balance the budget.

Table 5
City of New York
Newly Proposed Tax Cuts, Fiscal Years 2002-05
(dollars in millions)

	2002	2003	2004	2005
Measures that increase the City's competitiveness	**($148)**	**($392)**	**($676)**	**($894)**
Elimination of Commercial Rent Tax	(55)	(172)	(352)	(476)
Earned Income Tax Credit	(48)	(48)	(48)	(48)
Business Taxes: 10% reduction	(23)	(121)	(223)	(314)
PIT credit for "S" corporations	(22)	(51)	(53)	(56)
Low priority or misguided proposals	**($257)**	**($329)**	**($341)**	**($355)**
Extension of Co-op/Condo Property Tax relief	(185)	(194)	(204)	(214)
Elimination of the Sales Tax on clothing & footwear	(53)	(96)	(98)	(101)
Repeal Hotel Tax $2 flat fee	(19)	(39)	(39)	(40)
Total Tax Cut Program	**($405)**	**($721)**	**($1,017)**	**($1,249)**

Source: City of New York, Office of Management and Budget, *Financial Plan FY 2001-2005* , Summary Book (NY: OMB, January 25, 2001).
Note: Totals may not add due to rounding.

THE RESULTING LARGE BUDGET GAPS

Growing expenditures, disappearing one-shots and backloaded tax cuts leave the City with large budget gaps in fiscal year 2003 and beyond. Moreover, the gaps are understated in the Mayor's Plan because some of the assumptions are unrealistic or ignore possible adverse developments. If adjustments are made for plausible risks, a low range estimate of the fiscal year 2005 gap is $4.2 billion, and a high range estimate is $5.8 billion, or 13 percent of expenditures.

Gaps acknowledged in the January Plan

The January Plan balances the coming year's budget, but not those of subsequent years. In fiscal years 2003 to 2005 the gap between revenues and expenditures ranges from $2.3 billion to almost $2.5 billion.

These gaps cannot be attributed to pessimistic economic and revenue assumptions. Revenues in 2005 are expected to be $1.1 billion higher than they were in fiscal year 2001, an increase of 3 percent. This is in spite of the previously described $1.2 billion program of new tax cuts that are assumed to be enacted. Underlying this revenue growth are assumptions about continued growth in the local economy.

In calendar year 2000, New York City gained almost 100,000 jobs, and employment growth exceeded the national average—2.8 percent versus 2 percent. The Plan projects 42,000 new jobs in calendar 2001, surpassing projected national average job growth by a full percentage point—1.1 percent versus 0.1 percent. Similarly, estimated growth in real gross city product outpaced growth in gross domestic product in 2000, 7.6 percent versus 5.0 percent. This trend is expected to reverse in 2001, with the growth in real gross domestic product exceeding that in real gross city product, 2.5 percent versus 1.2 percent.

Projections for 2002 are more guarded, but still anticipate continued growth. Jobs are projected to increase 0.9 percent, and then pick up again in 2003 to 1.4 percent. Likewise, real gross city product is expected to grow 0.3 percent in 2002, before rising sharply again to 5.3 percent in 2003. In 2004 and 2005 real gross city product is projected to expand at rates of 4.8 percent and 3.2 percent, respectively. The Plan does not anticipate a recession or any period of absolute contraction in employment or real gross city product, nor does it hold any funds in reserve for that eventuality. The Plan relies on national prosperity continuing steadily for 14 years, since 1991.

Adjustments to the Plan's projections

Regrettably, the gaps estimated in the Mayor's January Plan are unrealistically low. A more cautious set of projections would consider adjustments for: (a) intergovernmental aid that likely will not be forthcoming, (b) additional costs for the likely labor settlements, and (c) revenue losses from a less robust economy.

