Analysis of the Mayor’s Preliminary Budget for 2001

IBO’s Reestimate of the Mayor’s Preliminary Budget for 2001 and Financial Plan through 2004

March 2000
This report presents the Independent Budget Office’s (IBO) analysis of the Mayor’s preliminary budget, as required by section 246 of the New York City Charter. It provides a follow-up to IBO’s January 2000 *Fiscal Outlook* report which forecast city finances under the assumption that existing spending policies and tax laws are allowed to run their course. Those projections serve as the starting point for our consideration of the Mayor’s budget.

In this report we have identified a number of policy initiatives contained in the budget that are of public interest or are expected to have a fiscal impact that is different than estimated by the Administration. Chapter 1 provides an overview of IBO’s repricing of the Mayor’s budget for 2001 and financial plan through 2004. Chapter 2 provides our reestimate of the preliminary budget revenue forecast along with a discussion and repricing of the Mayor’s tax reduction initiatives. Chapter 3 contains an analysis of preliminary budget spending proposals, highlighting major changes from existing law and those areas where significant pricing differences with the Mayor’s projections occur.

New to this year’s report, Chapter 4 provides an overview of the capital program and financing plan, including a discussion of the debt limit; in April, IBO will release a more detailed analysis of the capital program highlighting capital spending by major program area. Other innovations in the current report include an analysis of the pension funding proposals, an estimate of the distributional impact of eliminating the personal income tax surcharge, and a discussion of the new Workforce Investment Act.

This report was completed under the supervision of Frank Posillico, Andrew Rein, and George V. Sweeting. Kerri Kiniorski served as project manager and coordinated final production. A list of IBO contributors along with their respective areas of responsibility and phone numbers follows at the end of the report; this collaborative effort is the product of their expertise and hard work.

Ronnie Lowenstein
Deputy Director
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• Unless otherwise noted, all references to years in both text and figures denote New York City fiscal years (July 1st to June 30th).

• Numbers in the text and figures in this report may not add to totals because of rounding.
Overview

This report presents the Independent Budget Office’s (IBO) analysis of the Mayor’s preliminary budget for 2001 and financial plan through 2004.

After analyzing and repricing the proposed policy changes, which include spending reductions and tax cuts, we find that the city’s near-term outlook is bright, but the long-term prospects are cloudy. The near-term good news results from a growing local economy that has generated large budget surpluses in each of the past four years. Nevertheless, challenges remain to the long-run fiscal health of the city—including the need to balance revenue and spending levels and growth rates, finance substantial capital improvements, and control the expansion of debt service costs.

As shown in Figure 1-1, IBO projects that the city’s fiscal fortunes during 2000 and 2001 would remain strong if the Mayor’s proposals were adopted. Although the table shows a balanced budget for the current year, in fact we expect a surplus of nearly $2.7 billion—$470 million higher than the Administration’s estimate.

The city is forbidden by state law from carrying excess funds over from one fiscal year to the next; therefore, we have assumed (as does the financial plan) that all current year surplus funds will be used to prepay 2001 debt service. The resulting reduction in 2001 expenses contributes significantly to a balanced budget for the upcoming fiscal year. IBO estimates that 2001

<table>
<thead>
<tr>
<th>Figure 1-1. Mayor’s Financial Plan Results in Budget Balance through 2001, But Large Gaps Thereafter</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dollars in millions</strong></td>
</tr>
<tr>
<td><strong>2000</strong></td>
</tr>
<tr>
<td><strong>Revenues</strong></td>
</tr>
<tr>
<td><strong>Expenditures:</strong></td>
</tr>
<tr>
<td>Before Prepayments</td>
</tr>
<tr>
<td>1999 Prepayments</td>
</tr>
<tr>
<td>2000 Prepayments</td>
</tr>
<tr>
<td>Additional Surplus (IBO est.)</td>
</tr>
<tr>
<td>2001 Prepayments</td>
</tr>
<tr>
<td><strong>Total Spending</strong></td>
</tr>
<tr>
<td><strong>IBO Surplus/(Gap) Estimate</strong></td>
</tr>
</tbody>
</table>

SOURCE: IBO.
NOTES: Excludes intra-city revenues and expenditures. The 2000 surplus totals $2.705 billion, however, it is used to prepay 2001 expenditures so it does not appear on the bottom line.
would end with $320 million in excess funds that the
city could, if it follows past practice, use to help
balance 2002.

Beyond 2001, however, we project gaps that grow
from $2.1 billion in 2002, to $3.2 billion in 2003 and
to $3.4 billion in 2004, or 8.6 percent of revenues.
These gaps arise for two reasons. First, based on the
assumption that economic growth slows to a more
moderate rate, the city will no longer have surpluses
to help balance the budget. Second, spending is
growing at a rate of 3.2 percent annually, outstripping
the 1.1 percent annual growth in revenues.

Our gap projections exceed the Mayor’s forecast
by $489 million in 2003 and $925 million in 2004.
The precise reasons for these differing estimates are
detailed below. In general, however, we forecast higher
tax revenues—$427 million higher in 2004—but these
are more than offset by our higher estimates of
spending. These higher estimates are primarily due to
our inclusion of four years of employee salary increases
instead of two and our exclusion of savings attributed
to state and federal actions we consider unrealistic.

As we have pointed out in the past, such large out-
year gaps could portend the need to cut spending or
raise taxes in the years ahead, particularly in the event
of an economic downturn. It is important to note that
the Mayor’s financial plan through 2004 assumes
continued economic growth at a more moderate rate.
In the event of an economic downturn, however,
spending pressures would increase—particularly for
social programs—at a time when revenue growth
would decrease, thereby making future budget gaps
even larger. If this were to occur, the city would face
an unenviable choice between increasing taxes in a
slow economy or reducing spending when it is needed
most.

Absent an economic downturn, if history is any
guide, these out-year gap projections will become
smaller as a result of changes to the Mayor’s financial
plan as each new fiscal year approaches. In addition
to reestimates of tax revenues and service costs, those
changes have included incremental service reductions,
tax increases, and the use of non-recurring revenues
to pay for ongoing expenses. The negative
consequences of such last minute budgetary changes,
however, highlight the need for the city to plan
strategically for its financial future.

**Figure 1-2.**
**IBO’s Estimates Under the Mayor’s Financial Plan**

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>Average Change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxes</td>
<td>$21,433</td>
<td>$20,991</td>
<td>$21,186</td>
<td>$21,590</td>
<td>$22,331</td>
<td>1.0%</td>
</tr>
<tr>
<td>Miscellaneous Revenues</td>
<td>2,942</td>
<td>3,066</td>
<td>2,603</td>
<td>2,558</td>
<td>2,529</td>
<td>-3.7%</td>
</tr>
<tr>
<td>State/Federal Categorical Aid</td>
<td>11,873</td>
<td>11,837</td>
<td>12,082</td>
<td>12,316</td>
<td>12,413</td>
<td>1.1%</td>
</tr>
<tr>
<td>Other</td>
<td>1,836</td>
<td>2,108</td>
<td>2,375</td>
<td>2,420</td>
<td>2,455</td>
<td>7.5%</td>
</tr>
<tr>
<td>Total Revenues</td>
<td>38,084</td>
<td>38,002</td>
<td>38,246</td>
<td>38,884</td>
<td>39,728</td>
<td>1.1%</td>
</tr>
<tr>
<td><strong>Expenditures:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>City-Funded</td>
<td>26,211</td>
<td>25,845</td>
<td>28,294</td>
<td>29,768</td>
<td>30,748</td>
<td>4.1%</td>
</tr>
<tr>
<td>State/Federal Categorical Funded</td>
<td>11,873</td>
<td>11,837</td>
<td>12,082</td>
<td>12,316</td>
<td>12,413</td>
<td>1.1%</td>
</tr>
<tr>
<td>Total Expenditures</td>
<td>38,084</td>
<td>37,682</td>
<td>40,376</td>
<td>42,084</td>
<td>43,161</td>
<td>3.2%</td>
</tr>
<tr>
<td><strong>IBO Surplus/(Gap) Estimate</strong></td>
<td>$0</td>
<td>$320</td>
<td>($2,130)</td>
<td>($3,200)</td>
<td>($3,433)</td>
<td></td>
</tr>
</tbody>
</table>

**SOURCE:** IBO.
**NOTES:** Excludes intra-city revenues and expenditures. Appendix A presents a more detailed repricing of the Mayor’s financial plan.
IBO Reestimates

IBO has reestimated the revenues and expenditures that would result from adopting the Mayor’s preliminary budget. (See Figure 1-2 for a summary.) Note that differing estimates of city revenues and city-funded spending have a direct impact on projected gaps, while varying estimates of state and federal categorical aid have no net budgetary impact because any additional aid is offset by an identical amount of spending.

Figure 1-3 displays the differences between IBO’s estimates and the projections contained in the Mayor’s financial plan. The table starts with the Administration’s gap estimates and then adds the variation between the Mayor’s and IBO’s estimates to crosswalk to IBO’s gap estimates.

Revenues

As detailed in Chapter 2, IBO’s revenue estimates exceed those in the financial plan. Primarily as a result of higher estimates of personal income growth, securities industry profits, and growth in assessed property values, IBO’s estimates of tax revenues vary from $230 million to $636 million higher than the financial plan. The majority of these additional revenues come from personal income, business income, and property taxes. In addition, IBO’s estimates of the revenue loss due to the proposed tax cuts is slightly lower than the Administration’s projection.

These higher tax revenues are partially offset by lower revenues from other sources. The financial plan includes significant revenues from prior-year airport rent, asset sales and desired state and federal actions. Since there is little evidence that these will materialize, they are excluded from our forecast.

Spending

Although we forecast greater revenue than does the Administration, our higher spending estimates more than offset those additional collections. As detailed in Chapter 3, we project higher spending nearly every year of the financial plan. Absent the prepayment adjustment that transfers the additional 2000 surplus we identified, our estimates exceed those of the Administration by $336 million in 2001, $382 million in 2002, $844 million in 2003, and $1.2 billion in 2004.

The largest portion of the additional spending in the latter years of the plan is attributable to labor costs. Although collective bargaining agreements will expire this calendar year, the financial plan includes funding for new agreements for 2001 and 2002. We add increases in 2003 and 2004, which cost $327 million and $672 million, respectively, using the assumption that base salary increases equal the rate of inflation. Since it is impossible to predict the outcome of collective bargaining, it should be noted that if the agreements exceed the rate of inflation by one percentage point each year, city-funded spending—and the budget gap—would be over $500 million higher by 2004. Conversely, if the agreements lag inflation by one percentage point annually, city-funded spending—and the budget gap—would be $500 million lower by 2004.

We also have higher spending estimates for education, Medicaid and public assistance. Finally, we exclude $245 million in annual savings from desired state and federal actions since there is little evidence they will happen.

Budget Management

Strategic management of the city’s finances is just as important in good times as in bad. The challenge in a period of expansion is to take actions that strengthen the city’s fiscal future, notwithstanding the fact that there is no immediate pressure to do so. It is notable that city-funded spending growth has been slower in this expansion than the last. However, the city still faces significant future budget gaps despite enjoying the longest post-war economic expansion. These gaps are primarily due to the budget management strategy that has been used in recent years and to new policy proposals.
### Figure 1-3. Details of Pricing Differences Between IBO and the Administration

**Items that Affect the Gap**

*Dollars in millions*

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gaps as Estimated by the Mayor</strong></td>
<td>$0</td>
<td>$0</td>
<td>$(2,172)</td>
<td>$(2,711)</td>
<td>$(2,508)</td>
</tr>
<tr>
<td><strong>IBO Pricing Differences:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Revenues:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxes:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property</td>
<td>13</td>
<td>108</td>
<td>202</td>
<td>250</td>
<td>205</td>
</tr>
<tr>
<td>Personal Income</td>
<td>130</td>
<td>226</td>
<td>144</td>
<td>80</td>
<td>31</td>
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<tr>
<td>General Sales</td>
<td>(7)</td>
<td>6</td>
<td>9</td>
<td>(2)</td>
<td>(40)</td>
</tr>
<tr>
<td>Business Income</td>
<td>98</td>
<td>170</td>
<td>194</td>
<td>157</td>
<td>140</td>
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<tr>
<td>Real-Estate Related</td>
<td>(4)</td>
<td>74</td>
<td>87</td>
<td>73</td>
<td>91</td>
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<tr>
<td></td>
<td>230</td>
<td>584</td>
<td>636</td>
<td>558</td>
<td>427</td>
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<tr>
<td>Tax Reduction Program</td>
<td>-</td>
<td>42</td>
<td>35</td>
<td>13</td>
<td>19</td>
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<tr>
<td>STaR Reimbursement</td>
<td>-</td>
<td>(30)</td>
<td>(47)</td>
<td>(46)</td>
<td>(41)</td>
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<tr>
<td>Anticipated State / Federal Actions</td>
<td>-</td>
<td>(30)</td>
<td>(30)</td>
<td>(30)</td>
<td>(30)</td>
</tr>
<tr>
<td><strong>Miscellaneous Revenues:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Airport Rent</td>
<td>-</td>
<td>(350)</td>
<td>(170)</td>
<td>(140)</td>
<td>(70)</td>
</tr>
<tr>
<td>Asset Sales</td>
<td>(50)</td>
<td>(30)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total Revenues</td>
<td>180</td>
<td>186</td>
<td>424</td>
<td>355</td>
<td>305</td>
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<td><strong>Expenditures:</strong></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Public Assistance</td>
<td>12</td>
<td>12</td>
<td>7</td>
<td>(33)</td>
<td>(80)</td>
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<tr>
<td>Medicaid</td>
<td>(43)</td>
<td>(68)</td>
<td>(85)</td>
<td>(103)</td>
<td>(124)</td>
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<tr>
<td>Education</td>
<td>259</td>
<td>83</td>
<td>(53)</td>
<td>(130)</td>
<td>(103)</td>
</tr>
<tr>
<td>Anticipated State &amp; Federal Actions</td>
<td>-</td>
<td>(245)</td>
<td>(245)</td>
<td>(245)</td>
<td>(245)</td>
</tr>
<tr>
<td>Labor Costs</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(327)</td>
<td>(672)</td>
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<td>Sports Facilities</td>
<td>90</td>
<td>(90)</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Lead Law / Demolition</td>
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<td>-</td>
<td>22</td>
<td>22</td>
<td>22</td>
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<tr>
<td>Overtime</td>
<td>(28)</td>
<td>(28)</td>
<td>(28)</td>
<td>(28)</td>
<td>(28)</td>
</tr>
<tr>
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<td>470</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total Expenditures</td>
<td>(180)</td>
<td>134</td>
<td>(382)</td>
<td>(844)</td>
<td>(1,230)</td>
</tr>
<tr>
<td><strong>Total Pricing Differences</strong></td>
<td>-</td>
<td>320</td>
<td>42</td>
<td>(489)</td>
<td>(925)</td>
</tr>
<tr>
<td><strong>IBO Surplus/(Gap) Estimate</strong></td>
<td>$0</td>
<td>$320</td>
<td>$(2,130)</td>
<td>$(3,200)</td>
<td>$(3,433)</td>
</tr>
</tbody>
</table>

**SOURCE:** IBO.

**NOTES:** Negative pricing differences (in parentheses) widen the gaps estimated by the Mayor. Positive pricing differences narrow the gaps. Excludes intra-city revenues and expenditures.
Leveraging Economic Strength

This year’s proposal continues the recent strategy of relying on a surplus and surging tax revenues to balance the following year’s budget, thus relieving the pressure to take significant actions to control long-run spending growth. However, this year differs from the recent past in the magnitude of the proposed tax reductions, which are backloaded with their first year impact being less than one-quarter of their impact in the fourth year. The result of these actions is that future budget gaps are large by historical standards.

Fundamentally, the preliminary budget is balanced on the strength of the local economy. Adopting the 2000 budget left 2001 with a $1.9 billion gap. During the year, based on IBO and Administration estimates, additional agency expenditures and state and federal actions increased the gap to $2.3 billion. Using IBO’s revenue and expenditure estimates, we see that resources in excess of this needed $2.3 billion are provided by the 2000 surplus ($1.6 billion is used) and additional revenues ($826 million), primarily taxes, above what was projected. As a result, few discretionary actions were necessary or taken. The balance of the proposed “gap-closing” actions, discussed below, essentially support salary increases to be agreed upon and the first year of the proposed tax cuts.

Using Non-recurring Resources

The preliminary budget also relies heavily on one-time resources. Using one-time resources is problematic because, once used, they disappear only to leave unsupported spending that drives future budget gaps. Using IBO estimates, the preliminary budget relies on $2.1 billion in non-recurring actions. These include $345 million from the sale of the Coliseum and $154 million from proposed agency spending and revenue initiatives—“PEGS.”

The non-recurring actions also include the planned use of $1.6 billion of the 2000 surplus. Here, it is important to consider that the prospective plan to use one-time resources may not be needed. Each of the last four years’ adopted budgets has relied on a significant surplus. However, in each year the surplus ultimately has not been needed, primarily because tax revenues exceeded expectations; from 1997 through 1999, tax revenues exceeded adopted budget projections by an average of $1.3 billion annually. While this could be repeated in 2001, eventually, when the economy slows, the surplus will be used, only to leave a hole in the following years’ budgets.

Controlling Spending

As previously discussed, one cause of future budget gaps is that spending growth is outstripping revenue growth. Although city-funded spending growth has been slower in this expansion than the last, the proposal would increase city-funded spending 6.4 percent from 2000 to 2001, and at an average annual rate of 3.4 percent from 2001 through 2004 (after including Transitional Finance Administration (TFA) debt service and adjusting for debt service prepayments).

While significant to the programs directly affected, the preliminary budget recommends relatively modest reductions in spending, and pays little attention to actions that would improve productivity. The proposed agency spending reductions total $318 million, just over one percent of city-funded expenditures. A significant number of these will not affect services because they are either due to workload reductions (such as correction and foster care), shifts in funding to the state or federal government, or procurement savings.

As a long-run strategy, increasing the productivity of the workforce allows spending to be controlled without reducing services. However, few of the proposed agency reductions involve increases in productivity. The financial plan does include additional savings attributable to what is termed “labor productivity,” which would total $250 million in 2001. But the city has not provided any details regarding these savings other than to suggest they could come from fringe benefit costs. While this type of action would reduce city spending, it would not increase the output per worker. It would not reorganize work processes or use technology, for example, to increase the output or quality of services or reduce their cost.
Cutting Taxes

A significant aspect of this year’s budget is the Mayor’s substantial tax reduction proposal. The proposed cuts grow four-fold from $476 million in 2001 to $2.0 billion in 2004, when they would represent 8 percent of tax revenues. Over one-third of the total value of the cuts is due to allowing the expiration of a 14 percent surcharge on the personal income tax. The next largest cut comes from the elimination of the commercial rent tax, followed by significant cuts in business taxes and property taxes for owners of cooperatives and condominiums.

Mirroring the problem of using one-time resources is the difficulty of supporting programs whose full impact is not felt in the first year. These tax cuts are supported in the coming year by the additional resources discussed above, but they represent a large portion of the future budget gaps. Absent the tax cuts, the future budget gaps would be cut by more than half; in 2004 the gap would be $1.4 billion instead of $3.4 billion. Another perspective is provided by the fact that the cuts reduce the average annual growth in tax revenues from 3.3 percent to 1.0 percent.

Alternative Strategies

How the gap is closed and other policy choices have a significant impact on the city’s fiscal future. Different choices could better prepare the city to weather future circumstances. As we have pointed out in the past, the city’s fiscal outlook would improve if it used surpluses to fortify its long-term fiscal foundation instead of using them to balance budgets without regard to difficulties down the road. The city could establish a rainy day fund for use only when needed to address a short-term emergency, such as an economic downturn. Also, the city could repay a portion of its outstanding debt and/or substitute pay-as-you-go financing for borrowing, both of which would help the city balance future budgets by lowering annual debt service costs.

If the surpluses were used to address long-term concerns, other actions would be required to balance the budget. These should include increasing productivity to protect services while controlling spending. Achieving budgetary savings always requires effort and perseverance. However, it is better to do so over time when the economy is strong, rather than abruptly in a weak economy when revenue growth slows and spending pressures grow.
Revenues

Overview

For the current fiscal year, IBO estimates that city revenues from all sources will total $38.1 billion. The projected 5.0 percent increase over 1999 is strong, given the increasing impact of enacted tax cuts. This growth rate is unlikely to be sustained for the financial plan period, however, if the preliminary budget’s tax reduction proposals are adopted. After 2000, total revenues will first decline and then increase only slightly, to grow by an average annual rate of only 0.2 percent over the 2000-2002 period. Growth is expected to pick up somewhat in the final two years of the financial plan, averaging 1.9 percent annually. By 2004 total revenues are projected to reach $39.7 billion, representing only 1.1 percent average annual growth from the current year.

This chapter details IBO’s revenue forecast, which reflects projected changes in baseline tax and other revenues plus our estimates of the impact of the proposed tax reduction program. The first section summarizes the economic outlook behind the revenue forecast. The bulk of the chapter focuses on tax revenues, beginning with a review of our baseline revenue forecasts and then taking a closer look at the Mayor’s tax reduction program. This section of the chapter reestimates the cost and analyzes the impact of the many proposals contained in the tax program, including: elimination of the PIT surcharge; two personal income tax credits; termination of the commercial rent tax; extension of the real property tax abatement for co-ops and condos; elimination of the mortgage recording tax for first-time buyers; cuts in business income taxes; restructuring and reducing the utility tax; and a cut in the hotel occupancy tax. The chapter concludes with a discussion of our forecasts of state and federal categorical aid and revenues other than taxes, including revenue from the legal settlement between tobacco companies and state governments.