Unrealistic intergovernmental aid. The first adjustment presented in Table 6 is the failure to realize sources of intergovernmental aid that are highly questionable. In the January Plan, the Mayor anticipates that beginning in 2002 the City will obtain $350 million annually in new aid from the State and federal governments. Among the items the City is hoping for are a new federal general revenue sharing program (counted on for $50 million annually), more federal payments for the City's protection of United Nations' dignitaries, greater State efforts to combat Medicaid fraud, and new State legislation to reduce tort settlements against the City. While these changes may be desirable, they are not highly probable. Counting on them for $350 million annually is not cautious planning.

Costs of possible labor settlements. Table 6 also shows the fiscal impact of three adjustments related to the City's collective bargaining settlements. The first is recognition of the cost generated by the recent Health Benefit Agreement in the form of higher City contributions to union welfare funds. The Agreement requires these contributions to increase by $200 per member and retiree in 2003, but this new cost is not reflected in the January Plan. The estimated annual cost is $103 million annually.[13]

[13] See note 10 for calculations. This expense could increase even more when a new settlement is negotiated for years after 2003.

Table 6
City of New York
Adjustments to the January Plan
Fiscal Years 2003 - 2005
(dollars in millions)

	2003	2004	2005
January Plan Gaps	**($2,423)**	**($2,466)**	**($2,307)**
Revenues	39,143	39,862	40,767
Expenditures	(41,566)	(42,328)	(43,074)
CBC Adjustments			
Unrealistic intergovernmental aid	(350)	(350)	(350)
Welfare fund payment increase	(103)	(103)	(103)
Labor settlement at inflation rate	(514)	(955)	(1,426)
Subtotal of Low-Range Gap Adjustments	**($968)**	**($1,408)**	**($1,880)**
Low-Range Estimate of Gaps	**($3,391)**	**($3,874)**	**($4,187)**
Percentage of Expenditures	**8%**	**9%**	**10%**
Higher cost labor settlement (5% + 5%) in fiscal years 2000-01	(671)	(688)	(707)
A less robust economy	(440)	(800)	(906)
High-Range Estimate of Gaps	**($4,501)**	**($5,363)**	**($5,800)**
Percentage of Expenditures	**11%**	**13%**	**13%**

Sources: City of New York, Office of Management and Budget, *Financial Plan Fiscal Years 2001-2005* (NY: OMB, January 25, 2001), Volume 1, and CBC staff estimates. See text.
Note: Totals may not add due to rounding.

A second adjustment is allowing for a settlement tied to the pace of inflation in years 2003-05. The January Plan assumes wages will be frozen for this entire period, an unlikely scenario. Raises equaling inflation would require an additional $514 million in 2003, and the cost rises to $1,426 million in 2005.[14]

These two labor settlement adjustments and the loss of unrealistic intergovernmental aid have a combined negative effect on the budget gaps of $968 million in fiscal year 2003, rising to $1,880 million in fiscal year 2005. The resulting low range estimate of the gap in fiscal year 2005 would be $4,187 million, or 10 percent of projected expenditures.

A third labor adjustment considers the possibility that the wage settlements currently being negotiated for the period 2000-01 will be higher than the 2.5 percent that the January Plan anticipates. This development is possible for four reasons. First, recent changes in collective bargaining practices permit some of the unions to seek mediation and arbitration from a State panel that historically has been more sympathetic to union arguments for parity with suburban jurisdictions than the City office that previously conducted arbitration. Second, there is a need to

[14] This calculation uses the City's estimates of calendar year consumer price index of 187.9 in 2001, 193.0 in 2002, 198.0 in 2003, 203.1 in 2004, and 208.9 in 2005, adjusted for the fiscal year. Applying these to the City's 2000 personal service base of $15,534 million (which includes salaried and unsalaried pay, adjusted additional gross pay, and Social Security contributions) results in personal service expense increases of $514 million in 2003, $955 million in 2004, and $1,426 million in 2005.

raise wages for some positions to take into account current labor shortages. Third, there were press reports that the City was close to a settlement with a coalition of several uniformed unions that would have provided increases of 5 percent annually for 2000 and 2001. Finally, the Metropolitan Transportation Authority's settlement in December 1999 with the Transport Workers' Union is thought by some observers to provide a precedent for the City's contract. That settlement provided increases of 5 percent, 3 percent, and 4 percent over the course of a three-year contract.