Economic Outlook

In recent years, the economy has performed beyond expectations, posting impressive gains year after year. This past year was no exception. IBO forecasts continued economic growth, though at a reduced pace, in calendar year 2000 and over the financial plan period. The preliminary budget also forecasts a slowdown for the same period, but is more conservative in its outlook for local personal income and securities industry profits. (IBO’s economic forecast is contrasted with the Administration’s January plan forecast in Appendix B.)

Recent developments. Fueled by continued strong consumer spending, the U.S. economy experienced another very strong year in 1999. Real (inflation-
adjusted) gross domestic product (GDP) grew a robust 4.1 percent, inflation remained modest, the rate of unemployment reached its lowest level in 30 years, and we are enjoying the longest economic expansion since World War II. Warning signs have surfaced, however, including volatility in stock prices and concerns over rising oil prices.

New York City had a strong 1999 as well. Employment and income grew at rates slightly higher than the nation’s. The 85,000 jobs created in 1999—including 80,800 new private sector jobs—surpassed the record established just the year before, while the unemployment rate dropped below 8.0 percent for the first time since 1990. Despite this growth, the city’s rate of inflation is lower than the nation’s.

The national outlook. IBO’s forecasts of real GDP and national employment growth are on a par with the Administration’s estimates in 2000, where both expect 1.7 percent job gains and very similar growth in real output of 3.7 percent (IBO) and 3.6 percent (OMB). IBO forecasts that real GDP and employment growth will generally decelerate over the remainder of the forecast period; by 2002, we expect real output to grow a full percentage point slower than in 1999. The Administration also anticipates slower growth through 2002, followed by growth at an increased pace in 2003 and 2004.

IBO projects that the rate of inflation will rise to 2.5 percent in 2000, and retreat somewhat to 2.3 percent in 2001 and 2002, and 2.4 percent in 2003 and 2004. In contrast, the Administration predicts inflation to dip to 2.1 percent in 2001, and rise to 2.7 percent in 2003 and 2004. Both IBO and the Administration expect the Federal Reserve to further tighten monetary policy by raising the federal funds rate (a key interest rate controlled by the Fed) in 2001 and 2002. IBO anticipates that the Federal Reserve’s vigilance will hold inflation in check but come at a price of gradually rising unemployment rates, which we forecast to exceed 5.0 percent by 2003. OMB also forecasts the unemployment rate to rise, reaching 4.5 percent in 2002 and remaining at that level over the next few years.

The city outlook. IBO is forecasting that the city’s economy will continue to grow, but at a slower pace. We expect the rate of local job creation to decline steadily over the next several years, with 62,300 additional jobs in 2000 but only 28,100 in 2001 and an average of 25,900 per year over the remainder of the forecast period. The Administration’s employment forecast is very similar to IBO’s through 2002, but more optimistic for 2003 and 2004. IBO projects that personal income growth will decelerate to 5.7 percent in 2000—2 percentage points less than in 1999—but remain relatively strong through 2004. In contrast, the Administration forecasts more moderate personal income growth, leading to estimates that are on average $10.6 billion (or about 3.3 percent) less than IBO’s each year. Finally, both IBO and the Administration forecast local inflation to accelerate, though the Administration expects prices to rise more rapidly than does IBO each year of the forecast period.

Tax Revenues

With the sustained strength of the local economy, New York City’s tax revenues have continued to grow, although the increase has slowed due to recently enacted tax cuts. By the end of fiscal year 2000, revenues will total $21.7 billion, including $270 million in personal income tax (PIT) revenues that are dedicated to the Transitional Finance Authority (TFA). The 2000 slowdown in tax revenue growth—to 1.3 percent—is due in large part to the loss of PIT revenue from in-state commuters. Tax cuts under the STaR program have also contributed to the slowdown.

Tax revenues are expected to decline in 2001, the result of slower baseline revenue growth in addition to new tax cuts. Slower economic growth and a reduction of Wall Street firms’ profits in the near term plus even greater impacts of enacted tax cuts will
constrain the growth of baseline revenues—the sum of projected tax revenues before accounting for the expected effects of proposed but not yet enacted tax cuts—to only 1.1 percent. The addition of a new set of tax cuts is expected to reduce tax revenues by $476 million in 2001, compared to revenues in the absence of new cuts. On balance, total tax revenues are projected to decline by 1.1 percent if the Mayor’s tax reduction package is enacted in its entirety.

Baseline revenue growth picks up after 2001, to average 4.3 percent from 2001 to 2004. But the impact of the tax reduction package quadruples during this period, so the forecast of total tax revenue including proposed tax cuts is for steadily increasing modest growth—1.2 percent in 2002, 2.0 percent in 2002, and 3.4 percent in 2004. Total tax revenues are projected to reach $22.9 billion by 2004 if the entire tax program is adopted; without the program, revenue would be $2.0 billion higher.

IBO’s forecast of baseline tax revenues—revenues excluding proposed tax reductions—is summarized and compared to the Administration’s below. This is followed by a general overview of the Mayor’s tax reduction program and a detailed discussion of the program’s major components.

Baseline Revenue Forecast

- IBO forecasts only a 1.1 percent expansion of baseline tax revenues from 2000 to 2001, followed by moderate annual growth averaging 4.4 percent through 2004.
- IBO’s forecast of baseline revenues exceeds OMB’s by $230 million in 2000 and by substantially greater amounts—as much as $637 million—in the out-years. Higher forecasts of personal income, general corporation, and real property taxes account for most of the difference.

Even without incorporating the effects of the proposed tax reduction program, tax revenues (including TFA-dedicated receipts) are expected to increase by only 1.1 percent in the upcoming fiscal year—from $21.7 billion in 2000 to $21.9 billion in 2001 (see Figure 2-1). Real property tax collections are projected to expand 3.2 percent in 2001, fueled by an even faster expected increase in assessed property values. But the growth of the property tax—the city’s biggest single revenue source—will largely be offset by declines in the personal income tax (PIT) and general corporation tax (GCT). A moderation of both securities industry profits and national corporate profit growth in calendar year 2000 will cause GCT revenue to fall by 4.2 percent in fiscal year 2001, while the deepening of the STaR cuts and the further elimination of receipts from commuters will result in a 2.2 percent decline in PIT collections. Also contributing to the weak revenue growth in 2001 are general sales tax revenues, which are expected to remain unchanged from 2000 due to slower economic growth and the impacts of clothing tax cuts and utility deregulation.

After 2001, baseline revenue growth is expected to pick up, with the forecast calling for revenue to increase annually by 4.4 percent—about $1 billion—on average from 2001 to 2004. Fueled by continued strength of the real estate market and assessed property values, property tax collections are expected to be particularly strong and account for much—$400 to $600 million a year—of the overall revenue growth. Significant increases in PIT collections are expected to occur only after 2002, when the phase-in of the STaR cuts and the loss of commuter tax revenue will both be complete. Resumption of general sales tax growth, by more than $100 million each year, also contributes substantially to faster baseline revenue growth after 2001.

Comparison with the preliminary budget. IBO’s baseline tax forecast exceeds that presented in the preliminary budget throughout the forecast period—by $230 million in the current fiscal year and by larger amounts ranging from $427 million to $637 million in the following years (see Figure 2-2). The largest difference is for 2002, when IBO’s baseline forecast is 2.9 percent greater than OMB’s.
### Figure 2-1.
**IBO Revenue Estimates Under the Mayor’s Proposals**

*Dollars in millions*

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>Average Change</th>
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</thead>
<tbody>
<tr>
<td><strong>Tax Revenues:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property Tax</td>
<td>7,787</td>
<td>8,033</td>
<td>8,633</td>
<td>9,130</td>
<td>9,531</td>
<td>5.2%</td>
</tr>
<tr>
<td>Personal Income Tax</td>
<td>4,875</td>
<td>4,766</td>
<td>4,737</td>
<td>5,019</td>
<td>5,327</td>
<td>2.2%</td>
</tr>
<tr>
<td>(excluding TFA)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General Sales Tax</td>
<td>3,415</td>
<td>3,404</td>
<td>3,506</td>
<td>3,633</td>
<td>3,776</td>
<td>2.5%</td>
</tr>
<tr>
<td>General Corporation Tax</td>
<td>1,573</td>
<td>1,507</td>
<td>1,545</td>
<td>1,577</td>
<td>1,605</td>
<td>0.5%</td>
</tr>
<tr>
<td>Unincorporated Business Tax</td>
<td>713</td>
<td>714</td>
<td>750</td>
<td>787</td>
<td>827</td>
<td>3.8%</td>
</tr>
<tr>
<td>Banking Corporation Tax</td>
<td>431</td>
<td>444</td>
<td>458</td>
<td>472</td>
<td>486</td>
<td>3.0%</td>
</tr>
<tr>
<td>Real Estate-Related Taxes</td>
<td>1,154</td>
<td>1,177</td>
<td>1,215</td>
<td>1,274</td>
<td>1,375</td>
<td>4.5%</td>
</tr>
<tr>
<td>Other Taxes (with Audits)</td>
<td>1,485</td>
<td>1,422</td>
<td>1,420</td>
<td>1,432</td>
<td>1,447</td>
<td>-0.6%</td>
</tr>
<tr>
<td><strong>Total Taxes Before Reductions</strong></td>
<td>21,433</td>
<td>21,467</td>
<td>22,263</td>
<td>23,324</td>
<td>24,374</td>
<td>3.3%</td>
</tr>
<tr>
<td>Tax Reduction Program</td>
<td>-</td>
<td>(476)</td>
<td>(1,077)</td>
<td>(1,734)</td>
<td>(2,043)</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Total Taxes After Reductions</strong></td>
<td>21,433</td>
<td>20,991</td>
<td>21,186</td>
<td>21,590</td>
<td>22,331</td>
<td>1.0%</td>
</tr>
<tr>
<td>STaR Reimbursement</td>
<td>260</td>
<td>472</td>
<td>687</td>
<td>709</td>
<td>737</td>
<td>29.8%</td>
</tr>
<tr>
<td>Dedicated Personal Income Tax (TFA)</td>
<td>270</td>
<td>472</td>
<td>538</td>
<td>565</td>
<td>572</td>
<td>20.6%</td>
</tr>
<tr>
<td>Miscellaneous Revenues</td>
<td>2,942</td>
<td>3,066</td>
<td>2,603</td>
<td>2,558</td>
<td>2,529</td>
<td>-3.7%</td>
</tr>
<tr>
<td>State / Federal Categorical Aid</td>
<td>11,873</td>
<td>11,837</td>
<td>12,082</td>
<td>12,316</td>
<td>12,413</td>
<td>1.1%</td>
</tr>
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<td><strong>All Other Revenues</strong></td>
<td>1,306</td>
<td>1,164</td>
<td>1,150</td>
<td>1,146</td>
<td>1,146</td>
<td>-3.2%</td>
</tr>
<tr>
<td><strong>Total Revenues as Estimated by IBO</strong></td>
<td>$38,084</td>
<td>$38,002</td>
<td>$38,246</td>
<td>$38,884</td>
<td>$39,728</td>
<td>1.1%</td>
</tr>
</tbody>
</table>

**SOURCE:** IBO.

**NOTES:** Miscellaneous revenues are net of intra-city revenues. All other revenues include unrestricted government aid, anticipated aid, other categorical grants, inter-fund revenues, and disallowances.

Through 2003, much of the difference is due to IBO’s higher forecast of PIT collections, which results from IBO’s projections of faster personal income growth compared with OMB’s. While the forecasts of GCT revenue are almost identical in the current year, in 2001 and the out-years IBO’s forecast exceeds OMB’s by at least $100 million each year; most of the higher GCT forecast is explained by IBO’s higher projections of profits in the securities industry.\(^5\)

Finally, starting in 2001, IBO’s forecast of real property taxes is substantially higher, especially from 2002 to 2004 when it is at least $200 million more each year than OMB’s projections. IBO’s projection of faster growth of the assessed values accounts for most the difference with OMB’s property tax forecast. Other factors include IBO’s assumptions about the timing of payments and refunds and the number of taxpayers participating in the STaR program.
**Figure 2-2.**
Details of Differences Between IBO’s Estimates and the Mayor’s Revenue Forecasts

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Revenues as Estimated by the Mayor</strong></td>
<td>$37,431</td>
<td>$36,776</td>
<td>$36,555</td>
<td>$37,044</td>
<td>$37,847</td>
</tr>
<tr>
<td><strong>IBO Reestimates:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax Revenues</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property Tax</td>
<td>13</td>
<td>108</td>
<td>202</td>
<td>250</td>
<td>205</td>
</tr>
<tr>
<td>Personal Income Tax (excluding TFA)</td>
<td>130</td>
<td>226</td>
<td>144</td>
<td>80</td>
<td>31</td>
</tr>
<tr>
<td>General Sales Tax</td>
<td>(7)</td>
<td>6</td>
<td>9</td>
<td>(2)</td>
<td>(40)</td>
</tr>
<tr>
<td>General Corporation Tax</td>
<td>2</td>
<td>116</td>
<td>127</td>
<td>109</td>
<td>113</td>
</tr>
<tr>
<td>Unincorporated Business Tax</td>
<td>20</td>
<td>4</td>
<td>9</td>
<td>(8)</td>
<td>(24)</td>
</tr>
<tr>
<td>Banking Corporation Tax</td>
<td>76</td>
<td>50</td>
<td>59</td>
<td>56</td>
<td>51</td>
</tr>
<tr>
<td>Real Estate-Related Taxes</td>
<td>(4)</td>
<td>74</td>
<td>87</td>
<td>73</td>
<td>91</td>
</tr>
<tr>
<td>Tax Reduction Program</td>
<td>-</td>
<td>42</td>
<td>35</td>
<td>13</td>
<td>19</td>
</tr>
<tr>
<td>STaR Reimbursement</td>
<td>-</td>
<td>(30)</td>
<td>(47)</td>
<td>(46)</td>
<td>(41)</td>
</tr>
<tr>
<td>Miscellaneous Revenues:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Airport Rent</td>
<td>-</td>
<td>(350)</td>
<td>(170)</td>
<td>(140)</td>
<td>(70)</td>
</tr>
<tr>
<td>Asset Sales</td>
<td>(50)</td>
<td>(30)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>State / Federal Categorical Aid</td>
<td>203</td>
<td>568</td>
<td>729</td>
<td>920</td>
<td>1,004</td>
</tr>
<tr>
<td>All Other Revenues</td>
<td>-</td>
<td>(30)</td>
<td>(30)</td>
<td>(30)</td>
<td>(30)</td>
</tr>
<tr>
<td><strong>Inclusion in the Budget:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dedicated Personal Income Tax (TFA)</td>
<td>270</td>
<td>472</td>
<td>538</td>
<td>565</td>
<td>572</td>
</tr>
<tr>
<td><strong>Total Revenues as Estimated by IBO</strong></td>
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<td>$38,246</td>
<td>$38,884</td>
<td>$39,728</td>
</tr>
</tbody>
</table>

**SOURCE:** IBO.

**NOTES:** Miscellaneous revenues are net of intra-city revenues. All other revenues include unrestricted government aid, anticipated aid, other categorical grants, inter-fund revenues, and disallowances.

**Tax Reduction Program**

The January Plan includes an ambitious tax reduction program encompassing cuts in the personal income, commercial rent, property, mortgage recording, business income, utility, and hotel taxes. IBO estimates that if fully enacted this tax program would lower city tax collections by $476 million in 2001 and over $2.0 billion in 2004. This would bring the total value of tax reductions enacted since 1994 to approximately $4.5 billion—nearly a 17 percent reduction in the city’s overall tax burden.

To a considerable extent, these enacted and prospective cuts are and would be bankrolled by the revenue surpluses brought in by the city’s booming economy. This same long economic expansion has also underwritten large state tax cuts in New York. It is indeed common for state and local governments to reduce taxes during economic expansions, while (as was the case around the country as well as in New York City during the early 1990s) being forced by balanced budget constraints to raise taxes in recessions. But the percentage tax burden reduction pursued by New York City appears to be exceptionally large.
Because the city’s tax reduction program is so large—even for a booming economy—enactment of the proposed new cuts would leave the city’s ability to balance future budgets particularly vulnerable to any significant slackening of economic growth. However, these reductions also address the city’s long-term vulnerability to tax competition from other jurisdictions. A recent IBO study has found that even with the tax reductions enacted to date, New York City imposes substantially heavier taxes than other large cities. If the proposed tax program can be sustained without compromising the funding of city services, it would further narrow (but not eliminate) the gap between New York and other cities. New York City’s tax environment would also compare more favorably to that of its surrounding suburbs.

Due in part to its impact on New York City’s tax competitiveness, the enacted and prospective 17 percent reduction in the city tax burden yields proportionately smaller actual revenue losses. This is because, as IBO has shown in a number of studies,
the tax cuts themselves stimulate growth in the city’s economy and tax base. IBO has found that the secondary revenues brought in by tax cut related growth can offset anywhere from 8 percent (city clothing sales tax cut) to 30 percent (city utility tax cut) to 50 percent (city hotel tax cut) of the primary revenue losses.7

Like OMB, IBO does not explicitly incorporate estimates of secondary tax impacts into forecasts of proposed tax program costs and overall tax revenues. However, insofar as the values of the economic variables used in revenue forecast models have been affected by past tax policy changes, the impact of the tax reductions enacted and pursued in the current boom is—at least to some extent—implicitly reflected in baseline economic growth and tax revenue forecasts.

**PIT Surcharge Elimination**

- The proposal to eliminate the personal income tax (PIT) surcharge is by far the largest component of the tax reduction program. It would reduce tax revenues by close to $800 million annually by the end of the financial plan period.

- Tax savings from surcharge elimination would be highly concentrated among a relatively small number of upper-income filers. Taxpayers with incomes over $250,000—accounting for less than 5 percent of all tax returns filed—would enjoy almost 44 percent of the tax savings.

The centerpiece of the preliminary budget’s tax reduction program is the proposal to eliminate the 14 percent surcharge on personal income tax (PIT) liability, accounting for roughly 40 percent of the program’s cost. All filers who now incur tax liability would receive a tax cut, though the bulk of the benefits would be received by a minority of taxpayers.

**Background.** The surcharge is equal to 14 percent of the non-surcharge (or base rate) liability of city residents and accounts for roughly 12.3 percent of total PIT revenue. The surcharge has been in effect since tax year 1991. Initially established as a temporary measure that would expire in three years, the surcharge has been renewed several times. Without another renewal, the surcharge will expire on December 31, 2001. In contrast, renewing the surcharge would entail amending the state law that authorizes the surcharge, in addition to city legislative approval.

Several other PIT reductions have been enacted in recent years. Another surcharge, known as the 12.5 percent surcharge, first enacted for tax year 1990 and generally dedicated to criminal justice programs, was allowed to expire at the end of 1998. By tax year 2001, the phase-in of the STaR program’s PIT cuts—a roughly 6 percent reduction in PIT base rates plus a flat credit of $125 per household ($62.50 for single filers)—will be complete. Finally, since tax year 1997, city residents who are proprietors or partners in businesses paying the city’s unincorporated business tax have been eligible for a PIT credit (see discussion below).

**Timing and fiscal impact.** The proposal initially published in the financial plan calls for allowing the surcharge to expire at the end of tax year 2001 simply by not renewing it. But in presenting the proposal to the City Council and the public, the Mayor called for enacting legislation that would eliminate the surcharge as soon as July of this tax year.

To allow comparison with the published financial plan, IBO’s estimates of the impact of eliminating the PIT surcharge are based on the initial, published proposal (see Figure 2-3). Specifically, allowing the surcharge to expire at the end of 2001—as initially proposed—would reduce fiscal year 2002 revenues by $228 million. The full effect of eliminating the surcharge would be felt in the next two years, when PIT receipts would be reduced by $739 million in 2003 and $788 million in 2004. These cost estimates are slightly higher than the Administration’s because
they are based on IBO’s higher baseline PIT forecast (see Figure 2-1).

Abolishing the surcharge before it is due to expire would hasten the fiscal impact. PIT revenue in 2001 would fall by approximately $700 million if surcharge elimination were to take effect in July, at the beginning of the city’s new fiscal year.

**Beneficiaries of surcharge elimination.** Almost all city residents filing tax returns would benefit from the elimination of the 14 percent surcharge; only those too poor to incur any city liability in the first place would not have their income taxes reduced. Surcharge elimination would thus generally reduce the tax burden of New Yorkers.

Using a sample of 1997 tax returns (the latest year available) and projections of how various types of income will grow, IBO has modeled the distribution among different income groups of the tax savings that would result from surcharge elimination. For tax year 2002, taxpayers on average would receive a $174 cut, but upper-income filers who constitute a minority of New York City filers would enjoy the bulk of the tax savings. The distribution of tax savings among different income groups is proportional to the distribution of PIT liability, and the liability distribution itself is skewed toward a small number of the most affluent because income distribution in New York is particularly unequal.8

As shown in Figure 2-4, in tax year 2002, the first year after the surcharge will expire under current law, tax filers with reported incomes of $125,000 or more are projected to account for 13.1 percent of all returns filed.9 This group of filers would receive well over half—57.8 percent—of the projected $726.5 million in tax savings for the year, similar to their percent share of PIT liability (59.4 percent with the surcharge and 59.6 percent without).

The concentration of tax liability and tax savings is especially striking looking at the less than 1 percent of returns reporting incomes of $1 million or greater. They would receive 26.6 percent of the tax savings and account for 27.6 percent of tax liability. Surcharge elimination would reduce these taxpayers’ PIT liability by an average of $6,052 per return, compared with $174 per return for all filers.

### Figure 2-4.
**PIT Surcharge Elimination Tax Savings By Income Groups, Tax Year 2002**

<table>
<thead>
<tr>
<th>Income Group</th>
<th>Percent of Tax Returns</th>
<th>Tax Savings ($ millions)</th>
<th>Percent of Savings</th>
<th>Tax Savings Per Return</th>
<th>Percent of Total PIT Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under $30,000</td>
<td>40.6%</td>
<td>$32.5</td>
<td>4.5%</td>
<td>$19.20</td>
<td>3.5%</td>
</tr>
<tr>
<td>$30,000 to $59,999</td>
<td>24.4%</td>
<td>$65.8</td>
<td>9.1%</td>
<td>$101.52</td>
<td>13.6%</td>
</tr>
<tr>
<td>$60,000 to $99,999</td>
<td>16.5%</td>
<td>$159.7</td>
<td>22.0%</td>
<td>$177.08</td>
<td>16.7%</td>
</tr>
<tr>
<td>$100,000 to $124,999</td>
<td>5.4%</td>
<td>$48.4</td>
<td>6.7%</td>
<td>$215.42</td>
<td>6.7%</td>
</tr>
<tr>
<td>$125,000 to $249,999</td>
<td>8.2%</td>
<td>$104.4</td>
<td>14.4%</td>
<td>$304.05</td>
<td>14.6%</td>
</tr>
<tr>
<td>$250,000 to $999,999</td>
<td>4.1%</td>
<td>$122.3</td>
<td>16.8%</td>
<td>$708.55</td>
<td>17.4%</td>
</tr>
<tr>
<td>$1,000,000 and over</td>
<td>0.8%</td>
<td>$193.3</td>
<td>26.6%</td>
<td>$6,052.46</td>
<td>27.6%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100.0%</td>
<td><strong>$726.5</strong></td>
<td>100.0%</td>
<td>--</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

**SOURCE:** IBO.

**NOTES:** Income is measured by federal adjusted gross income in 1999 constant dollars. For all filers, the average tax savings per return is $174.
The distribution of the tax savings that resulted from the 1998 expiration of the 12.5 percent PIT surcharge was similarly concentrated among the wealthiest New Yorkers. When the proposal to let the 12.5 percent surcharge expire was initially made by the City Council Speaker, it was coupled with a proposal to make the schedule of PIT base rates more progressive—that is, increase the degree to which marginal tax rates are higher in high-income brackets—in order to distribute the resulting tax savings more evenly among taxpayers of different income levels. However, the 12.5 percent surcharge expired without base rate restructuring. The Administration’s current proposal to eliminate the 14 percent surcharge has not been linked to any further changes in PIT rates that would significantly alter the distribution of the benefits.

Finally, it is important to note that the amounts of tax savings per income group reported in Figure 2-4 are simply the decreases in PIT liability that would result from surcharge elimination. Not all of the city tax savings would be enjoyed by taxpayers as additional disposable income because local income tax payments are deductible from federal income tax. With surcharge elimination, taxpayers who itemize deductions would deduct a smaller amount of city tax liability and thus pay more in federal taxes. Because the upper-income taxpayers who pay most of the PIT are most likely to itemize, a significant portion of the tax savings would be captured not by the taxpayers themselves but by the federal government—between $.28 and $.40 of each city tax dollar saved by the 23 percent of city tax filers who itemize on their federal returns, given marginal federal tax rates ranging from 28.0 percent to 39.6 percent for all but the lowest income bracket.

PIT Credits

The tax reduction program includes two proposals for PIT credits. One would enhance an existing credit for resident business owners who pay both the city’s personal income and unincorporated business tax (UBT). The other would establish a similar credit for those owners of subchapter S corporations paying either the city’s general corporation tax (GCT) or banking corporation tax (BCT). Because the details of each of these proposals are still being developed, the fiscal impacts presented in the financial plan are essentially guidelines as to how much the combined credits are intended to cost rather than cost estimates for fully specified tax proposals.

Enhanced UBT-PIT Credit

- Unlike most changes in city tax law, enhancing the existing PIT credit for UBT payers would not require New York State legislative approval.
- By limiting benefits to residents, the UBT-PIT credit maintains the city’s ability to tax, through the UBT, the incomes of unincorporated business partners and proprietors who work in the city.
- In part because recent increases in another tax credit have eliminated UBT liability for many small businesses, the distribution of income among resident UBT payers is weighted heavily toward those with high personal incomes.

The existing UBT-PIT credit. The tax reduction program includes a proposal to increase the existing PIT credit for UBT payments. City residents who are proprietors or partners in businesses paying the city’s UBT also pay taxes on their personal income that includes already-taxed business income. Beginning in tax year 1997, however, these residents have been entitled to a partial credit against their PIT liability for UBT payments. The amount of the credit allowed under current law varies with residents’ personal taxable income. Residents with New York State taxable incomes of $42,000 or less in a year may claim 65 percent of their UBT payments as a PIT credit. The share of UBT payments allowed for the credit decreases by one-tenth of a percentage point for every $200 increase in taxable income until it reaches a minimum of 15 percent of UBT payments.
for taxpayers with annual incomes greater than $142,000.

The state law authorizing New York City to establish the UBT-PIT credit enables the city to increase the credit without having to obtain further state legislative approval. Thus, unlike the other proposals of the tax reduction plan, the proposal to increase the UBT-PIT credit could be put into effect by the city itself.

**The proposed credit increase.** The proposal presented in the financial plan is to increase the UBT-PIT credit beginning in the current tax year, at a projected cost of $43 million in city fiscal year 2001, growing to $56 million by 2004. The proposed cost is roughly in line with a doubling of the current credit. These estimates assume that the number of taxpayers who take the credit will increase as more people become familiar with it, and it is likely that any credit enhancement would increase that number even more.\(^{11}\)

Because of its structure as a credit against resident PIT liability, the UBT-PIT credit reduces the double taxation of city residents’ business income without forfeiting the city’s ability to tax (through the UBT) the incomes of commuters’ unincorporated businesses.\(^ {12}\)

**Distribution of benefits.** In recent years, reductions in the UBT targeted at small businesses have eliminated UBT liability for over 20,000 small business proprietors and partnerships, resident and commuters alike. Given that many small businesses—including all sole proprietorships with incomes below $55,000—no longer pay the UBT, it is not surprising that the distribution of benefits of the proposed increase in the UBT-PIT credit is heavily weighted toward those UBT payers with high personal incomes. Almost half (49.2 percent) of those who took that UBT-PIT credit against 1997 tax liabilities had taxable incomes above $142,000. In spite of their being allowed only the minimum credit (15 percent of UBT), together these taxpayers received 79.1 percent of the total amount of credits claimed.

Simply doubling the current credit would maintain the concentration of tax savings among UBT payers with incomes above $142,000. Providing a relatively greater enhancement of the credit to resident UBT payers with incomes below $142,000 would have only a limited impact on this group’s share of the tax savings because so many small business no longer pay the UBT. For example, even if the UBT-PIT credit were maximized to 100 percent of UBT liability for those with incomes below $142,000 yet remained at 15 percent for all others, at least half of the benefits would still be received by the latter, high-income group.

**Subchapter S Corporation-PIT Credit**

- The proposed Subchapter S corporation-related (S corp) PIT credit would target tax savings toward resident shareholders of many relatively small businesses paying city corporation taxes.
- The credit would also make the PIT treatment of resident S corp shareholders more comparable to that of resident proprietors and partners of unincorporated businesses.

**Tax treatment of S corps under current law.** The Mayor’s tax reduction program includes a proposal to allow resident shareholders of subchapter S corporations a credit against PIT liability for their share of corporation taxes paid to the city. S corps are a special type of small business eligible for certain tax benefits at the federal and state levels. In order to organize as an S corp, a firm must meet several qualifications, the most important of which are that it have no more than 75 shareholders and that its shares not be publicly traded.

Under federal law, the earnings of an S corp are exempt from corporate income tax, though the earnings distributed to individual shareholders as dividends are subject to the federal personal income tax.\(^ {13}\) Under state law, S corps can elect New York State S Corp status and receive various tax benefits.
The most basic benefit is that although S corps are subject to the state’s corporate franchise tax, they pay a much lower rate—currently 0.975 percent of net income rather than the regular 8.5 percent state rate for the current year.

Under city law, S corps are treated like all other corporations and subject to either the city’s general corporation tax (GCT) or banking corporation tax (BCT) with no preferential treatment.

**The proposed credit and its cost.** The current proposal would not alter the corporate taxation of S corps on the city level, but it would benefit city residents who are shareholders in S corps subject to the GCT and BCT. Specifically, starting in the current tax year these taxpayers would be permitted a credit against PIT liability for a portion of GCT or BCT payments attributable to the taxpayer’s stake in the S corp. The proposal is patterned after the existing UBT-PIT credit and it would be structured similarly, with the percent of business tax liability that could be claimed as a PIT credit decreasing as the taxpayer’s income rises. By matching information reported on S corps’ federal tax returns with information obtained from local GCT, BCT, and PIT returns, the Department of Finance estimates that 49,000 resident taxpayers would qualify for an S corp-related PIT credit.

The stated aim is for the new credit to have the same structure of percentages as the UBT-PIT credit, and thus any enhancement of the latter credit would necessitate a more costly S corp-related credit. The financial plan calls for an S corp credit that would cost the city an estimated $45 million in 2001, increasing gradually to $56 million in 2004—amounts roughly the same as the estimated cost of the current UBT-PIT credit. The cost estimates for the S corp credit should be considered very preliminary, however, because the cost would ultimately depend on the generosity of the enhanced UBT-PIT credit if having equivalent PIT credits remains the goal.

**Policy goals of the credit.** The proposal to give city residents a PIT credit for their share of S corp-related GCT and BCT payments serves goals related to both personal and business income taxation.

The proposal would reduce double taxation of business income for city residents, who alone among owners of local S corps are subject to the city’s PIT in addition to corporate taxes. The new proposed credit, like the already existing one for UBT payers, targets benefits specifically to city residents while retaining the city’s ability to tax business income generated in the city by S corp shareholders who do not reside here.

The new credit would also make the treatment of resident shareholders in local S corps more similar to the treatment of city residents who are business partners and proprietors paying the UBT. Finally, both the proposed and the existing PIT credits would benefit resident owners of New York City-based small businesses, because S corps, like most unincorporated businesses, are relatively small entities.

**Commercial Rent Tax Elimination**

- The preliminary budget proposes reducing the commercial rent tax in 2001 and then eliminating it in 2004.

- The reduction would cost the city $237 million in 2001; complete elimination of the tax in 2004 would cost $411 million.

- Eliminating the CRT would remove one of the city’s unique and most controversial taxes, although its defects may be overstated.

The preliminary budget calls for reducing the commercial rent tax (CRT) by two-thirds in 2001 and then eliminating it entirely in 2004. If enacted, this would be the last in a series of reductions in one of the city’s unique taxes, one that has often drawn attention from those concerned with the city’s tax burden relative to other locations.
The CRT is paid by commercial tenants based on the amount of rent they pay to their landlords. Tax liability is determined by a single flat rate applied to the base rent. A sliding-scale credit which phases out as taxable rent increases helps to moderate what would otherwise be a steep rise in the marginal tax paid on rents just over the zero liability threshold.

Although the CRT tax burden has been reduced several times since its peak in 1977, in recent years the city has made much more dramatic changes, significantly decreasing both the number of firms subject to the tax and the liability of the remaining taxpayers. Since September 1995, only leases in buildings south of 96th Street in Manhattan are subject to the tax, and since June 1997, only tenants with base rents above $100,000 have any tax liability. As recently as May 1994, Manhattan tenants south of 96th Street with base rents above $11,000 faced a tax liability.

For tenants still subject to the tax, the most important change has been a reduction in the effective tax rate, which has fallen from 6.0 percent to 3.9 percent since September 1995. IBO estimates that the cumulative value in 2000 of the cuts enacted since 1995 is $350 million. These reductions account for the precipitous fall in CRT revenues (excluding audits) from $629 million in 1994 to $340 million in 2000; without the cuts, CRT revenue would be $690 million this year.

These enacted changes have greatly reduced the number of CRT taxpayers while increasing the share of large firms among those still paying the tax. Nevertheless, tenants with relatively modest rents still account for the majority of remaining taxpayers. Based on rent distributions supplied by the Department of Finance, IBO estimates that 72 percent of the remaining taxpayers have annual rents of $400,000 or less. The average rent for this group of taxpayers is nearly $180,000.

The Mayor’s proposal. The preliminary budget calls for reducing the effective tax rate from 3.9 percent to 1.3 percent for 2001 through 2003. The lower effective rate would be achieved by discounting the amount of base rent subject to tax. Beginning in 2004, the tax would be entirely eliminated. (The CRT liability year runs from June 1 to May 31, so the rate changes would actually take effect on June 1, 2000 and June 1, 2003.) IBO estimates that the cost to the city of the preliminary budget proposal, including foregone audit revenue, would be $237 million in 2001, growing to $277 million in 2003 and $411 million in 2004. IBO’s estimates of the costs are slightly lower than the preliminary budget’s due to different assumptions about the course of baseline tax liability.

The CRT owed by a firm paying $180,000 a year in rent would fall from $7,020 in 2000 to $2,340 in 2001 and then to zero in 2004. Although reducing the effective rate benefits all taxpayers, the dollar value is concentrated at the higher end, with over 60 percent of the benefit flowing to taxpayers with annual rents of $1 million or more.

Evaluation. New York’s tax on commercial occupancies is subject to a number of criticisms. Simply because it is unique, the CRT stands out when tenants, and potential tenants, evaluate how the city’s tax structure affects them. The existence of such a unique tax sends a negative signal about the city’s tax policy environment. The additional burden of the CRT is also assumed to undermine economic development by reducing the city’s competitiveness.

Perhaps the greatest defect of the CRT is that it pyramids one tax upon another. Commercial rents, which are the basis of the tax, already include a portion of the owner’s property tax. Indeed, commercial leases in the city usually include a tax escalation clause passing all property tax increases directly on to tenants. Thus, a portion of a tenant’s CRT burden is a tax on the landlord’s property tax.

While the arguments against the CRT have become well known, some of the criticisms are overstated. Moreover, there has been little discussion of the positive role played by the CRT in the city’s tax structure.
The economic development argument against the CRT focuses on the additional burden placed upon businesses in Manhattan that they would not face in competing localities. This would be true if the ultimate bearer of the CRT is always the tenant. However, it is unlikely that this is the case.

In a soft market, when the supply of space exceeds demand, the landlord’s need to secure tenants results in the shift of much, if not all, of the true cost of the CRT to the landlord who must sacrifice some potential rent to attract and keep tenants. Although this shifting is a constraint on earnings in the real property sector of the city’s economy, the tax itself presumably has little effect on the city’s ability to attract and hold businesses that need to rent space in Manhattan when the market has sufficient space available.

When market conditions favor landlords and tenants are competing for a limited supply of commercial space, as is presently the case in Manhattan, tenants bear more of the burden of the CRT and little is shifted to landlords. However, such market conditions occur precisely when the city is succeeding in retaining and attracting businesses, making an economic development rationale for eliminating the tax less persuasive.

The CRT is appropriately viewed as a companion to the city’s real property tax. Indeed, it was created in 1963 when the city was approaching a constitutional limit on the size of the property tax levy. Prohibited from raising the necessary revenue through the property tax, the city turned to a tax that allowed it to capture the growth in the value of commercial properties by taxing the rents that underlie the buildings’ market values.

Although the constitutional operating limit is no longer a significant factor in the city’s overall tax structure, the CRT continues to function as a compliment to the property tax. Assessment increases for commercial buildings, excluding increases attributable to physical improvements and new construction, are phased in over five years. Thus, the city does not immediately receive the revenue benefits of improving market values. Given that most assessment increases subject to the phase-in requirement are attributable to improving rental incomes, the CRT allows the city to capture these increases earlier in the business cycle.

Coop/Condo Tax Abatement

- Extending the abatement—which is scheduled to expire after 2001—for a second time would cost the city $195 million in 2002 and $224 million by 2004.
- The abatement, which was originally intended as a stopgap measure pending more comprehensive reform, does a poor job of targeting benefits to apartment owners with greatest need.

The preliminary budget tax program calls for extending the existing coop/condo property tax abatement, which expires at end of the next fiscal year, for three more years. Designed to reduce the disparity in tax burdens between owners of cooperative and condominium apartments and owners of one-, two-, and three-family homes, the abatement will cost the city $171 million in 2000 and $182 million in 2001. IBO estimates that if the abatement were extended at the 2001 level, the cost would grow to $195 million in 2002 and $224 million by 2004. These estimates, which are somewhat higher than those given in the preliminary budget, take into account IBO’s forecast of assessment growth for these properties and a gradual increase in the number of qualifying properties. The cost in 2004 would equal 2.4 percent of what property tax revenues would be that year, but for the abatement.

Background. The city’s property tax system has four tax classes, with assessment procedures and tax rates differing for each class. Most coop and condo apartment buildings in the city are assigned to class 2 for property tax purposes, while one-, two-, and three-family homes are designated as class 1. The city’s average effective tax rate (property tax as a percentage of market value) for class 1 houses is...
0.74 percent. In contrast, average effective tax rates for most coops and condos are 1.18 percent and 1.44 percent, respectively, both significantly higher than the class 1 rate.\textsuperscript{17}

Advocates for coop and condo owners have long contended that the city should treat all homeowners equally, regardless of whether they live in apartment buildings or houses. In 1996, legislation was enacted to create a temporary three-year abatement to narrow the gap in effective rates. Last year the program was extended for two more years, through 2001. The abatement reduces taxes on qualifying apartments by 17.5 percent.\textsuperscript{18}

The abatement was instituted as a stopgap measure to provide some relief while the city developed a long-term solution to eliminate the difference in tax burdens faced by apartment owners and class 1 homeowners. The original abatement legislation included a requirement that the city deliver recommendations for resolving the problem to the State Legislature. Two legislated deadlines for delivering such a plan have since been missed, but in testimony before the City Council, the Commissioner of Finance has recently indicated that a study is almost complete and will be released this spring. Although the report is intended to serve as the basis for developing a long-term solution, with cost and distributional impacts that are likely to be different from those under the current abatement, the preliminary budget proposes to simply extend the abatement at the current level for three more years.

Abatement shortcomings. Because the current abatement suffers from a number of shortcomings, extending it in its current form may be undesirable from the perspective of sound tax policy. First, the abatement does a poor job of targeting benefits to the buildings with the greatest need. Effective tax rates on coops and condos—and hence the gap between class 1 tax burdens and the burdens on apartment owners—vary greatly across the city. These differences stem from distortions in the assessment process that cannot be equalized by an abatement that reduces tax bills by the same percentage for all owners. The areas of the city receiving the largest reductions in the class 1 gap (the difference between the effective rate for coops and condos and the city’s target class 1 effective rate) are those with the smallest gaps to begin with, and the least need for relief.\textsuperscript{19} The smallest class 1 gaps are found in the neighborhoods flanking Central Park.

Second, the current abatement is inefficient. IBO found that in 1999, $29 million (19 percent) of the benefits were going to apartment owners who either already had tax burdens below the class 1 level \textit{before} the abatement, or who needed only a portion of their abatement to reach the class 1 level. This inefficiency could be mitigated by reducing or eliminating the abatement for some apartments based on such criteria as value or location. However, the preliminary budget tax program does not propose any changes to address this inefficiency.

Finally, extending the abatement for three more years postpones the promised reform that would give all apartment owners the full benefits of class 1 treatment. The Department of Finance’s forthcoming report is expected to contain one or more options for achieving this goal. IBO’s earlier report analyzed one comprehensive solution—albeit one with major implementation issues to be resolved—that would have coops and condos assessed and taxed using sales-based market values subject to the same protections enjoyed by class 1 property owners. Such a reform would eliminate the differences in effective rates among apartment owners, and all coops and condos with tax burdens above the class 1 level would have their taxes brought down to that level.\textsuperscript{20} The largest reduction in tax burdens in percentage terms would be concentrated in the areas of the city—largely outside Manhattan—which now have the largest class 1 gaps.

The cost of a long-term solution using sales-based values to tax coops and condos has declined over the past few years. In IBO’s December 1998 study, we estimated that it would cost $270 million (based on 1999 market values) to completely eliminate the
class 1 gap. Since then, the appreciation in coop and condo apartments, which results in lower effective tax rates, has narrowed the gap. Thus, the cost of a comprehensive solution is likely to be smaller today than it was two years ago.

**Mortgage Recording Tax**

- Eliminating the mortgage recording tax for first-time homebuyers would reduce city revenues by $19 million in 2001.

- IBO projects that about 8,000 first-time homebuyers would be able to take advantage of the tax benefit each year.