The high range scenario shown in Table 6 assumes the settlement for 2000 and 2001 will provide increases of 5 percent annually, as opposed to the 2.5 percent covered by the reserve in the January Plan. This increases costs in 2000 and 2001 (not shown in Table 6), and also increases the cost in 2003-05 because the base for subsequent years' raises is expanded. The added annual cost from higher settlements in the 2000-2001 negotiating round is $707 million in 2005.[15]

A less robust economy. As previously indicated, the January Plan anticipates that the local economy will gradually slow down, but continue to grow in 2001 and 2002, and then recover sharply with relatively rapid growth in 2003 and 2004. Forecasted tax revenues follow a similar pattern. Recognizing the impact of recommended tax cuts, revenues decline in 2002 and 2003, but then rise at rates of 2 percent or more in 2004 and subsequent years.

If the economic slowdown is more prolonged, then the revenue impacts would be more severe. Table 6 shows the impact on City tax revenues of two successive years (2001 and 2002) of a flat economy and then a slower recovery than the January Plan anticipates.[16] Under this scenario, the shortfall in tax collections from the Mayor's Plan would be $440 million in 2003, growing to $906 million in 2005.

A high range estimate of future budget gaps combines all of the labor adjustments with this less robust economic scenario. The effect of the adjustments is a substantial increase in the projected gaps for fiscal years 2003 to 2005. If all these adjustments prove necessary, then the budget gaps rise to $5.8 billion or fully 13 percent of projected expenditures in fiscal year 2005.

[15] A wage settlement of 5 percent in 2001 and 5 percent in 2002, when applied to the fiscal year 2000 wage base of $15,534 million (see previous note) would raise the City's wage base to $17,126 million in 2002. Increasing this amount by the City's estimated inflation rate would raise personal service spending above the amounts cited in note 13 by $671 million in 2003, $688 million in 2004, and $707 million in 2005.

[16] The January Plan estimates growth in real gross city product of 1.2 percent in 2001, 0.3 percent in 2002, 5.3 percent in 2003, 4.8 percent in 2004 and 3.2 percent in 2005. The CBC staff estimated the revenue impact of a longer downturn—zero percent growth in real gross city product in 2001 and 2002, then 2.6 percent in 2003, and returning to the January Plan estimates of 4.8 percent in 2004 and 3.2 percent in 2005. Under this scenario, and assuming passage of the Mayor's tax program, tax revenues to the City would fall short of January Plan estimates by $67 million in 2001, $231 million in 2002, $440 million in 2003, $800 million in 2004, and $906 million in 2005.

BETTER BUDGET STRATEGIES

Current and future New Yorkers deserve more far-sighted policies than those being proposed by the Mayor in his January Financial Plan. Fundamental changes are necessary to provide a sounder fiscal legacy. Four strategies will help to build a better future.

Use the surplus prudently

Using a surplus to cover recurring expenses only postpones the inevitable task of sizing New York City's government to fit its economic base. Instead, the surplus should be used to provide long-lasting improvements to the City's fiscal health.

More prudent uses of the surplus include any of the following.

- Reduce the City's $37 billion in outstanding debt by retiring bonds early, particularly the higher interest bonds.
- Lower future outstanding debt by financing some capital projects with the current surplus on a pay-as-you-go basis.
- Establish a rainy day fund, with explicit and objective criteria for withdrawal, to protect against future economic downturns.

Pursue labor agreements with large productivity gains

One of the hallmarks of the recent economic boom enjoyed in New York City and nationally is greater productivity. In the national private sector, productivity has grown an average of 2.2 percent annually since 1995. Businesses have profited by making their workforces more efficient. They have succeeded in this through investments in technology, organizational streamlining, giving line workers greater responsibility and stronger incentives, and outsourcing secondary activities.