The preliminary budget contains a proposal to eliminate or reduce the mortgage recording tax (MRT) for most first-time homebuyers, including buyers of condo apartments. The MRT is levied on mortgages used either to purchase or to refinance real estate. The MRT burden is composed of two separate taxes, one levied by the state and the other by the city. Currently, the state charges 1.0 percent of the mortgage amount; it devotes half of the levy to the Metropolitan Transportation Authority (MTA) and the State of New York Mortgage Agency (SONYMA) and the rest to the city’s general fund. A local law under state authority establishes the city’s direct MRT rates at 1.0 percent for all mortgages under $500,000, 1.125 percent for larger residential mortgages, and 1.75 percent for larger commercial mortgages. As a result, the city’s general fund accrues three-quarters of every dollar of the MRT on mortgages smaller than $500,000.

The proposal calls for the complete elimination of both the city’s and the state’s MRT for first-time homebuyers with mortgages under $200,000. Although the plan also proposes a partial cut for first-time homebuyers with mortgages up to $300,000, the size of this reduction is still unspecified. While the city can alter its portion of state action, reducing the state portion of the tax as well would require legislation by the state.

**Fiscal impact.** Using data from the U.S. Census Bureau’s Housing and Vacancy Survey, IBO estimates that about 8,000 first-time homebuyers in the city finance their purchase with mortgages of less than $300,000 each year. In contrast, the financial plan assumes that approximately 18,000 homebuyers would qualify for the tax benefit annually.

IBO estimates that the tax reductions would lower the city’s MRT revenues by $19 million in 2001 if the tax cut is in effect for the full fiscal year, and $20 million in the out-years. (With no information available on how the partial reduction in the MRT for mortgages between $200,000 and $300,000, our analysis assumed a 50 percent cut in the rates for all mortgages within that range.) For those qualifying, the total tax savings would average $3,150, of which $2,360 would be a direct cost to the city. The financial plan’s estimated cost is higher at $48 million, with the difference largely due to the higher estimate of the number of purchasers qualifying for the benefit.

Neither of these cost estimates includes the state portion of the MRT dedicated to the MTA and SONYMA. If the city were compelled to compensate the state for the dedicated revenues forgone due to the tax cut, the cost of eliminating the MRT for first-time homebuyers would be one-third higher.

Like reductions in other taxes, the MRT cut would have secondary impacts that would tend to boost other tax revenues over time, thereby reducing the overall cost of the tax program. For example, if more people buy homes in response to the decline in the MRT, the city would collect additional revenue from the real property transfer tax. In addition, this tax cut would also have the intangible benefit of increasing the homeownership rate, giving more residents more stake in the city’s welfare.
Business Tax Reductions

- The preliminary budget proposes a 10 percent reduction in the city’s business income tax rates. The cost of the reductions is expected to reach $285 million by 2004.

- New York City imposes a high tax burden on businesses, and cuts might make the city a more competitive business location. If the tax cuts lead to service reductions, however, some of the benefit could be undermined.

- Business income taxes are one way the city can tax non-residents who use city services.

The preliminary budget proposes a 10 percent reduction in the city’s business income tax rates, to be phased in over three years. The total cost of these cuts is expected to grow to $285 million by 2004, with $154 million of the reduction coming from the general corporation tax (GCT), $83 million from the unincorporated business tax (UBT), and $49 million from the banking corporation tax (BCT).

The tax cuts proposed in the preliminary budget were not presented in great detail, and these figures should be taken as rough approximations. IBO assumes that the tax reductions would be phased in gradually, with rates declining in three equal steps. Under this assumption, more than half of the tax payments made in fiscal year 2001 would still be based on current tax rates. As a result, we project that the cost of the three tax cuts would total $27 million in 2001, but would rise sharply in 2002 and beyond.

General and banking corporation taxes.
Recent business tax reductions by New York State have spurred interest in reducing these taxes at the city level. Through changes enacted in the 1999 and 2000 budgets, the state corporate income tax rate along with the insurance and bank tax rates are being reduced in three half percentage point steps from 9.0 percent to 7.5 percent. These tax cuts will set the state rates well below the city’s current corporation income tax rate of 8.85 percent and bank tax rate of 9.0 percent, both of which are imposed in addition to the state taxes. The proposed 10 percent cut would bring the city’s corporation rate down to 7.97 percent and the banking corporation rate down to 8.1 percent by 2004, both roughly within a half percentage point of the state’s eventual rate.

The state’s tax reductions benefit the city economically, improving the bottom line for city businesses. Lower state taxes make the city more attractive relative to locations in other states, while not altering the relative merits of city and non-city locations within New York State. Economic research on state and local taxes suggests that tax reductions do yield economic growth, but that the growth is likely not to be sufficient to prevent a net decrease in tax revenues. The decrease in state rates, however, would provide the city with a rare combination: city economic growth resulting from a lighter tax load at no fiscal cost to the city itself.

Unlike the state’s cut, a reduction in city business income tax rates would reduce city revenues. Adverse fiscal consequences, however, should not necessarily rule out reductions in the city’s business taxes. Most states, including New Jersey and Connecticut as well as New York, tax corporations doing business within their borders. Corporations in New York City bear the very unusual burden of paying a corporate income tax to local government as well. The city’s economic success of the last several years shows that in spite of the costs, many businesses are thriving here. Looking to the future, however, weaker economic growth and the maturation of new industries will cause firms to look for ways to operate at lower cost. While the quality of services in the city may be as important a factor in the city’s attractiveness to business, an effort should be made to keep the tax rates on business as low as possible.

Unincorporated business tax. The unincorporated business tax (UBT) is unique to New York City and Washington, DC, two cities with no alternative way of taxing the business income of their numerous high-income commuters. While the federal
government or a state can tax earnings from unincorporated businesses through a personal income tax on its residents, cities with commuters from other jurisdictions often rely on a small tax on the city-based earnings of their non-resident workers to help cover the cost of providing city services. The fact that residents are permitted to apply a portion of UBT payments as credits against their city personal income tax liability reinforces the UBT’s role as a tax on non-resident earnings. In reducing the business tax rates—particularly the UBT rate of 4.0 percent, considerably lower than the rate on corporations and banking corporations—the city should consider whether services to non-residents would be given away too cheaply.

Utility Tax Restructuring

- Following the state, the city plans to move from a gross receipts to net income basis of taxing utilities.
- This reform would also directly impact the city’s sales tax revenues and utility costs.
- Substantial secondary revenue impacts can be expected from utility tax reduction.

The city proposes to eliminate its existing utility gross receipts tax (ULT) while extending net income taxation to utilities. While few details for this proposal are available, it is generally intended to conform to the state’s utility tax reform proposal and is, like the latter, a response to utility deregulation and a means of lowering utility bills. Unlike the state proposal, however, the city’s restructuring would cover telecommunications as well as energy companies. The financial plan’s projected costs for the city utility tax restructuring—rising from $81 million in 2001 to $148 million in 2004—include anticipated increases in net income tax revenues.

In addition to the impacts on utility gross receipts and net income tax revenues, this proposal would also involve some losses in sales tax revenues and some savings in the city’s own utility costs. The city sales tax revenue loss—about $7 million per year when UXT elimination is fully phased in—would result from the fact that the utility gross receipts tax is itself part of the base for the sales taxes levied on most utility sales. The offsetting annual saving in city government utility costs—around $11 million—would follow from the fact that utility gross receipts taxes are part of the transmission or “wheeling” costs the city incurs on its own energy purchases.

Replacing the city UXT would also have significant secondary revenue impacts resulting from the effects of lower utility bills on economic growth. IBO has previously estimated that increases in other city taxes would eventually offset about 30 percent of the cost of eliminating the city UXT. The secondary revenue offset to the cost of shifting to income-based utility taxation would likely be of a similar order of magnitude. The city would additionally see substantial secondary revenue gains from the state’s utility tax restructuring and reduction.

Hotel Occupancy Tax Cut

- Eliminating the flat, $2 per day portion of the city’s hotel occupancy tax would have the direct effect of reducing revenues by up to $39 million a year during the financial plan period.
- Because of factors specific to tourism and to the structure of city taxes on hotel occupancy, a significant share of the direct loss of tax receipts would be offset by positive secondary revenue impacts.
- Because the hotel occupancy tax is generally borne by non-residents, it does not add to the tax burden facing city residents and businesses.

The proposal and its direct cost. The tax reduction package includes a proposal to cut the city’s hotel room occupancy tax by eliminating one of its two components. The tax on hotel room rentals, which is levied in addition to the city and state general sales taxes, currently equals...
5.0 percent of the room rent plus a flat fee of $2.00 per day for rooms renting for $40 or more per day (or smaller amounts for rooms renting for less than $40).

Prior to 1986, the tax did not include a variable component—only the flat per day tax. The current city rates have been in effect since 1986, with the exception of September 1990 through the end of November 1994, when the tax’s variable component was increased by one percentage point to 6.0 percent. Also, from June 1990 through August 1994, New York State levied its own hotel occupancy tax, equal to 5.0 percent of room charges and levied only on hotel rooms renting for $100 or more. By the end of 1994, the burden of hotel taxes had been greatly eased in the city, first by the September repeal of the state tax and then, in December, by the return of the city’s tax rate to 5.0 percent.

The current proposal is to eliminate the flat per day component of the tax starting December 1, 2000. With the average hotel room rate now exceeding $200 a day, this part of the tax is equivalent to a tax rate of less than 1 percent on hotel room charges, far less than the five percent rate that constitutes the variable component of the tax.21 Because virtually all hotel rooms rent for at least $40 a day, revenue from the flat component of the tax basically equals $2 multiplied by the number of hotel room rentals (that is, the number of rooms rented times the number of days).

IBO estimates that eliminating the $2 per room flat fee this December would reduce hotel occupancy tax revenues by $19 million in 2001, when revenue would be lost for only half of the fiscal year, and roughly $39 million annually thereafter (a projected 19.5 million room rentals times $2 per room).22 These estimates differ from those of the Administration by no more than $1.0 million a year.

Secondary impacts and other considerations. To the extent that a cut in the hotel occupancy tax increases the number of overnight visitors to New York, the direct loss of tax revenue would be offset in part by a boost in tax revenue resulting from increased visitor spending in the city.23

In a 1997 fiscal brief, IBO examined the impact on revenues of the near concurrent 1994 state and city hotel tax cuts using an econometric model of hotel occupancy and room rates.24 We found that the number of hotel stays increased in response to the tax cuts, above and beyond the very significant influences of other factors such as domestic and foreign economic growth and the city’s crime rate. When updated with data from the past few years, the model yields similar results. Calculating the increase in hotel occupancy that would be induced by the proposed hotel tax cut and adding together all possible secondary impacts indicates that up to half of the proposal’s cost could be offset by additional tax revenue resulting from increased visitor spending.

Several factors specific to hotel occupancy and visitor spending combine to boost the secondary impacts of a reduction in the hotel occupancy tax. Because hotel stays are subject to both the city’s general sales and hotel occupancy taxes, increased hotel occupancy and higher room rates that result from a tax cut generates revenue from both taxes, not just the hotel occupancy tax. Moreover, increases in hotel occupancy are accompanied by more spending on meals, retail goods, entertainment, transportation, and in other areas of the local economy that generate additional city tax revenue. Finally, tourism is an export industry, so more visitor spending brings new dollars into the city economy, as opposed to stimulating spending in one area of the city economy at the expense of spending in another.

Because these factors are specific to tourism and the structure of the city’s taxes on hotel occupancy, the extent to which reducing the city’s hotel occupancy tax may generate positive secondary effects cannot be generalized to cuts in other city taxes. It is misleading to presume that all tax cuts would be as effective in stimulating economic activity and revenue growth to offset as much of their direct revenue costs as would the proposed hotel tax cut.
There is a major argument against cutting the hotel occupancy tax, however. Almost all of the tax is exported—that is, the tax is directly borne by individuals who reside outside New York or by businesses located elsewhere. With the increase in tourism in recent years, the tax has been a growing source of revenue without contributing to the tax burden facing city residents and businesses.

**Other Revenues**

IBO forecasts that revenue from sources other than taxes will total $4.2 billion in 2001, $410 million lower than projected in the preliminary budget. The same pattern holds for the out-years of the plan, with IBO’s forecast of other revenues $200 million below the Administration’s in 2002, $170 million below in 2003, and $100 million below in 2004.

Other revenues include funds from unrestricted intergovernmental aid, private grants, inter-fund capital transfers, state and federal revenue sharing, and miscellaneous revenues from recurring and non-recurring sources. Based on our review of all other revenues, the following items should be noted:

**Airport rent.** IBO estimates that airport rental income will be $15 million in 2001 and each year thereafter. Our estimates diverge from those contained in the budget beginning in 2001, and are lower by $350 million in that year, $170 million in 2002, $140 million in 2003, and $70 million in 2004. Airport rent consists of two factors: prior-year rental income and anticipated current-year rent receipts. The collection of airport back rent has been under arbitration for some time and there is little evidence to suggest that this issue will be resolved in the city’s favor. Accordingly, IBO’s revenue forecast entirely excludes contested rental income from past years.

**Tobacco settlement payments.** The city’s Tobacco Settlement Asset Securitization Corporation (TSASC) receives payments from the nation’s tobacco companies. These payments result from a national legal settlement to reimburse state and local governments for past health care expenditures due to tobacco-related illnesses. TSASC uses these payments to service tobacco bond debt, and then transfers any remaining funds to the city’s operating budget. In 2001, TSASC expects to receive payments from the tobacco companies totaling $220 million and to spend $81 million on debt service. The remaining $139 million will flow to the city as miscellaneous revenue. As TSASC debt service increases each year during the financial plan period, the residual revenue flowing to the city will decline. The residual will equal $135 million in 2002, $101 million in 2003, and $56 million in 2004.

**State revenue sharing.** The preliminary budget proposes an incremental increase in state revenue sharing of $30 million in 2001 and each year thereafter. The initiative would require state legislation, but it is not currently under consideration and unlikely to be enacted. As a result, IBO projects that no additional revenue sharing funds will be received from the state government.

**Non-recurring revenues.** The preliminary budget includes $375 million in non-recurring revenue for 2001. IBO accepts the city’s projected revenue from the sale of the New York Coliseum, $345 million. In contrast, IBO projects that the $30 million of revenue to be realized from the sale of city assets in 2001 will not take place as planned. Similarly, uncertainty surrounding the sale of $50 million in assets before the end of the current fiscal year has led IBO to exclude these revenues from our forecast. Asset sales specific to 2000 and 2001 include mortgages held by Housing Preservation and Development and the Department of Citywide Administrative Services, along with the sale of real property, which includes various development sites under the jurisdiction of the Economic Development Corporation.
Categorical Grants

Categorical grants received from the state or federal government to fund specific expenditures account for approximately 30 percent of all general funds spent by the city each year. IBO projects that state and federal categorical grants will total $7.4 billion and $4.4 billion, respectively, in 2001. For some types of categorical aid, such as education and welfare, IBO has developed forecasts based on programmatic changes and caseload projections that affect the level of aid received from the state and federal governments. IBO’s forecast of categorical aid in other parts of the budget is based on a methodology that takes the grant level in the current year, adjusts for historical trends, and applies growth factors on an agency-by-agency basis.

IBO’s forecast of state categorical grants is $89 million higher than the estimate contained in the preliminary budget for 2001, and continues to exceed the Administration’s projections by $236 million in 2002 growing to $583 million in 2004. The major reason for the difference is IBO’s significantly higher forecast of state aid for education, offset in part by IBO’s decision to exclude $170 million annually in state aid anticipated by the administration.

IBO’s forecast of federal categorical grants is $479 million higher than the estimate contained in the preliminary budget for 2001, and remains higher through 2004. Our estimates of education, health, childcare, and housing aid—which together account for over 60 percent of all federal grants—are significantly greater than the preliminary budget’s. This, however, is offset in part by IBO’s lower estimate of social services federal grant levels attributable to lower family assistance caseload projections starting in 2002 when the five-year limit on federal assistance will begin to take effect. Our forecast also excludes $75 million in anticipated federal aid that we believe is unlikely to occur.

Notes

1 In order to present a clearer picture of revenue growth, references to tax revenues in the text of this chapter will include the portion of personal income tax (PIT) revenues dedicated to the Transitional Finance Authority. In the tables, however, TFA-dedicated revenues are reported on a separate line, below the sum of tax revenues, in order to present figures that are comparable to those of the preliminary budget. See IBO’s May 1998 report, Analysis of the Mayor’s Executive Budget for 1999, for a critical discussion of the Administration’s decision to remove TFA-dedicated revenues and TFA debt service payments from the city budget.

2 While the legal status of the non-resident PIT on commuters will not be certain until several lawsuits—including some from out-of-state commuters—are decided in court, most observers believe the tax will be abolished for all commuters. Therefore, IBO’s forecast, as does OMB’s, assumes the complete elimination of the commuter tax.

3 Under STaR, New York State reimburses the city for revenue lost from the program’s personal income and real property tax cuts, so on balance the program does not affect the city’s budget.

4 Since tax year 2000 is the first year in which no commuters will incur PIT liability, the full fiscal impact of the complete demise of the commuter tax will be first be felt in fiscal year 2001. The fiscal impact in 2001 may be even stronger because it is likely that during that year the city will have to refund the taxes that are still being withheld from out-of-state commuters while the city appeals a lower-court ruling. IBO’s forecasts do not reflect this additional impact on 2001 revenues, however, because we follow OMB’s assumption that there will be an accounting mechanism to accrue refunds made to commuters in 2001 to prior fiscal years.

5 In contrast to OMB’s expectation that securities industry profits will average $5 billion annually, IBO projects profits averaging $9 billion a year over the next five years—a significant decline from the $16 billion in 1999 profits and the nearly $11 billion annual average for the three preceding years.


7 These offsets do not include the additional impacts of state sale, utility, and hotel tax cuts on New York City economic growth and tax collections. See Would Clothing Tax Cuts Pay for Themselves? (IBO, June 1997), Reductions in the City’s Hotel Occupancy Tax Rate (IBO, July 1997), and Eliminating the City Utility Tax: Economic and Fiscal Impacts (IBO, May 1999).
In a forthcoming fiscal brief, IBO will present details on the extent to which the inequality of income distribution in New York City has increased in recent years, and the changing share of income tax receipts attributable to the city’s highest income filers.

The over-$125,000 returns account for 17.8 percent of people—adults and children—covered by all tax returns filed. This percent is somewhat greater than the percent share of this group’s number of returns (13.1 percent) because the higher the income, the more likely a tax return is a return for a married couple filing jointly, and the less likely it is for a single filer.

Unlike the 14 percent surcharge, the 12.5 surcharge was not strictly proportional to base liability; this surcharge was determined by a schedule of different marginal rates for different income brackets.

Evidence from tax year 1997—the first year of the credit and so far the only year for which detailed data is available—suggests that many taxpayers who were eligible for the credit did not take it. About 13,300 New Yorkers claimed a total of $25.2 million in UBT credits against their PIT liability, a little more than half the amount of total credits initially projected by the Department of Finance.

Evidence suggests that among unincorporated business partners and proprietors working in NYC, commuters are likely to have higher incomes.

The federal treatment of S corps is thus similar to the treatment of partnerships. Earnings are exempt from tax for the business as a whole, yet the income is taxed only after it has been distributed to either the partners or shareholders. While receiving similar tax benefits, partnerships and S corps differ significantly in terms of structure and liability.

In order to be consistent with the preliminary budget’s presentation of CRT elimination, these estimated costs include reductions in audit revenues attributable to the proposal. Note that all other tax program costs are estimated without accounting for their impact on audit revenues.

The New York State Constitution limits the amount of the city’s operating budget funded from the property tax to 2.5 percent of the full value of the property tax base. In 1963, the property tax accounted for a much greater share of tax revenues than in more recent years. At that time the city did not have a personal income tax, and the gross receipts tax accounted for a smaller share of revenue than do the business income taxes that have replaced it.

The market value of commercial properties reflects the discounted value of current and future rents earned from the property.

This 1998 measure of the effective tax rates for coops and condos is based on true market value rather than the official city market value, which is artificially lowered under section 581 of the real property tax law. See IBO, The Coop/Condo Abatement and Residential Property Tax Reform in New York City, December 1998. With the appreciation in coop and condo units since 1998, effective rates based on true market value would be lower if measured today.

For apartments in buildings with average assessed values of $15,000 or less per apartment, the percentage is 25 percent. Apartments that have not been sold by the sponsor or developer are excluded, as are those in buildings enjoying J-51 or 421-a benefits.

The target class 1 effective tax rate uses the city’s guideline of an 8 percent assessment level multiplied by the class 1 tax rate.

Those with burdens already below the class 1 level would likely be held harmless from the reform.

NYC hotel room rates averaged $218 a day for the first 11 months of 1999 (PKF Consulting, Trends in the Hotel Industry, November 1999).

The number of NYC hotel room rentals was 18.5 million in calendar year 1998 and preliminary estimates suggest that room rentals rose slightly in 1999.

IBO’s and OMB’s estimates of the cost of reducing the hotel occupancy tax do not include these potential secondary impacts.

See Reductions in the City’s Hotel Occupancy Tax Rate: The Impact on Revenues (IBO, July 1997).

A portion of this aid is related to proposed changes in Medicaid expenditure policy, which are discussed in Chapter 3.
Overview

- IBO estimates that the policies contained in the Mayor’s budget would result in significantly more spending than estimated by the Administration.

- IBO estimates that the preliminary budget would increase total spending 4.3 percent between 2000 and 2001 and at a 3.2 percent average annual rate from 2000 through 2004, after adjusting for inter-year prepayments.

- Total spending in 2004 would be $5.2 billion, or 13.6 percent, higher than in 2000. Over half of this increase is attributable to the Board of Education ($1.8 billion) and to debt service ($1.1 billion, adjusted for prepayments).

- City-funded spending would increase 6.4 percent between 2000 and 2001, and 4.2 percent annually on average between 2000 and 2004, after adjusting for inter-year prepayments.

IBO estimates that under the policies proposed in the preliminary budget, total expenditures would decline from $38.1 billion in 2000 to $37.7 billion in 2001, and then increase to $43.2 billion in 2004. These figures are distorted, however, by the prepayments that are used to transfer surpluses from one year to the next. Adjusted for those prepayments, spending would grow 4.3 percent between 2000 and 2001 and at a 3.2 percent average annual rate from 2000 through 2004.

Spending growth is not distributed evenly across functions. Figure 3-1 shows IBO’s projections of spending by major area from 2000 through 2004. Spending for some functions is projected to increase significantly between 2000 and 2004, including (on an average annual basis) debt service (7.0 percent, adjusted for prepayments), Sanitation (4.7 percent), and the Board of Education (4.1 percent). Other areas’ expenditures are projected to grow more slowly, including the Administration for Children’s Services (0.6 percent) and the Department of Homeless Services (0.8 percent).

It is important to note that these agency expenditures include IBO’s estimates of additional intergovernmental aid and anticipated collectively-bargained salary increases. The salary increases include the two years of merit pay that the financial plan locates centrally, and which we allocate to each agency, as well as additional expected increases in labor costs. These issues are discussed in more detail later in this chapter.

Most of the spending contained in the budget is funded with revenues generated from the collection of city taxes and other city sources such as licenses and fees. Adjusted for prepayments, this city-funded spending would rise from $26.1 billion in 2000 to $30.7 billion in 2004, an average annual rate of 4.2 percent.
IBO estimates that the policies contained in the Mayor’s budget would result in significantly more spending than estimated by the Administration. As shown in Figure 3-2, IBO’s spending forecast exceeds the estimates contained in the Mayor’s budget for almost every year of the financial plan. In this chapter, we explain the reasons for differences in our spending estimates. Generally, these differences occur due to varying economic, technical, and legislative assumptions. For instance, we have assumed higher overtime costs for city employees (a technical reestimate) and have assumed that certain state and federal actions would not occur over the next year (a legislative reestimate).

Part of this difference is attributable to the city’s practice of recognizing some intergovernmental aid only when it is received. Although the financial plan does not include this aid, IBO estimates and includes it to provide a more accurate picture of spending. It should be noted, however, that because these funds are presumed to be received and spent in equal amounts, they have no effect on the city’s budget gap. IBO also includes both the debt service and

<table>
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<th>Figure 3-1. IBO Expenditure Estimates Under the Mayor’s Proposals</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
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<td>457</td>
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<td>Board of Education</td>
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<td><strong>All Other</strong></td>
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<td>$40,376</td>
<td>$42,084</td>
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SOURCE: IBO.

NOTE: Excludes intra-city expenditures.
associated revenues of the Transitional Finance Authority, which do not affect the budget gap.

In contrast, differences in estimates of city-funded spending affect the city’s bottom line. The greatest difference in future years is our inclusion of four years of collectively-bargained labor increases instead of the two included in the financial plan. We add increases in 2003 and 2004, which cost $327 million and $672 million, respectively, using the assumption that base salaries will increase at the rate of inflation. Since it is impossible to predict the outcome of collective bargaining, it should be noted that if the agreements exceed the rate of inflation by one percentage point each year, city-funded spending—and the budget gap—would be over $500 million higher by 2004. Conversely, if the agreements lag inflation by one percentage point annually, city-funded spending—and the budget gap—would be $500 million lower by 2004.

In addition to presenting IBO’s spending estimates, this chapter discusses the budgetary implications of a number of programmatic initiatives presented in the preliminary budget and is organized around broad spending areas. First, discussions of spending estimates and initiatives in the areas of health/social services, education, and uniformed services are presented. Next is a section on debt service costs, followed by a variety of other broad program areas, such as housing and cultural affairs. The chapter concludes with a presentation of several miscellaneous spending issues, including labor costs and stadium financing.
Health and Social Services

Spending on health and social services accounts for over 27 percent of the city budget in 2001. IBO projects that spending on these programs, including public assistance, health, and children’s services, will increase at an average annual rate of 1.4 percent, from $10.3 billion in 2000 to $10.9 billion in 2004.

This section provides an overview of health and social service programs, primarily focusing on public assistance and Medicaid. In addition to providing information comparing IBO’s forecasts to the Mayor’s, we also provide a more detailed look at the universal work program and federal legislation—namely, the Workforce Investment Act—that will affect employment and training programs. We have also outlined the impact of the Mayor’s preliminary budget on five programs within health and social services—anti-eviction legal services, foster care, youth services, lead poisoning prevention programs, and pest control activities.

Public Assistance

- IBO forecasts total caseloads to continue to decrease. However, beyond 2000, IBO expects this downward trend to moderate, as new welfare reform policies result in a caseload that is smaller but increasingly needy and difficult to place in private employment.

- Due to the expected impact of the five-year limit on eligibility for Family Assistance, recipients will shift from Family Assistance to Safety Net Assistance, resulting in lower overall costs, but higher costs for the city.

Since the overhaul of the welfare system, the number of individuals receiving public assistance has decreased dramatically. This decrease in caseloads, as well as the way in which public assistance is now funded has implications for how much the city will spend on public assistance in upcoming years.

Preliminary budget projections. The preliminary budget projects that the number of persons receiving Family Assistance (FA) will decrease from 562,000 in June 1999 to 527,000 in June 2000, and 505,000 in June 2001, and stay constant during the remaining years of the financial plan. Similarly, the number of Safety Net Assistance (SNA) recipients is projected to decrease from 113,000 in June 1999 to 94,000 in June 2000, and 85,000 in June 2001 and thereafter.

Based on these expected caseload reductions, the Administration projects expenditures for public assistance grants to decrease from $1.5 billion in 2000 to $1.4 billion in 2001 and later years. The budget also projects city expenditures to decrease from $426 million in 2000 to $405 million in 2001 and thereafter.

IBO projections. IBO’s caseload projections for the FA and SNA programs differ from those in the preliminary budget, as can be seen in Figure 3-3 and Figure 3-4.

For FA, IBO projects a faster caseload decline in the near term than the preliminary budget. This rapid decrease will be driven by a growing economy as well as the continued conversion of all income maintenance centers to job centers over the next several months, a process that has been temporarily delayed by litigation. The new job centers are being created to implement the Mayor’s policy of front-end diversion, employing new job search requirements and other mechanisms designed to greatly reduce the number of individuals who end up on the welfare rolls. We expect this emphasis on front-end diversion to contribute to the decline in FA recipients to 500,000 by June 2000. Beyond 2000, IBO expects the downward trend to moderate as the new policies result in a FA caseload that is smaller but increasingly needy and difficult to place in private employment. By June 2001, we expect the FA caseload to reach 473,000, a projection 32,000 lower than the preliminary budget.

IBO’s projections begin to diverge more significantly from the preliminary budget’s in January 2002 because we project that the five-year limit on federal assistance will cause 52,000 individuals to lose eligibility for FA, even if the state exempts the maximum number of households based on hardship.
Over time the cumulative impact of the five-year limit will increase, with 117,000 individuals losing FA eligibility by January 2003 and 195,000 losing eligibility by January 2004. As a result we expect the FA caseload for 2002, 2003 and 2004 to dip well below the Mayor’s projections, which do not account for this provision of federal welfare law.

IBO’s SNA caseload projections follow a similar course through 2001, with the extension of job centers and front-end diversion reducing the number of individuals receiving assistance to 87,000 in June 2000 and 80,000 in June 2001—somewhat lower than the Mayor’s projections. As with FA, our SNA projections begin to diverge widely from the preliminary budget in 2002 due to our incorporation of the impact of the five-year limit on federal assistance, which we expect to shift thousands of individuals from FA to SNA. As a result we expect the SNA caseload to greatly exceed the Mayor’s projections for 2002, 2003 and 2004.

The shift from FA to SNA is likely to have budget implications for New York City, due to the difference in the way that the two programs are funded. For SNA the state and city are responsible for the entire cost of the program, with a city share of 50 percent. For FA the federal government covers half of the costs, with a city share of only 25 percent. For this reason any shift of recipients from FA to SNA will require additional city expenditures.

Although IBO’s forecast of total public assistance spending is lower than the preliminary budget’s, we forecast higher city spending. IBO projects that total expenditures for public assistance grants will decrease from $1.4 billion in 2000 to $1.3 billion in 2001 and later years. We expect city spending to decrease from $414 million in 2000 to $377 million in 2001, and then gradually rise to $470 million in 2004, as the impact of the five-year limit on federal assistance begins to be felt. The movement of recipients from FA to the non-federally funded SNA program will lead to a growth in city expenditures exceeding the Mayor’s projections by $17 million in 2003 and $64 million in 2004.
Welfare Update: Participation in Work Activities

On December 28, 1999 the Mayor announced that the city had achieved “full engagement” in work activities for all able-bodied public assistance recipients—thus accomplishing the previously stated goal of ending welfare dependency by the year 2000 and replacing it with work in exchange for earnings. However, the definition of full engagement is looser than the extremely strict work requirements outlined on July 20, 1998 when the new policy was announced.

The 1998 announcement stated that all family heads and single adults receiving assistance would be required to participate in a full-time 35 hour work week, exempting only the severely disabled and mothers with newborns. Individuals with physical or other limitations not severe enough to qualify for disability payments would be provided with work opportunities in specialized work settings.

In our September 1998 study, Welfare Reform Revisited: Implementation in New York City, IBO estimated that full implementation of such a policy could have resulted in the need to administer work activities for about 219,000 cases or 80 percent of the caseload. This would have been an additional 150,000 adult recipients on top of the 69,000 already participating. Only 20 percent of the cases would have been exempt. We estimated that the additional city costs of implementing such a massive work program could top more than $500 million annually, due mostly to the need to provide subsidized child care for the children of participants.

The available data provide a general breakout of public assistance recipients in December 1999. According to statistics provided by the city’s Human Resources Administration (HRA), there were about 267,000 total cases receiving assistance from either the Family Assistance (FA) or Safety Net Assistance (SNA) programs. Just under half of these cases—132,000—included at least one adult who was engaged in some type of work or training or who was actively being evaluated for placement in such a program. Of the remaining half the cases, about 50,000 were exempt because of age, AIDS, or caring for a newborn; 34,000 were contesting work requirements; 23,000 were being sanctioned for failure to participate; 20,000 were indefinitely disabled; and 8,000 were temporarily disabled.

The 132,000 cases classified as engaged represent modest growth in the number of participants in work activities. According to the Mayor’s Management Report, from June 1998 to October 1999 the number of individuals participating for enough hours of work each week to satisfy federal and state requirements increased by 16,000, from 69,000 to 85,000. Another 30,000 of the 132,000 engaged have been called in for assessment but are not yet working. Except for the additions between October and December the rest of the adults now counted as engaged are working too few hours to satisfy federal and state requirements. Those in the latter group are working fewer than the 35 hours a week specified in 1998 announcement.

Virtually all of the increase in individuals working has occurred among those in private employment whose earnings are low enough to allow them to remain eligible for public assistance. This is consistent with the city’s emphasis on private sector job placements. In contrast, there was little growth in the Work Experience Program (WEP), in which participants work for public or non-profit agencies in return for receiving their monthly public assistance grant.

It is not clear if the city has attained an optimum level of work activity. There may be other public assistance recipients who would benefit from placement into work or training programs appropriate to their needs. Conversely, there may be some individuals in work and training programs that would be better served by other activities. The adoption of a more flexible definition of full engagement, however, has distinct advantages for the city. While easily fulfilling the work requirements contained in federal and state welfare law, a policy of modest growth in work programs avoids the need for a major infusion of city funds. Such a policy also avoids the logistical problems involved in trying to find appropriate work slots for those individuals who are particularly needy and hard to place.
**Medicaid**

- IBO forecasts that the Human Resources Administration’s (HRA) Medicaid expenditures will increase 5.1 percent in 2001 and an average of 6.6 percent annually from 2001 to 2004.

- IBO’s forecast of HRA Medicaid spending exceeds the preliminary budget estimate by $68 million in 2001.

- Enrollment of Medicaid recipients in the mandatory managed care program is growing more slowly than anticipated, delaying expected savings.

- The NYC Medicaid outreach initiative and programs funded in NYS Health Care Reform Act of 2000 (HCRA) will increase Medicaid enrollment, thereby increasing Medicaid expenditures in later years of the plan.

- Proposed changes in federal and state policy that would reduce city Medicaid spending are unlikely to be approved.

**Preliminary budget projections.**
The preliminary budget projects that city Medicaid expenditures by HRA will be $2.5 billion in 2001, a 4.1 percent increase from 2000. The average annual increase from 2001 to 2004 is projected to be 6.1 percent. This growth is driven by several key factors, including the increasing costs of providing services, expansion of Medicaid enrollees, and the impact of managed care. These Medicaid estimates do not reflect savings identified elsewhere in the preliminary budget that would occur if the federal and state governments adopted policy changes advocated by the Administration (see below for a discussion of these initiatives).

A major portion of the spending increase is associated with several services—nursing facilities, inpatient hospitalization, free standing clinics, and pharmaceuticals. As a group, these services account for 60 percent ($1.4 billion) of the total Medicaid budget. These expenditures are projected to rise $79 million between 2000 and 2001, more than 80 percent of the budgeted change.

**IBO’s projections.** Based on an analysis of industry growth rates, managed care trends, and new Medicaid-funded programs, IBO projects that Medicaid expenditures at HRA will exceed the levels forecast in the city budget (see Figure 3-5). Overall, IBO estimates that total Medicaid expenditures at HRA will increase 5.1 percent from $2.4 billion in 2000 to $2.5 billion in 2001. IBO’s projection is $43 million more than budgeted for 2000, and $68 million more than budgeted for 2001. The gap between IBO and the preliminary budget continues to grow in the later years of the plan due to our projections of higher inflation and effects of HCRA. IBO projects that costs will rise around 6.6 percent annually between 2001
and 2004—slightly faster than the 6.1 percent projected in the preliminary budget.

IBO projections exceed those in the Mayor’s budget for two key services: pharmaceuticals and nursing facilities. In 2000, IBO estimates these services will cost $591 million, $35 million higher than the Administration. Furthermore, based on recent history, IBO projects growth rates for these services that are higher than the Administration’s assumptions. IBO projects annual growth rates of 12 percent for pharmaceutical costs (versus 11 percent in the preliminary budget) and 5 percent for nursing facility expenses (versus 3 percent). In 2001, the IBO estimate is $53 million higher than budgeted by the Mayor, which accounts for slightly more than 75 percent of the difference between the preliminary budget and IBO’s estimate.

Medicaid managed care. The number of the city’s non-elderly Medicaid recipients enrolled in managed care is a very important factor in the development of the city’s Medicaid budget. In the past, the Administration has estimated that a shift into managed care will yield savings of 10 percent, because managed care can provide services more efficiently. Thus, the rate at which the Medicaid population transitions into managed care could have a significant effect on overall Medicaid spending.

The city and state have recently reached an agreement with the federal government that creates a mandatory managed care program for Medicaid recipients. Currently, there are 1.8 million Medicaid recipients in the city. Of those, approximately 300,000—either elderly or otherwise exempt—will remain in the traditional fee for service program. The remaining 1.5 million Medicaid recipients are now required to enroll in a managed care plan. Roughly 25 percent of this population, approximately 400,000, have already enrolled, while the others will be required to join over the next several years.

The preliminary budget assumes savings of $15 million during 2001, which would require managed care enrollment to double by the end of 2001. Under this scenario, net monthly enrollment would have to exceed 30,000. This seems somewhat optimistic since the net increase in managed care enrollment was only 2,000 recipients each month for the first five months of mandatory enrollment. While IBO assumes growth will pick up substantially as problems with the enrollment process are resolved, annual growth is unlikely to exceed 25 percent. At this rate—which means adding 7,500 new enrollees a month—managed care would result in savings of $4 million for 2001.

Medicaid outreach initiative. The Mayor proposes an outreach initiative to expand Medicaid; this drives about 10 percent of the spending growth between 2000 and 2001. IBO has made no adjustments to these projections. The city plans to invest in a new phone system, to develop an advertising campaign at a cost of $1.0 million per year, and to dedicate staff to encourage people to enroll in the Medicaid program. The budget anticipates that this outreach program will add 10,000 additional recipients in 2000, 30,000 in 2001, and 50,000 a year through 2004. This program will attempt to fully reverse the 200,000-person decline in overall Medicaid enrollment that began with the implementation of welfare reform in 1995.

Health Care Reform Act of 2000. The State of New York recently enacted the Health Care Reform Act of 2000 (HCRA), which provides a framework for health care finance in New York State. HCRA establishes funding streams and distribution mechanisms to support a broad range of health care needs throughout the city and the rest of the state. Increases in the state’s cigarette tax, the use of new tobacco settlement monies, and the renewal of hospital and insurance company assessments will provide funds to support the state’s health care system. Most significantly for the city’s Medicaid budget, HCRA expands access to health care through the enactment of Family Health Plus and other programs designed to encourage insurance companies to cover those currently without health insurance.
Family Health Plus and a Home Care Workers’ demonstration program are two HCRA programs that may require local Medicaid spending. Family Health Plus is a health insurance program that will be targeted to the indigent population that is not eligible for Medicaid. Each person who signs up for the program will select a managed care plan, which will provide a full range of medical services. Adults in families with children will be eligible to enroll as long as their total family income is less than 150 percent of the Federal Poverty Level (FPL), $25,000 for a family of four. Single adults without children qualify if their annual income is less than 100 percent of the FPL, approximately $8,300. Family Health Plus will be funded by Medicaid, the costs of which are shared by the city, New York State, and the federal government.2

The state has yet to formally develop these programs, so a number of assumptions are used to forecast their size and expense. Growth will depend on a number of factors, such as the time it will take for managed care organizations to implement the program and the effectiveness of marketing Family Health Plus to the eligible population. The financial plan assumes membership will average 48,000 in fiscal year 2002, 96,000 in 2003, and 144,000 in 2004. IBO anticipates slower growth in the program, with a membership average of 19,500 people in fiscal year 2002, 59,000 in 2003, and 104,000 in 2004.

Costs to the city will also be driven by the premium rates that are approved by the NYS Insurance Department. The financial plan assumes that premiums will be $125 per month, which is low given the demographics of the population that is likely to enroll. IBO estimates a premium of $225 per month, with the city providing 25 percent. The financial plan estimates city expenditures in 2002 of $18 million, while IBO estimates $13 million. In 2003 and 2004, the financial plan includes $90 million, while IBO estimates a total of $110 million. IBO’s significantly higher unit cost estimate is offset by its lower enrollment projections, resulting in a total spending forecast that is close to the financial plan.

HCRA sets aside up to $95 million of state funds to partially fund a demonstration program that will provide continuous health care coverage to home care workers employed in New York City. These workers, who are employed by certified home health and personal care agencies, often have irregular or episodic employment. As a result, they do not receive continuous benefits, including health care coverage, from their employers. The pilot program will permit increased Medicaid payments, partially funded by New York City, to be made to certified home health and personal care agencies. These agencies will use the additional Medicaid revenues to purchase continuous health coverage for their employees, even though the home care workers may not be employed continuously. The preliminary budget does not include this program, which IBO estimates will cost the city approximately $5 million per year starting in 2002.

State and federal policy. The preliminary budget includes a number of proposals for changes in state and federal policy that, if enacted, could reduce the city’s Medicaid expenses. The most significant proposal is for an adjustment to the formula used to determine the federal share of Medicaid costs, currently set at 50 percent. The matching rate for each state is based on per capita income, and does not adjust for other indicators such as the incidence of poverty. The change would reduce city costs by $85 million annually. While the current method of determining the federal share may be unfavorable to New York State, Congress is unlikely to pass legislation that will alter the current formula. As a result, the city is unlikely to achieve these savings in the near term.

The city also has a number of proposals at the state level that would save the city $86 million annually. These actions include fighting pharmaceutical fraud, reducing dispensing fees paid to pharmacies, monitoring transportation expenses, curbing Medicaid utilization for substance abusers, reducing the city share of Medicaid managed care premiums, and shifting the responsibility of providing early intervention services from Medicaid to Child Health Plus, which requires no local contribution. Although
the Mayor proposes working closely with the Governor to pursue these initiatives (many of which were proposed in last year’s preliminary budget) it may be difficult to obtain legislative approval in Albany.

Anti-Eviction Legal Services

- The preliminary budget proposes to eliminate two programs—currently supported by $4.9 million in city funds and $9.5 million in state and federal funds—that provide anti-eviction and other legal services contracted by the Human Resources Administration.

- A similar proposal in last year’s preliminary budget was rejected and funds were restored in the adopted budget.