Mayor Giuliani initially advocated pursuing productivity enhancements in the current negotiations with the municipal employee unions. His capitulation on productivity in the recently signed Health Benefit Agreement is particularly disappointing, especially given the opportunity provided by this round of negotiations to achieve productivity improvements.

New York City's workforce should be smaller, better paid and more productive than is now the case. A more productive government would provide the same or better services at a lower cost. It is what citizens have come to expect from the private sector, and the same should be true of a modern municipal government.

Progress toward this goal will be possible only if the Mayor assigns it a high priority in his ongoing negotiations with the municipal employee unions. He should reconsider the provision of the Health Benefit Agreement that capitulates on including productivity gains in the Financial Plan, and should develop a meaningful productivity agenda to be pursued in the

negotiations. Without this effort, future New Yorkers are destined to have to pay more in taxes for a government that produces less in services.

While collective bargaining is the most effective instrument for pursuing productivity gains, it need not be the only one. Management can pursue greater productivity in other ways. These include:

- Aggressive use of new technology, both in providing direct information and services to citizens and in improving back-office processes. For example, in its study of municipal revenue collection practices, the CBC found that new technologies could save $15 million annually in administrative costs.[17]
- Civilianization of administrative positions currently held by uniformed employees in the City's four uniformed agencies. Uniformed officers now perform tasks that could be performed equally well or better by civilians, with significant cost savings. For example, a recent study by the City Comptroller found that 1,610 positions at the Police Department could be civilianized, saving $48.5 million annually.[18]
- Competition between private and public sector service providers. Competitive contracting could be applied to a variety of municipal services.
- Reduction in discretionary overtime.

Focus on high-priority tax cuts, and abandon other proposals

New York City's taxes are too high, placing it at a competitive disadvantage. Reducing the local tax burden is vital, along with better services and infrastructure, to attracting and retaining businesses and residents.

While lower taxes are important, all tax cuts are not equally important. Those deserving the highest priority are cuts that bring taxes in line with the burdens imposed on competing jurisdictions, and those that help create a common playing field on which all businesses can compete, rather than favoring one firm or activity over another.

Some of the tax cuts proposed in the January Plan fit this strategy, and should be supported. These proposals include elimination of the commercial rent tax, providing a personal income tax credit for "S" corporations, and lowering business taxes 10 percent.

Other proposals in the tax program are not critical to the City's competitiveness and should be abandoned. Repealing the $2 flat tax on hotel rooms is not likely to improve the City's already thriving tourist and hotel businesses. Extending property tax abatements to condominiums and cooperative units is also misguided. New York City's system for taxing real property divides properties into four classes, each with differing tax rates. The resulting effective tax rate on commercial and utility property is relatively high (at $3.72 and $4.88 per $100 of market value, respectively), while single-family homeowners enjoy a relatively low tax ($0.75

[17] Citizens Budget Commission, *Opportunities to Improve Municipal Revenue Collection by Using Information Technology* (NY: CBC, June 1998).
[18] City of New York, Office of the Comptroller, Bureau of Management and Audit, *Audit Report on the Opportunities for Savings Through Civilianization in the New York City Police Department*, February 1, 1999.

per $100 of market value). The coop and condo abatement expands the preferential treatment received by single-family homeowners to coop and condo owners. Instead, the real property tax should be economically neutral, taxing all properties at the same rate. Extending the abatement spreads inequitable benefits to typically higher income households, further shifts the tax burden onto businesses, and delays the task of overhauling the way in which New York City taxes property.

Design a smarter 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.[19] 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 sixties and seventies, 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 year the City estimated that the Wicks Law raises capital project costs by 14 percent.[20] It should be repealed, and the Mayor should continue his support for such efforts.

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

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

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 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.