Mirroring a proposal from last year, the preliminary budget proposes to eliminate a number of Human Resources Administration’s (HRA) legal services contracts for non-profit organizations that provide anti-eviction and other legal services to the poor. This action would result in annual savings of $4.9 million for the city, and would trigger the annual loss of almost $9.5 million in state and federal matching funds.

The cuts would affect two initiatives that provide legal services for more than 10,000 cases annually. One initiative, funded with $2.9 million in city money plus an additional $8.7 million in matching state and federal Emergency Assistance for Families funds, provides anti-eviction legal services for people at risk of losing their homes. A second initiative, funded with $2.0 million in city money plus $750,000 in matching funds, offers legal services for domestic violence victims, senior center clients, and other groups served by HRA. HRA has stated that the contracts for these services are duplicative and can be provided through other legal services contracts that are funded in the budget, a view challenged by many in the advocacy community.

Workforce Investment Act

- The federal Workforce Investment Act (WIA) will alter the way in which employment and training programs are funded and administered.

- WIA focuses on providing services to youth year-round and does not provide funds specifically for a summer youth employment program.

Since 1983, the Job Training and Partnership Act (JTPA) has been providing funds for programs targeting economically disadvantaged adults and youths, dislocated workers and others that face significant employment barriers. Policymakers began trying to reform JTPA in the early 1990s because of poor program outcomes and multiple agencies with overlapping responsibilities. The outcome was the enactment of the Workforce Investment Act (WIA), federal legislation which was signed into law in August 1998 and is set to replace JTPA in July 2000.

The new law is intended to be a workforce preparation and employment system serving the needs of businesses and individuals, including adults and young people, who are either unemployed or underemployed. The focal point of the new system is the one-stop center, providing one location for all employment needs and training information. Unlike JTPA, WIA does not fund training providers directly. Instead, WIA will provide training vouchers, called “individual training accounts,” which will allow adult customers to purchase the training they deem most appropriate from a list of eligible training providers. To increase accountability of these training providers, as well as state and local areas, WIA requires tracking of performance measures for all training participants, as well as measures relating to customer satisfaction of both participants and employers. This information will be provided to new participants in order to help them choose the most appropriate provider for their needs.

Management. WIA mandates the establishment of state and local workforce investment boards. Both types of boards must consist of a majority of business representatives as well as representation from
educational institutions, organized labor, and community-based organizations. The state board’s role will be to assist the Governor in developing a five-year strategic plan describing statewide workforce development activities, explaining how the requirements of the Act will be implemented, and outlining how special populations will be served. The local board’s role will include designating one-stop operators, identifying training providers, and monitoring system performance. At the local level there will also be a youth council, a subgroup of the local board that coordinates youth activities.

As mandated by WIA, New York City submitted a comprehensive five-year local plan along with public comments to the state Department of Labor for approval. According to the New York City plan, the Human Resources Administration (HRA) will be primarily responsible for providing services to adults while the Department of Employment (DOE) will be responsible for providing services to dislocated workers and youth. Using a state Department of Labor Welfare to Work grant, HRA is already operating a prototype one-stop center in Jamaica, Queens.

**Funding.** WIA authorizes three distinct funding streams: adults, dislocated workers, and youth. Eighty-five percent of adult and youth funds will be allocated to local areas; the remainder will be reserved for statewide activities. For dislocated worker programs, 48 percent of funds will be allocated to local areas; the remainder will be reserved for statewide activities and emergency grants. WIA allocations will also include technical assistance, demonstration projects, and federal incentive funds that are tied to whether states meet their expected levels of performance. The Secretary of Labor is required to award an incentive grant to each state that exceeds its expected performance levels for workforce investment, adult education, and vocational education that the state and Secretary of Labor have negotiated.

With regard to youth programs, WIA shifts the emphasis from summer employment (as specifically authorized under JTPA) to serving youth year-round. In addition, 30 percent of the funds must be targeted toward out-of-school youth. Therefore, despite requiring a summer jobs component, WIA will provide less funding specifically for summer employment programs.

**Impact on New York City.** It is difficult to fully determine the new system’s fiscal and programmatic impact on New York City. In fiscal year 1999, the city received $121 million in federal funds under JTPA. In fiscal year 2000, the city is expected to receive about $129 million in JTPA funding. According to the preliminary budget, the city expects to receive $123 million in WIA allocations for fiscal year 2001, which, according to the state Department of Labor, is divided into $43 million for adults, $42 million for youth, and $39 million for dislocated workers. Since this is the first year under the new system, it is uncertain whether New York City will receive additional grants in the course of the year as has typically occurred under JTPA. However, the city is guaranteed additional funding of up to $3 million if it attains its negotiated performance measure goals.

Many in the city are concerned about summer youth employment funding. For fiscal year 1999, the city received $47 million in federal JTPA funds for a summer youth employment program that served over 40,000 low-income youth. With $42 million in total local youth funding for fiscal year 2001, an emphasis on year-round services, and 30 percent of funds set aside for out-of-school youth, there could be significantly fewer jobs available for this upcoming summer. Based on recent testimony, DOE has developed a summer youth employment and year-round program for 15,000 in-school and out-of-school youth using federal JTPA funds provided for transition purposes. The city has also requested additional funding from the state’s WIA set-aside fund. However, city officials are likely to be faced with the choice between a smaller summer jobs program or allocating additional city funds.

**Youth Services**

- IBO estimates that the preliminary budget proposals will reduce funding for the Department of Youth and Community Development by 22.9 percent for 2001. This includes an $11.3 million cut to Council Member initiatives.
A similar proposal in last year’s preliminary budget was rejected and funds were restored in the adopted budget.

IBO estimates that spending for the Department of Youth and Community Development (DYCD) will decline by 22.9 percent, or $32.4 million, from $141.4 million in 2000 to $109.0 million in 2001. This includes $14.2 million in newly proposed reductions, $10.1 million of previously included reductions, and a cut in federal aid. Beyond 2001, spending is projected to be flat.

Council Member initiatives account for $11.3 million of the $14.2 million in newly proposed reductions. These include the elimination of grants to the After School Corporation ($7.5 million) which provides care for children between 3 p.m. and 6 p.m. The program is funded through public and private sources. Currently, the private funding requires a match by the city. It is unclear what will happen to the program if city funding is withdrawn. At a minimum, 7,500 children would lose these services without the city funds. If the matching funds are also withdrawn, roughly 20,000 children could be affected.

Other cuts in Council Member initiatives include discretionary funding for youth services ($2.7 million), community development and youth services contracts that provide housing, transportation and other assistance ($650,000), two tennis league contracts ($286,000), and a Pratt community development contract to provide technical assistance to community-based organizations ($200,000). Additionally, $2.6 million is cut from Borough Presidents’ discretionary funds for community-based programs.

Last year, the Mayor proposed similar cuts to the DYCD, which totaled $19.7 million or 17 percent of the agency’s total budget. The proposed cuts included the Youth Development and Delinquency Program ($8.5 million), the After School Corporation ($5.0 million), and Council Member and Borough President discretionary funds ($5.6 million). All of the funds were restored in the adopted budget.

In addition to the proposed cuts this year, the financial plan includes a $10.0 million reduction in funding for some on-going programs. Among these is Citizenship NYC, which is funded at $1.0 million in 2001, compared with $4.0 million in the current year. This program assists immigrants in becoming eligible for citizenship. Finally, the preliminary budget does not include $7.0 million in local initiatives. Historically, additional funding for these initiatives has been added during the adoption process; however, they are funded for one year at a time and are not included in the baseline.

**Foster Care**

Since caseloads have declined, the preliminary budget reduces foster care spending by $25.3 million in the current year and by $39.7 million in each of the out-years.

Based on caseload declines, the financial plan reduces spending for foster care in 2000 by $25.3 million—$15.7 million in city funds and $9.6 million in federal funds. This represents a 3.2 percent reduction from the November plan. For 2001 through 2004, there are reductions in each year of the financial plan of $24.7 million in city funds and $15.0 million in federal funds.

Between 1998 and 1999, the foster care caseload declined by 5.4 percent, while admissions to foster care declined 15.0 percent. In the last six months the caseload decreased further, from 38,081 to 35,616 cases. Consequently, the preliminary budget projects a caseload decline of 6.5 percent in 2000. Caseloads are expected to level off over the next four years.

Recent caseload declines are due in part to fewer children being referred to foster care. Instead, many children are now referred to preventive services. For example, 771 more children were referred for preventive services in 1999 than in the previous year. Through these services, which can include mental health services, housing assistance, or day care, the Administration for Children’s Services helps stabilize a family so children can remain in their homes. Other reasons for the caseload decline include an increase in the number of adoptions completed and in the number of children discharged from foster care, either because they reached 18 years of age or because the
family’s goals were met and the child was allowed to return home.

The reduction in city spending—$115.0 million over five years—is combined with the loss of $70.0 million in federal Title IV-E foster care money. Currently, the federal funds can only be used for foster family services and contract maintenance; therefore, the decline in caseload results in a decline in federal aid. In order to prevent the loss of funds, New York State is negotiating a Title IV-E waiver that would allow more flexibility in how funds are spent and allow the state and city to keep funds that are spent within the waiver guidelines.

**Lead Poisoning Prevention**

- The Department of Health’s Lead Poisoning Prevention Program is funded at $7.3 million annually from 2000 through 2004.
- The city has added $6.1 million in 2000 and $5.2 million annually thereafter specifically for preventing lead poisoning in children.

The Department of Health’s (DOH) existing Lead Poisoning Prevention Program is funded this fiscal year at $7.3 million (of which roughly $2.0 million has been spent so far) and at the same level from 2001 through 2004. The DOH capital plan also earmarks $2.3 million over the next two years for the purchase of new equipment, including x-ray fluorescence (XRF) lead paint analyzers.

Local Law 38 of 1999, which imposes new lead prevention requirements on landlords, DOH, and HPD, has a slight direct budgetary impact on DOH. The law’s requirements on DOH—medical referrals, the lead hazard pamphlet, and promulgation of work practices—have already been implemented. However, to address Councilmembers’ concerns, the Mayor agreed at the time of the law’s passage that the city would undertake several additional health-related measures, including creating up to 10 new lead safe houses throughout central Brooklyn, northern Manhattan, and the South Bronx, hiring 51 new employees (some of whom will work in affected communities), and purchasing up to six new mobile outreach vans to provide assistance to families.

To accomplish these measures, the city appropriated an additional $6.1 million for this year and $5.2 million annually for fiscal years 2001 to 2004 in the DOH budget. The budget for fiscal year 2000 initially provided $2.0 million, matched by the state with an additional $1.1 million. In November, the budget was modified to add another $3.0 million for the current fiscal year, and an additional $2.2 million per year ($1.3 million in city funds and $0.8 million in state money) beginning in 2001.

It is unlikely, however, that most of these funds will be spent by June 30 since no funds have been expended to date. Furthermore, requests for proposals have not yet been issued for safe houses and vans. At the preliminary budget hearing held by the Council’s Health Committee, DOH estimated that it would take between one to two years to have the safe houses fully operating.

**Pest Control**

- Funding for pest control activities has increased significantly since 1995.
- The Department of Health has recently launched a pest control program targeting mosquitoes.

Funding for pest control activities has increased significantly in recent years. The preliminary budget proposes $16.3 million for pest control activities in DOH for 2001, a 12 percent increase over expenditures in 2000. Even though spending between 2001 and 2004 is projected to remain flat, the pest control budget is 25 percent more than the prior year, and is almost 2.5 times greater than it was in 1995.

The pest control budget is divided between two main functions: rodent and mosquito control. Spending for rodent control services makes up the majority of pest control expenditures. In 1998, the Mayor introduced the Comprehensive Rodent Control Initiative (CRCI), a rodent control and extermination program that targets the city’s most infested neighborhoods. As a result, expenditures in 1998 increased by 63 percent to $9.8 million. Total rodent control expenditures for the current year are projected
to be $12.0 million, with $4.5 million for general rodent control activities and $7.5 million for CRCI. The initiative was set to phase out by the end of this fiscal year, but it has been renewed for 2001 through 2004 and will continue to be financed annually with $5.2 million and $2.3 million in city and state funds, respectively.

The DOH recently launched the Vector Control Program (VCP) to prevent and track mosquito-borne diseases. In January, $2.7 million in VCP funds were added to the current year’s funding to begin surveillance, education, and control activities. In addition $9.5 million was spent by the Mayor’s Office of Emergency Management to address the West-Nile Virus outbreak last summer.

Starting with 2001, the VCP program will be funded at an annual level of $4.4 million. If there is an outbreak this summer, it is likely that additional funds will be allocated as they were in the summer of 1999. In addition, the preliminary DOH capital budget earmarks over $3.0 million to establish computer-aided surveillance and tracking systems as well as to build the infrastructure of this new program.

Education

Education comprises 30 percent of city spending in 2001. Education spending is projected at $11.4 billion in 2001 growing to $12.7 billion by 2004 at an average annual rate of 3.9 percent. About 97 percent of education spending is attributable to the Board of Education (BOE), with the remainder allocated to the City University of New York (CUNY).

This section begins with an overview of the BOE budget, highlighting several factors contributing to spending growth. A discussion of the recently ratified principals’ contract follows, along with an examination of proposals to increase funding for summer school, low performing schools, and school safety. The focus then turns to the state budget and its impact on education aid for the city, followed by a discussion of the Chancellor’s budget request. The last item pertains to CUNY, particularly the budget of the university’s six community colleges.

Board of Education

- Board of Education spending is projected to reach $11.1 billion in 2001 and grow at an average annual rate of 4.1 percent through 2004. Although brisk, this rate of growth is less than the 9.1 percent annual average over the past three years.
- The preliminary budget funds the recently ratified contract providing principals with significant raises, incentive pay, and merit bonuses.
- The proposed budget would increase resources for summer programs, low performing schools, and school safety.

Budget overview. IBO estimates that under the policies proposed in the Mayor’s preliminary budget, BOE spending will be $11.1 billion in 2001, an increase of $547 million over the projected 2000 level. Spending will grow at an average annual rate of 4.1 percent during the financial plan period, reaching $12.3 billion in 2004.

By comparison, the Administration projects BOE spending of $10.6 billion in 2001 and $10.9 billion in 2004. Most of the difference between IBO’s forecast and the financial plan’s is due to IBO’s inclusion, at the agency level, of four years of anticipated salary increases. These collective bargaining costs for all BOE employees, including those paid with city and non-city funds, grow from $195 million in 2001 to $873 million in 2004. The balance of the difference, which grows from $226 million in 2001 to $561 million in 2004, is attributable to assumptions about the implementation of policy initiatives.

IBO uses an econometric model to forecast education spending. The model incorporates the historical relationship between actual expenditures and enrollment and staff levels. IBO’s projections assume that K-3 class sizes will be reduced to an average of 20 students by 2003 and that prekindergarten will be offered to all four-year-olds by 2002.
**Recent growth in spending.** Over the last three years, BOE spending has grown at an average annual rate of 9.1 percent (see Figure 3-6). This expansion follows a period of several years during which BOE spending barely kept pace with inflation. An important factor driving the recent spending increases has been state and local pressures to improve student performance and meet higher promotion and graduation standards. The Board has been reducing class sizes, expanding summer and evening sessions, and devoting more resources to instruction, especially early childhood and arts programs. As a result, pedagogical staff has increased from 80,900 to 92,600 during the past three school years (see Figure 3-7). IBO projects that under the preliminary budget, pedagogical headcount will continue to rise, but at a more moderate rate, peaking at 96,400 in 2003.

**Enrollment growth slows.** Preliminary data from the current school year indicate that enrollment growth in both general education and special education has leveled off. Total enrollment increased steadily from 1990 to 1997, adding nearly 20,000 students per year. Since 1997, total enrollment has increased by roughly 31,000 students and is projected to grow by 45,000 (1.0 percent annual growth) between 2000 and 2004 (see Figure 3-8). However, most of this growth is attributable to the expansion of prekindergarten beginning in 1999. IBO’s projections assume that prekindergarten enrollment will continue to expand, growing from 34,000 students in the current year to 77,000 in 2002. It is then expected to drop off to 71,000 in 2004, due to demographic changes. In contrast, enrollment other than in prekindergarten has grown by only 0.2 percent annually since 1997, and is expected to grow at an even slower rate between 2000 and 2004. According to BOE projections, K-12 general education enrollment will be nearly flat.

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**Figure 3-6. Average Annual Change in BOE Spending**

<table>
<thead>
<tr>
<th>Period</th>
<th>Nominal</th>
<th>Real</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-1997</td>
<td>3.4%</td>
<td>0.5%</td>
</tr>
<tr>
<td>1997-2000</td>
<td>9.1%</td>
<td>7.5%</td>
</tr>
<tr>
<td>2000-2004</td>
<td>4.1%</td>
<td>1.8%</td>
</tr>
</tbody>
</table>

SOURCE: IBO.  
NOTE: Figures for 2000-2004 are IBO projections.

**Figure 3-7. Number of Teachers Increasing**

Number of pedagogical employees

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NOTE: Includes teachers, principals, assistant principals, guidance counselors, psychologists, social workers, school secretaries, and other pedagogical employees.
during that period, growing by just over 1,000 students per year (0.1 percent).

Full-time special education enrollment is 1,500 students lower in the current school year than in 1999, the first decline since 1991 (see Figure 3-9). BOE projects special education enrollment will increase an average of 0.5 percent per year from 2000 through 2004. However, BOE continues to face pressure from the federal and state governments to limit special education referrals and place students in the least restrictive environments. It is unclear whether the 2000 data signals a turning point. A long-term reduction in the special education population would result in considerable savings. BOE spent $24,100 per full-time special education pupil in 1999, more than triple the $7,200 spent per general education pupil.

**Pay-as-you-go capital.** BOE faces daunting capital needs, with three-fifths of its students attending overcrowded schools and many school buildings outdated and in poor condition. School construction and repair is generally funded through the city capital budget with long-term debt (see page 53) but during the current school year BOE has begun funding some capital projects from its operating budget (pay-as-you-go capital). For example, BOE is spending $153 million out of its 2000 operating budget to install air conditioning in 7,100 rooms as preparation for an expanded summer program. Consistent with the city’s capital commitment plan, IBO’s spending estimates include $248 million in pay-as-you-go capital for education in 2000, $85 million in 2001, $75 million in 2002, and $80 million annually in 2003 and 2004. The $248 million in current year funding includes $46 million in state RESCUE (Rebuilding Schools to Uphold Education) funds.3

To a large extent, using the expense budget to fund capital projects has superseded the recent BOE practice of using expense budget surpluses to fund needs in the following year. The Board ended 1999 with a surplus of $248 million that it rolled into 2000. The roll consisted of two components: $212 million in city funds and unrestricted state aid; and $36 million in restricted state and federal funds. Because nearly all potential surpluses identified to date in the current year have been dedicated to pay-as-you-go capital, IBO expects only a modest roll of 2000 funds into 2001.

**Principals’ contracts.** The preliminary budget recognizes the $91 million annual cost of the recent labor agreement with the Council of Supervisors and Administrators (CSA). The contract, which was ratified in January, provides principals, assistant principals and other administrators their first base pay raises since October 1995.

All 4,700 school administrators, including principals, receive an 11 percent increase in four increments, the first retroactive to February 1998.
These raises are comparable to those received by other city workers under the last round of contracts. Principals receive an additional 20 percent raise in exchange for relinquishing tenure and working a longer day and longer year. In addition, principals earn bonuses for managing schools with large enrollments ($1,000-$3,250 per year) and/or low performing students ($10,000 per year). Principals also earn longevity bonuses of $3,400 for completing 22 or more years of BOE service. Finally, a fourth of CSA members in each job title are eligible for merit increases of $2,750 to $15,000 determined through performance-based evaluations.

Since pension benefits are based on salary at retirement, the CSA contract significantly boosts pension benefits for those covered. The city will need to make higher than anticipated contributions to actuarial pension funds on behalf of CSA members, many of whom are close to retirement age.

The Administration intends to introduce concepts contained in the CSA contract in upcoming negotiations with unions representing other municipal workers, including teachers. More specifically, the Mayor proposes to enhance productivity by linking pay increases for city workers to performance-based evaluations and changes in terms of employment.

**Summer school.** The preliminary budget increases annual funding for summer school from $97 million to $160 million. The enhanced summer program, part of the BOE’s initiative to end social promotion, provides failing students another opportunity to earn promotion to the next grade. Pupils in grades 3-8 who did not meet promotional standards during the regular school year will receive 100 hours of intensive instruction over a five-week period followed by standardized testing. High school students who have failed core classes or State Regents exams will take the specific classes they need for promotion or graduation. Summer school will also offer additional preparation to students working to meet the Regents’ more rigorous graduation requirements. While most of the summer 2000 program is funded in the fiscal 2001 budget, $10 million has been provided in fiscal 2000 to allow for the advance purchase of materials and supplies.

The preliminary budget designates $32 million, or one-fifth, of total summer spending to be contracted with private and nonprofit educational contractors. Several community school districts used outside contractors last summer for staff development, instructional materials, and direct services to students. Fifty-three outside providers are bidding to provide services in summer 2000.

There is some uncertainty about the enrollment for this year’s summer school program. Under state law attendance is not compulsory, even for students who are assigned to attend. Moreover, a large number of students voluntarily take advantage of summer school. In 1998, when there was no policy of assigning students to summer school, 215,000 students

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**Figure 3-9.**

**Special Education Enrollment Levels Off**

*Number of full-time special education students*

![Graph showing special education enrollment levels from 1990 to 2004.](image-url)

**Sources:** IBO; Comprehensive Annual Financial Reports of the Comptroller, 1990-1999.

**Note:** Data for 2000 is preliminary.
attended summer classes. In 1999, when 35,000 third, sixth, and eighth grade students were assigned to summer school—although not all attended—enrollment was 228,000.

This year, the Board has notified 320,000 students in grades 3-12 that they are at risk of not meeting the promotion or graduation standards; if their performance does not improve they will be assigned to summer school. Although some of those at risk will avoid summer school by meeting the promotion standards by the end of the school year, the number of assigned students will probably be several times greater than last year. While many of last summer’s voluntary students are likely to be among those whose attendance will be mandated this year, a large number of voluntary students potentially remain for this summer. For example, summer school includes voluntary literacy programs for children in grades K-2. Assuming that the Board would choose to allow all interested students to attend summer courses, it is possible that the 322,000 students planned for this summer in the preliminary budget underestimates the enrollment and therefore the costs of the program.

BOE will face significant organizational challenges in implementing this program, particularly in terms of staffing and transportation. Securing enough teachers requires collective bargaining to agree upon increases in per session pay or other incentives. Data systems for tracking attendance will also have to be upgraded to avoid a repetition of last year when thousands of students assigned to summer school apparently did not attend but were not recorded as absent. The Board is also installing air conditioning in many older schools (see page 44 discussion of pay-as-you-go capital spending).

Implementation of the promotion policy also includes extra instruction during the regular school year for students who are failing to meet the higher standards. For example, the preliminary budget includes $18 million for Eight-Plus, a new instructional program targeted to assist teenagers who have failed eighth grade but are too old to remain in middle school.

School performance. The State Education Department has placed 97 New York City schools on the list of schools under registration review (SURR), a net increase of six schools since 1999. These low-performing schools are at risk of being closed by the state. BOE has designated 42 elementary and middle schools as Category I SURR schools, which are the highest priority, because of their longstanding failure to turn around their performance. Under a pilot program, teachers in 40 of the Category I SURR schools work 15 percent more hours than the standard schedule in exchange for 15 percent more pay. The budget proposes $37 million to continue the extended-time pilot program as well as $9 million in new funding for SURR high schools. The preliminary budget also proposes turning over management of some SURR schools to private companies. The proposal, in essence, would outsource one-fifth of the instructional services at Category I schools by awarding $61 million in contracts to private and nonprofit organizations.

School safety initiatives. The preliminary budget includes $30 million to expand the school safety force by 500 agents or roughly 15 percent in 2001. BOE transferred responsibility for school safety functions to the Police Department in December 1999, although the funding remains within the BOE budget. An additional $8 million has also been provided to open 22 truancy-reduction centers staffed by school safety agents, attendance teachers, and counselors. The new promotion policy includes a 90 percent attendance standard. With an average daily attendance rate of 82 percent among high school pupils, many students will be held back if they do not improve their attendance.

State budget outlook. The Governor’s proposed executive budget for school year 2000/2001 would increase education aid for New York City as well as for the rest of the state, but would cause the city to receive a slightly smaller percentage of state aid than it did last year. Statewide, the budget would add $355 million (2.8 percent) to education spending, with the city receiving $102 million (28.7 percent) of the increase. According to data provided by the State Division of the Budget, the city will receive 36.2 percent of state-wide education aid in 2000 and would receive 36.0 percent under the proposed budget.
The Governor’s proposed budget would reduce the state’s commitments to the universal prekindergarten and class size reduction initiatives that were spelled out under a 1997 multi-year spending agreement between the governor and the legislature. The universal prekindergarten program, scheduled to be phased-in over four years beginning with the 1998/1999 school year, is intended to make publicly funded prekindergarten available to all four-year-olds. In the current school year BOE has 25,200 students enrolled in universal prekindergarten, with approximately 60 percent served by community-based providers in non-BOE facilities. IBO estimates that under the terms of the 1997 agreement, the city was to receive a minimum of $128 million for universal prekindergarten in 2000/2001. Under the Governor’s proposed budget, the city would receive $67 million for universal prekindergarten, only $4 million more than in the current year.

The state’s class size reduction program is being phased-in over three years, beginning with the 1999/2000 school year. The Board began reducing early grade class sizes in the current school year, combining funds from the state grant and a similar federal grant. Under the 1997 agreement, the city was to receive a state grant of $92 million for class size reduction in 2000/2001. Under the Governor’s proposed budget, the city would instead receive $49 million for class size reduction for 2000/2001, which is the same amount as in the current year.

The proposed state budget would also eliminate minor maintenance aid for school buildings and a program known as teacher support aid that has helped pay portions of teachers’ salaries in urban school districts. These programs provided New York City with $33 million and $63 million, respectively, in 2000. In contrast, the budget includes $15 million for a new initiative to help NYC attract more certified teachers.

The actual level of state aid flowing to New York City is determined when the state budget is adopted following negotiations between the Governor and the Legislature. The leaders of the Assembly and the Senate have each introduced education aid packages this year. Both plans would provide more aid to districts across the state (including New York City) than the amounts included in the Governor’s executive budget. Under the Assembly plan, education aid in 2000/2001 would grow by $1.3 billion statewide over the current year, while the Senate plan would provide for a $875 million increase. In addition, the Assembly plan would fund RESCUE, a school construction and repair initiative, at $500 million ($200 million for the city); the Governor and Senate would provide no money for this program.

**Chancellor’s budget request.** The Chancellor’s Budget Request, approved by the Board on February 16, 2000, highlights priorities for the coming year. Overall, the request specifies $1.6 billion in expense budget needs, roughly half of which have been funded in the Mayor’s preliminary budget and Governor’s executive budget. The outstanding request of $796 million includes restoration of the Governor’s proposed cuts to class size reduction, universal prekindergarten, teacher support aid, and minor maintenance aid.

Securing resources to support the Board’s new promotion policy is a major theme of the request. The Chancellor seeks $22 million in state transportation aid needed for summer school, and $85 million in other state aid for programs aimed at raising standards and ending social promotion. The request also includes $179 million in proposals submitted by School Leadership Teams for school-specific needs related to the promotion policy.

Another theme highlighted by the Chancellor in his budget request is the need to find additional resources for teacher recruitment and retention. His request identifies $85 million in new initiatives to help in these efforts with $15 million funded in the Governor’s executive budget and $70 million yet to be funded.

The request also calls for increasing the Board’s five-year capital plan for 2000-2004 by roughly $4 billion, with most of the new funding requested from the state. This would restore the plan to the $11 billion level originally proposed in November 1998.
CUNY Community Colleges

- City spending for CUNY will be nearly flat in 2001, largely due to the city’s decision not to fund collective bargaining costs for the community colleges.

- The Mayor’s preliminary budget proposes to eliminate merit scholarships for graduates of New York City high schools entering senior colleges.

- The fiscal impact of a new, more restrictive admissions policy remains uncertain.

Budget overview. IBO estimates that the preliminary budget would result in total city spending for the City University of New York (CUNY) of $381 million in 2001, a decrease of $5 million from the estimated 2000 level. Spending would then rise, beginning at in 2001, at an average annual rate of 1.0 percent, reaching $392 million in 2004. The 2001 budget provides approximately $338 million for community colleges, exclusive of pension contributions. In addition, $32 million in city funds are allocated to associate degree programs at senior colleges, and $10 million to public schools sponsored by Hunter College for gifted children.

The slow projected growth in spending—well below the rate of inflation—from 2001 to 2004 is primarily attributable to the city’s decision not to fund collective bargaining costs for the community colleges. Although the city budget does not provide funds for increased labor costs, the university still must pay salary and wage increases negotiated with its unionized employees. If CUNY fails to secure funding for these mandatory costs, the university will have to make up the gap using one or more of the following options: reduce course sections, cut other services, reduce operating costs, and/or seek a tuition increase.

The biggest factor behind the projected reduction in CUNY spending in 2001 is the preliminary budget proposal to eliminate $6.5 million in merit scholarships for senior college freshmen from New York City high schools. The budget, however, would preserve $500,000 in scholarships for community college freshmen.

New admissions policy. A major source of uncertainty surrounding CUNY’s budget is the impact of new restrictions on senior college admissions. The new policy conditions acceptance into bachelor’s degree programs on satisfactory performance on standardized tests. Some observers believe this policy could result in many students with remedial needs shifting to the community colleges, thereby increasing the fiscal burden on the city.

CUNY’s administration, however, contends the impact on community college enrollment will be minor. They assume that a number of new programs will improve the college preparedness of applicants, most of whom come from public high schools in the city. They also expect that summer immersion programs will enable many more students to improve their basic skills and pass the requisite entrance exams, reducing the number of students displaced from the senior colleges. The merit scholarship program, initiated in 1999, is one of the programs that CUNY has been counting on to help attract applicants ready to begin senior college work. The CUNY administration is seeking to restore the scholarships cut in the preliminary budget. CUNY has also requested $5 million from the city and another $5 million from the state to expand College Now, a collaborative program to raise academic standing of BOE high school students. The Governor’s executive budget includes a new $9 million SED grant to CUNY to provide additional academic support services and restructure remedial instruction.

Uniformed Services

Spending on uniformed services, which includes sanitation, fire, police and corrections, accounts for 16 percent of the city budget in 2001—about $6.1 billion. Nearly $3.2 billion of this budget is dedicated to the Police Department. The Fire Department receives about $1.1 billion, and the remaining $1.8 is distributed to the Department of Sanitation ($915 million) and Department of Correction ($885 million). Overall, spending for uniformed services is expected to increase to $6.8 billion in 2004—an average annual growth rate of 3.6 percent. In this section, IBO examines how the
Mayor’s preliminary budget will affect staffing and budgetary resources for each of these city services.

Sanitation

- IBO projects that Sanitation’s budget will grow from $860 million in 2000 to $1.0 billion by 2004—largely due to the growth in waste export costs (hauling trash outside the city) resulting from the upcoming closure of the Fresh Kills landfill.

- There is still much uncertainty about the city’s waste export strategy over the long term.

- The preliminary budget includes funding to complete implementation of weekly recycling in April 2000 for all five boroughs.

IBO estimates that the Department of Sanitation will spend $915 million in 2001, a 6.4 percent increase over 2000. IBO’s estimate for 2001 is $25.7 million higher than the Administration’s 2001 estimate due to our inclusion of collectively-bargained salary increases.

Between 2000 and 2004, IBO estimates that spending for Sanitation will grow at an average annual rate of 4.7 percent to $1.0 billion in 2004. The increase is driven primarily by waste disposal and export costs associated with the January 2002 closure of the city’s only remaining landfill (Fresh Kills on Staten Island) and to a lesser extent by IBO’s inclusion of salary increases. Waste export costs associated the Fresh Kills closure are projected to rise an average of 17.2 percent annually—from $112 million in 2000 to $212 million in 2004. Other departmental spending increases at an average of 2.3 percent annually.

Proposed reductions in personnel and program spending of $25.5 million annually are incorporated into our estimates for 2001 through 2004. Most of these are the result of savings due to the closure of Fresh Kills. With only 20 percent of the city’s waste stream destined for Fresh Kills in 2001 and none in 2002, the city expects lower staffing and operating needs.

Not surprisingly, most of Sanitation’s annual budget is allocated to activities related to street cleaning and refuse collection (49 percent), disposal of refuse and recycling materials (22 percent), maintenance and repair of collection trucks and other vehicles (8 percent), and snow removal (2 percent), as shown in Figure 3-10. The relatively high proportion of the budget allocated to executive administration (17 percent) is largely due to the addition of construction projects related to continued operation of Fresh Kills that will be financed on a pay-as-you-go-basis. Previously, these projects were included in the capital budget, but since the repayment period would be longer than the landfill’s useful life and could no longer be supported within long-term debt, they had to be transferred to the operating budget.

Waste export plan. Under an Interim Waste Export Plan, the amount of refuse the department brings to Fresh Kills has decreased each year since 1998 in anticipation of the January 2002 closure. Under the Interim Plan, Sanitation is awarding short-term contracts to private vendors to receive and dispose of 12,500 tons per day (tpd) of residential refuse that would otherwise be destined for Fresh Kills. Trash once carried by barge to Staten Island is

![Figure 3-10. Department of Sanitation Proposed Spending by Major Activity Area](image)
now hauled by garbage collection trucks to an incinerator in New Jersey or to transfer stations in either the city or New Jersey to be reloaded onto larger trailer trucks or rail for out-of-city export by private vendors.

In the first phases of the Interim Plan, implemented in 1998 through 2000, Sanitation contracted for out-of-city disposal of 7,400 tpd of refuse—about 1,900 tpd from the Bronx, 2,400 tpd from Brooklyn, 2,200 tpd from Manhattan, and 900 tpd from Staten Island. To complete the phase-in, the department still needs to contract for disposal of 5,100 tpd of refuse being collected from Queens and some parts of Brooklyn.

For 2001, the city’s costs will depend on how much of the 5,100 tpd remaining for out-of-city disposal will be contracted with private vendors, and at what cost. Sanitation is currently evaluating bids to export at least 2,500 tpd of the remaining tonnage. The preliminary budget and IBO spending projections are based on a low-end estimate of $55 per ton, which may underestimate the city’s eventual costs. These costs are purposely understated so that the maximum amount the city is willing to pay for waste export is not revealed during the contract negotiation process.

There is much uncertainty, however, about waste export over the long-term. There is likely to be emphasis on using rail or barge systems rather than trucks for waste export due to the negative effect on communities that become corridors for high volume truck traffic. Opposition is also strong to siting additional truck transfer stations or operating existing stations at higher capacity because the facilities are concentrated in just a few neighborhoods—areas that already have little tolerance for further traffic, noise, and odor problems.

There is greater political support for transfer of garbage by barge (the system currently used to bring trash to Fresh Kills) or by rail, rather than by truck. However, such arrangements would require agreements with barge-fed disposal sites and barge-fed rail loading facilities, or possibly upgrading and expanding the city’s existing marine transfer stations.

**Weekly recycling.** Currently all Sanitation/Community Districts in the city, except for 10 districts in the Bronx, receive weekly recycling pickups. The preliminary budget provides additional funding to fully implement weekly recycling in the Bronx beginning in April 2000.

**Fire**

- IBO projects that Fire Department spending will grow from $1.1 billion in 2000 to $1.2 billion by 2004—an average annual growth rate of 3.1 percent—largely due to estimated growth in salaries.
- Included in the department’s proposed budget are savings of $3.3 million annually from reduced overtime and medical leave among Emergency Medical Services (EMS) workers.

IBO estimates that the Fire Department will spend $1.1 billion in 2001, which is a 2.2 percent increase over 2000. IBO’s forecast for 2001 is $43.4 million above the Administration’s 2001 estimate due to our inclusion of collectively-bargained salary increases. Between 2000 and 2004, the financial plan holds Fire Department spending essentially flat. IBO projects, however, that the department’s spending will grow to $1.2 billion by 2004—an average annual growth rate of 3.1 percent—primarily due to IBO’s inclusion of salary increases.

Incorporated into these estimates are proposed reductions of $6.0 million for 2001, and about $5.0 million annually for 2002 through 2004. Of this, $3.3 million in annual savings are attributable to reducing overtime and medical leave among Emergency Medical Service (EMS) workers. The Administration had previously proposed to achieve these savings by shifting some ambulance services from EMS to private, hospital-based ambulances. During November Plan negotiations, however, the city agreed to keep the ambulance services in EMS, but the Fire Department will work with labor to achieve savings of $3.3 million annually through productivity gains.
For 2001, the budget includes $2.8 million to purchase state-of-the-art infrared cameras for each of the department’s 143 ladder companies. These infrared cameras generally cost about $18,000 each; however, the department is still negotiating with vendors and as a result the unit cost and number of cameras that will ultimately be purchased has not yet been decided.


The department’s civilian workforce grew substantially in 1996—from 1,124 positions to 4,328 positions—when the EMS was merged into the Fire Department from the city’s Health and Hospitals Corporation. Between 1996 and 2000 the department’s civilian workforce grew by 105 positions (about 2.4 percent) to a projected staffing level of 4,433. Twenty civilian positions are to be added for 2001 through 2004 at a cost of about $900,000 annually. These are restored positions for communications electricians that were eliminated several years ago as part of a plan to reduce the number of fire alarm call boxes throughout the city; however, the plan was not fully implemented.

Police

- The preliminary budget and financial plan propose holding NYPD uniformed staffing essentially flat through 2004, at about 40,200. However, the city’s share of total personnel costs would rise as federal funding for police officers is scheduled to expire after 2001.
- The preliminary budget projects a 7.5 percent reduction in NYPD civilian staffing next year, reflecting uncertainty over the continued availability of federal funds for civilian personnel.

The preliminary budget proposes to spend $3.0 billion for the Police Department (NYPD) in 2001, or about 8 percent of the city’s total budget. However, IBO estimates that NYPD spending will be $3.2 billion in 2001, which is a 2.4 percent increase over 2000. IBO’s estimate for 2001 is about $156 million more than provided in the preliminary budget—largely due to the inclusion of collectively-bargained salary increases.

The financial plan proposes an average annual decline in spending of 0.1 percent in total funds from 2000 to 2004. City funds are projected to increase by 0.8 percent on an average annual basis. In contrast, IBO projects average annual growth rates of 3.3 percent in total funds and 4.2 percent in city funds. More specifically, IBO estimates that NYPD expenditures will be $3.2 billion in 2001, $3.3 billion in 2002, $3.4 billion in 2003, and $3.5 billion in 2004. IBO’s larger projected increases in NYPD spending primarily reflect salary increases and overtime expenditures above those included in the Mayor’s financial plan.

Staffing. Personnel costs associated with uniformed NYPD staff account for over two-thirds of the agency’s budget. The financial plan holds uniformed staffing at about 40,200 through 2004. While this workforce is not projected to grow during the plan period, the city’s share of total costs is scheduled to increase as federal funding streams for police officers’ salaries expire. As reported in IBO’s January 2000 Fiscal Outlook, the federal funding the city has received since 1997 to pay a portion of police officers’ salaries is scheduled to taper off to zero by 2002, with city funds replacing federal funds beyond that point.

In contrast to the level staffing forecast for uniformed personnel, the financial plan projects a 7.5 percent reduction in civilian NYPD personnel—from just over 9,000 in November 1999 to 8,334 by the end of 2001. The projected decline reflects uncertainty surrounding the continued availability of federal funding for civilian personnel. Currently, almost 600 civilian positions are fully financed with federal funds. A reduction in the number of civilian positions would
run counter to arguments made by the City Council, City Comptroller, Citizens Budget Commission and others that many tasks currently performed by uniformed police personnel could be safely and competently performed by civilian staff, at significantly lower cost. For example, the City Comptroller has identified over 1,250 specific positions he contends could be assigned to civilian personnel, thereby freeing up uniformed personnel for direct law enforcement duties.

**Correction**

- IBO estimates that Department of Correction spending will increase by over 3 percent between 2000 and 2001, primarily as a result of collectively-bargained salary increases.
- DOC’s inmate population is declining. The average inmate population fell to 17,562 in 1999, a decrease of 18 percent since 1992.

The preliminary budget provides $854 million for the Department of Correction (DOC) in 2001, or slightly more than 2 percent of the city’s total budget. IBO estimates, however, that DOC spending will be $885 million in 2001, which is a 3.1 percent increase over 2000. IBO’s estimate for 2001 is about $30 million more than provided in the budget—largely as a result of including collectively-bargained salary increases.

The financial plan proposes average annual DOC spending growth of 1.0 percent in total funds and 2.7 percent in city funds from 2000 to 2004. However, IBO projects average annual growth rates of 3.7 percent in total funds and 5.6 percent in city funds. More specifically, IBO estimates that DOC expenditures will be $885 million in 2001, $944 million in 2002, $970 million in 2003, and $994 million in 2004. Our larger projected increases in DOC spending primarily reflect salary increases.

**Staffing and inmate population trends.** Personnel costs make up over 85 percent of DOC spending, with uniformed staff expenditures accounting for the majority of personnel spending. The financial plan calls for uniformed staffing to increase 1.3 percent over the plan period, from 11,170 in 2000 to 11,316 at the close of 2004. Civilian staffing is projected to remain constant at about 1,700.

After peaking in 1992 at 21,449, DOC’s average inmate population fell to 17,562 by 1999, a decrease of 18 percent. The decline in the inmate population continued during the first four months of the current fiscal year, falling to 16,262—about 10 percent less than the comparable period one year ago. Over the same period, uniformed staffing declined by 4.4 percent, from 11,820 in 1992 to 11,305 in 1999. Largely as a result of such declines in the inmate population without commensurate declines in staffing, DOC has cut overtime expenditures since the mid-1990s; in 1999 DOC spent $65 million in overtime, compared to $89 million in 1995. At the same time, the city’s jails have become safer, with more frequent weapons searches made possible by a smaller inmate-to-officer ratio. Further analysis of inmate, staffing, and safety trends are warranted, however, since the significant decline in the agency’s workload may provide additional opportunities for budgetary savings.

**Leasing of beds to state.** Since DOC’s inmate population has declined and the state prison system is overcrowded, the city leases excess jail capacity to the state. Under the terms of the lease agreement, newly sentenced state inmates may be retained in city jails for up to six months prior to transport upstate, with the city reimbursed at the rate of $100 per inmate per day. In 1999, the state paid $17 million to the city for these leased beds, with $26 million anticipated this year for a daily average of about 700 beds. Although the average cost of a bed in the city’s jail system is about $189 per day, OMB contends that the marginal cost of the beds leased to the state is actually well under $100 per day, therefore rendering the lease agreement advantageous to the city. Next year, the city anticipates leasing an average of only 200 such beds to the state as a result of the planned opening of two new state prison facilities.
Debt Service

The majority of the city’s capital program is financed with debt backed by city tax revenues. Chapter 4 explains how the entire capital program is financed, while this section presents the debt service impact on the city’s expense budget.

- Debt service payments have risen sharply in recent years and are expected to continue to rise over the forecast period.
- Adjusted for prepayments, debt service spending will rise 7.0 percent annually on average, from $3.5 billion in 2000 to $4.6 billion in 2004.
- Debt service as a percent of tax revenues is also rising, from 18.5 percent in 2001 to 20.0 percent in 2004. This is a significant increase from 1990, when debt service consumed 11.6 percent of tax revenue.

Five types of debt have a direct claim on the broad taxing powers of the city: General Obligation (GO) bonds, short term notes, bonds issued by the Municipal Assistance Corporation (MAC) and the Transitional Finance Authority (TFA), and capital lease obligations. GO debt and short-term notes are backed by the full faith and credit of the city and MAC debt is supported by the sales tax. Capital lease obligations are supported by annual city appropriations.

Accounting for Debt Service and Capital Expenditures

In discussions of the cost of financing the city’s capital program, debt service is typically equated with the payments for debt service made out of the city’s operating budget or general fund. In actuality, the general fund is only one of several different government funds involved in financing the city’s capital program and related borrowing costs.

- Capital expenditures are made out of the capital projects funds, and their main source of revenue is proceeds from sales of bonds; these proceeds are augmented by federal and state categorical aid and other revenues flowing directly into these funds.
- Payments covering the principal and interest on the bonds as well as capital lease costs—which together comprise actual debt service—are made out of the debt service funds, and their main source of revenue is operating transfers from the general fund; other debt service fund revenues include state categorical aid, investment income, and (as of 1997) city income tax payments flowing directly into the debt service fund.
- A share of the general fund’s transfer for debt service is, in turn, offset by state education building aid. Unlike other capital-related intergovernmental aid, building aid goes into the city’s general fund (while also appearing as unrestricted aid in the Board of Education budget).
- Debt service transfers from the general fund are also partially offset by payments from the Water Board to the city covering interest and principal on GO bonds that were issued for water and sewer purposes prior to the establishment of the New York City Municipal Water Finance Authority.
- Since 1986, investment in water and sewer projects has been largely financed by Water Authority revenue bonds that are liabilities of the authority’s own separate fund. Water Authority financing accounts for almost a quarter of the city’s total capital funding program.
Unlike these other obligations, TFA debt service is not paid from the city’s general fund. However, we include it here because its bonds are backed by a dedicated portion of the city’s personal income tax revenues.

The city has also started to finance a portion of its capital program with bonds issued by the Tobacco Settlement Asset Securitization Corporation (TSASC). Bonds issued by TSASC have no claim on city tax revenues. This new debt (issued in the form of Tobacco Flexible Amortization Bonds or TFABs) is serviced by payments received from tobacco companies under the terms of a national legal settlement. This gives the city added capacity to fund its capital program in the coming three fiscal years even while GO borrowing is constrained by the constitutional debt cap (see Chapter 4).

TSASC debt service and the portion of tobacco settlement revenues set aside to pay for it are not included in the general fund (or city’s financial plan). In contrast to the exclusion of TFA, there are grounds for this. As noted in the accompanying box, general fund debt service expenditures represent only the portion of the cost of financing city debt that is supported by city tax revenues. Other significant funding sources for debt service that are not carried in the general fund include debt service fund investment income ($79 million in 1999) and state categorical aid to the City University Construction Fund ($292 million in 1999). As another non-tax source of debt financing, TSASC debt service resembles the latter and is not included in the IBO projection of city debt service. It is important to note, however, that the city’s decision to finance capital expenditures by securitizing a portion of tobacco settlement payments does divert revenues that otherwise would have flowed into the operating budget and been available to finance other needs. TSASC debt service is projected to rise from $28 million in 2000 to $197 million in 2004.

Transfers and payments for debt service have been absorbing an increasing share of city tax revenues since 1990, and are projected to continue growing faster than taxes through 2004. Debt service trends have been obscured in recent years by the use of surpluses to prepay debt service due in the next fiscal year. Prepayments move debt service burdens between fiscal years, increasing the total costs of debt service in some years and lowering them in others. For example, IBO assumes that the expected 2000 surplus will be used to prepay $2.7 billion in debt service scheduled to be paid in 2001. Adjusted for prepayments, transfers and payments for debt service will rise from $3.5 billion in 2000 to $4.0 billion in 2001 and $4.6 billion in 2004.

Figure 3-11 shows the growth of tax-supported debt service (with prepaid debt service in its originally scheduled year) as a percentage of city tax revenues. The rising ratio of debt service to tax revenues—from 11.6 percent in 1990 to a projected 18.5 percent in 2001 and 20.0 percent in 2004—is attributable to several factors. New borrowing for capital spending rose from an average of $1.1 billion per year in the 1980s to $2.8 billion in the 1990s, an increase of about 75 percent after adjusting for inflation. Borrowing will remain strong over the financial plan period, averaging almost $2.9 billion per year without TSASC and over $3.3 billion per year with it.
Even without TSASC debt the 8.5 percent average annual growth in net new borrowing over the 2000-2004 financial plan period (most of it occurring in the last two years of the plan) far outpaces the 1.0 percent average annual tax revenue growth forecast for this period.

Other Spending Areas

Spending in all other areas, including housing, parks, culturals, libraries, and business services, accounts for over 21 percent of the city budget in 2001. IBO estimates that this spending will total $7.9 billion in 2000. By 2004, this spending will be $8.2 billion, an average annual increase of 3.0 percent. First, we will discuss the budget impacts for implementing Local Law 38 on the Department of Housing Preservation and Development. We then address the proposed budget cuts for cultural institutions, libraries, and parks. Finally we turn to the Department of Business Services.

Housing

- The Department of Housing Preservation and Development (HPD) has begun hiring personnel to implement Local Law 38 of 1999, the lead paint hazard reduction law that went into effect November 12, 1999. The total proposed budget for implementation in 2001 is $13 million, which will be funded by federal community development block grant money.

- HPD continues to have difficulty fully staffing its housing inspector positions; it cannot be determined from the budget how many inspector positions the department intends to fill in 2001.

- As the stock of city-owned “in-rem” properties continues to decline, more and more CDBG funds will become available for code enforcement and other purposes.

Local Law 38. As a result of the enactment of Local Law 38 of 1999, the city will incur additional costs related to the remediation of lead paint hazards in multiple dwelling units. The department of Housing Preservation and Development (HPD) estimates that the annual cost of the required measures will be $13.0 million beginning in 2001. This amount includes funds for emergency repairs, which are required by the new law when landlords fail to remedy a lead paint hazard after HPD issues a violation, and for 80 additional housing inspectors, legal staff, and other personnel. The department proposes shifting funding for Local Law 38 implementation from city funds to federal Community Development Block Grant (CDBG) funds in 2001. IBO’s reestimate of the preliminary budget assumes that the department will continue to use CDBG funds for this purpose in future years.

Code enforcement staffing and funding. The Mayor’s preliminary budget for 2001 proposes eliminating $6.6 million in Council initiatives enacted for 2000, including $2.7 million for enhanced code enforcement. These funds were originally intended to finance an increase in code enforcement personnel up to 268 positions, although by agreement with the Council, HPD shifted some of the funds to non-personnel expenditures. Given the proposed cut, on the one hand, and the increased budget for code enforcement for Local Law 38 on the other, it is unclear at this point how many inspector positions are funded for 2001 in the current financial plan.

Although the number of housing inspectors has increased along with the budget for the Division of Code Enforcement, the department has regularly had difficulty filling its total authorized positions. Assuming that the total number of authorized positions for 2000 is 268, the department is again below its authorized positions; as of mid-March, the Department employed 234 housing inspectors (see Figure 3-12).

In the future, HPD may be able to fund code enforcement from CDBG funds that are currently used for the maintenance and disposition of properties seized by the city through the “in-rem” process. As the in-rem stock declines, savings from maintenance could be used to fund other priorities in HPD, including code enforcement. HPD’s goal is to completely dispose of the in-rem stock by 2007. The proposed budget for in-rem property management for 2001 is $149.8 million.5
Buildings

- The Department of Buildings proposes hiring ten additional construction inspectors, although it has not yet filled all the positions which are currently vacant.

Construction oversight. To meet the need for more construction oversight, the Department of Buildings (DOB) proposes hiring ten additional construction inspectors (along with clerical support staff). The annual cost of the additional inspectors and support staff will be $605,000 in 2001 and beyond.

It is not clear, however, that DOB will be able to meet its goal of 96 construction inspectors. The brisk rate of construction in the city, and the resulting strong demand for workers in the building trades, has created a relative scarcity of qualified individuals to work as inspectors. As a result, the department has been unable to fill all of its current authorized positions. Although the 2000 budget authorized 86 construction inspectors, as of the end of February, the department actually employed only 74 (see Figure 3-13).

Revenues. The brisk rate of new construction has boosted revenues from construction permits. The department anticipates collecting an additional $2.5 million above earlier projections for construction permit fees in both 2000 and 2001, for a total of $41.0 million and $37.8 million, respectively.
Cultural Affairs

- Preliminary budget proposals would reduce city expenditures on cultural affairs by $30.7 million in 2001.

- The cultural programs unit, a collection of over 200 organizations receiving smaller city grants, would be affected the most by this reduction.

- In the past, large cultural affairs budget reductions proposed in the preliminary budget have been restored by the City Council.

IBO estimates that the Department of Cultural Affairs’ (DCA) spending would be $86.4 million in 2001, 24.4 percent less than the projected expenditures for 2000. DCA’s operating budget includes four major components: the cultural institutions group (CIG), cultural programs, the Cultural Challenge, and agency administration.

The CIG is comprised of 34 major cultural institutions, most of which are housed in city-owned buildings. This group includes organizations such as the Metropolitan Museum of Art, the Wildlife Conservation Society, and the New York State Theater (New York City Opera and New York City Ballet). In 2000, these institutions will receive city appropriations for operating and energy expenses ranging from $200,000 to $16.9 million, for a total of $91.0 million. The proposed budget for 2001 would reduce this appropriation by $16.6 million (18.3 percent), with reductions allocated fairly evenly among the institutions.

The cultural programs unit includes over 200 cultural organizations, programs, and events that will receive grants ranging from $5,000 to nearly $600,000, for a total of $18.2 million in 2000. This would be reduced by 75 percent to $4.6 million in 2001 under the proposed budget.

The Cultural Challenge awards grants to organizations on a competitive basis. These grants must be matched by private funding. Traditionally, 60 percent of these funds are reserved for allocation to members of the CIG. The Cultural Challenge is the only component of DCA’s budget that is fully preserved in the preliminary budget for 2001, with an allocation of $5 million.

In addition to providing subsidies and grants to cultural organizations, DCA administers several programs and initiatives in support of New York City arts and artists. Funding for these programs as well as DCA staff salaries and administrative expenses will total $3.7 million in 2000. The preliminary budget
proposes reducing this funding by 11.2 percent in 2001.

Over the last several years, DCA has been one of the primary targets of preliminary budget reductions. In the past, however, the proposed reductions have been restored by the City Council and supplemented through Borough Presidents’ allocations. Figure 3-14 shows historical differences between the preliminary budget, the adopted budget, and what was actually spent over the past five years. Because the purpose of this report is to estimate the fiscal impact of the Administration’s preliminary budget proposals, IBO’s expenditure projections assume that funding will not be restored in subsequent versions of the budget for 2001. However if the past is any indicator, it is likely that DCA’s budget will be somewhat higher than indicated by the preliminary numbers. Historically the shares allocated to agency administration, the CIG, and cultural programs have remained relatively constant.

Libraries

- Each of the city’s three library systems would receive 19 to 20 percent less city funding in 2001 under the Administration’s proposed budget.

- The preliminary budget includes a proposal to offset this reduction in funding by enhancing the libraries’ partnerships with private organizations and individuals, and by raising revenue from new user fees and concessions.

IBO estimates that city spending on New York City’s libraries in 2001 will total $185.5 million. This is $45.2 million (19.6 percent) less than projected spending for 2000. The reductions are applied fairly equally in percentage terms across the three library systems: the New York Public Library, Brooklyn Public Library, and Queens Borough Public Library (see Figure 3-15).

Queens and Brooklyn each have their own independent library systems, which are budgeted individually. The NYPL research libraries (the Humanities and Social Sciences Library, Schomburg Center for Research in Black Culture, New York Public Library for the Performing Arts, and the Science, Industry, and Business Library) are also budgeted separately. The remainder of the New York Public Library system includes several specialized branches, as well as all of the Bronx, Manhattan, and Staten Island neighborhood branches.

The libraries differ from other city agencies in that they are not-for-profit organizations chartered by the New York State Board of Regents. Only the city’s portion of library funding appears in the city budget. City money has accounted for approximately 65 to 70 percent of the branch libraries’ budgets in recent years. The libraries also receive state and federal aid and derive revenues from user fees and fines that do not pass through the city’s budget.

Like last year’s preliminary budget, the proposed 2001 budget calls for the creation of a “Private Partnership Incentive Program” to offset some of the

<table>
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<tr>
<th>Figure 3-15. Proposed Changes in City Subsidies to Libraries</th>
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<table>
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<th>2000</th>
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<td>Brooklyn Public Library</td>
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<tr>
<td>Queens Borough Public Library</td>
<td>62,003</td>
<td>49,870</td>
<td>-19.6%</td>
</tr>
</tbody>
</table>

SOURCE: IBO.
cuts. Although this program has been proposed in the past, it has never been implemented because reductions proposed in the preliminary budget have been restored by the City Council. The preliminary budget provides no details about this program or how it would operate. Currently, the branch libraries receive very little revenue from private donors. For example, the Queens Borough Public Library recorded $2.1 million, roughly 2.6 percent of their total budget, in private contributions from individuals, corporations, and foundations in 1999.

Also suggested in the preliminary budget is a program to raise revenues from branch libraries by increasing user fees. This proposal calls upon each of the three systems to raise $500,000 from “revenue initiatives, such as fees for video and CD rentals and concessions.” Although the preliminary budget proposes using these new revenues to offset reductions in city library subsidies, traditionally, the city has had little involvement in how city funds are spent by the libraries. Given the relationship between the city and the library systems, the proposals are closer to a recommendation than a requirement.

Parks and Recreation

- Under the preliminary budget, the Department of Parks and Recreation’s spending for 2001 would be 4.2 percent less than projected spending for 2000.

- Savings would result from decreased funding to a range of City Council programs, as well as continuation of the department’s hiring freeze.

- Revenue from Yankee and Shea Stadiums is expected to increase as a result of last year’s successful seasons, and citywide parks concessions revenue is expected to continue to grow.

IBO estimates 2001 spending of $175.0 million for the Department of Parks and Recreation, $2.4 million less than projected spending for 2000.

Proposed reductions include the elimination of $4.1 million for a range of programs added to the budget by the City Council in recent years, including the swimming program, the tree and stump removal program, and 102 seasonal playground and maintenance positions. Last year’s preliminary budget proposed similar funding reductions which were subsequently restored by the City Council.

Last year’s preliminary budget also proposed saving the department money by redeploying ten full-time laborers to other city agencies and redeploying 200 other full-time city parks workers to other agencies for four months during the winter. Although this proposal was adopted, legal and collective bargaining issues prevented the department from implementing these changes. As a result, the Administration has proposed restoring funding for these positions ($2.1 million) to the park’s budget.

In another effort to save money by reducing the off-season workforce, this year’s preliminary budget proposes continuation of the department’s long-term hiring freeze. Under this proposal, there would be a 100 percent full-time hiring freeze beginning in fiscal year 2001. Full-time positions vacated through attrition would be replaced with six-month seasonal positions. OMB estimates that 97 full-time positions would be replaced, saving $812,000 in 2001 and twice as much in the out-years of the financial plan.

One factor protecting the Parks Department from larger funding reductions is an anticipated increase in revenue from concessions and major league stadium rentals. While concession and rental revenues flow into the general fund, the city has traditionally offset cuts which it might otherwise have made in the Parks Department budget with increased revenues. Increased attendance following recent successful Yankees and Mets baseball seasons is expected to result in $5.1 million additional revenue in 2001.

The revenue from the Parks Department, generated mainly from concessions at facilities throughout the city, is expected to reach an all-time high of $43.3 million in 2001.
Business Services

- The appropriation for the Emerging Industries Fund was lowered from $25 million for 2000 to $4.5 million in the January plan because investments have not taken place at the expected rate. The 2001 and 2002 appropriations were increased from zero to $10 million in each year.

- In contrast, the January plan maintained the adopted appropriation amount of $20 million for New York Empowerment Zone, thanks to brisk disbursals. Appropriations of $10 million per year are anticipated for 2001 and 2002.

- Capital commitments for 2000 are substantially more than in past or future years, thanks to the $225 million appropriated for a new facility for the New York Stock Exchange.

Operating Budget. More than half of the funds appropriated for the Department of Business Services (DBS) is used for loans, funds, and grants to businesses for economic development purposes. Because it has proven difficult to predict the amounts needed by businesses meriting these funds, the amounts appropriated for DBS in 2000 and 2001 have been quite volatile.

At adoption of the 2000 budget, $66 million in city funds were appropriated for DBS, $20 million for loans, grants, and investment made by the New York Empowerment Zone (NYEZ) and $25 million for equity or debt financing for small companies in select industries through the Emerging Industries Fund (EIF). The NYEZ appropriation was $10 million in the 2000 executive budget, but, since only $15,000 of the $10 million adopted for 1999 was actually used, the remaining appropriation was “rolled over” into 2000. As a result of brisk disbursals to date in 2000, the NYEZ appropriation remains $20 million this year. Another $10 million is likely to be appropriated in 2001. The city agreed to provide $100 million in investment funds to the NYEZ over a ten-year period.

In contrast, EIF investments have not taken place at the anticipated pace. Hence, the preliminary budget has reduced the 2000 appropriation by $20 million to $4.5 million. The EIF appropriations for both 2001 and 2002 were increased from zero to $10 million.

Capital Budget. The DBS capital commitments for 2000 total $578.8 million, including $551 million for economic development. The balance is primarily for reconstruction of the Tweed Courthouse in lower Manhattan. The largest single economic development commitment is $225 million for construction of a new facility for the New York Stock Exchange. This project remains in negotiation, however, and its status is uncertain. The 2000 plan also provides $34 million for reconstruction of the Staten Island Ferry’s Whitehall Terminal.

A new minor league stadium on Staten Island is also under construction, and some of its funding—$28 million—is coming from the 2000 DBS capital budget. The total cost of the stadium comes to $71 million. That total also includes $21 million from the EDC operating budget for land acquisition, site remediation, and waterfront repair, and $12 million to be spent by the Department of Transportation on infrastructure related to the stadium.

The single largest economic development expenditure for 2001, for which commitments total $152 million, is $30 million for the Sportsplex complex in Coney Island, Brooklyn. Two other major economic development projects are also anticipated in that borough in 2001: $15 million for construction at the Brooklyn Army Terminal and $15 million for a minor league baseball stadium in Brooklyn. The total bill for that stadium is expected to be $20 million, with $5 million committed for 2000. Major expenditures anticipated for the years beyond 2001 include $15 million for redevelopment of Governors Island in 2002 and $79 million to be spent on waterfront commercial construction between 2002 and 2009.
Other Spending Issues

This section highlights a few other spending issues that affect the city budget: pensions, labor costs, tort reform, and stadium financing. Our analysis indicates that the preliminary budget has underestimated likely labor costs and costs associated with claims against the city. Also, it is important to note that even though the preliminary budget has appropriated $694 million for construction of stadiums, sports facilities, and other infrastructure improvements, the city does not have a plan as to how these funds will be spent.

Pensions

- The total contribution to the city’s five major pension plans reflected in the January financial plan was $702 million in 2000, significantly less than the $1.2 billion included in November.

- In 2001, the financial plan’s proposed contribution is $889 million, $295 million below the November amount. The city’s proposed contributions are a total of $831 million less in 2000 and 2001 as a result of a number of changes in assumptions and methods that were recommended by the city’s Chief Actuary.

The city’s contributions to its public employee pension plans are intended to ensure that the plans will be able to meet their contractual obligations to the city employees and retirees who are the plans’ members. The contributions are calculated to gradually pay down any unfunded liability—the difference between each plan’s assets and its expected liabilities.

One of the roles of the Actuary is to periodically review the assumptions governing the assessment of the plans’ ability to meet their obligations. Up-to-date information allows the Actuary to produce more realistic estimates of the retirement system’s needs. In October 1999, Watson Wyatt and Company, hired by the City Comptroller to perform a periodic review, reported the results of an experience study of the city’s retirement systems. Watson Wyatt provided updated estimates of demographic information such as the longevity of pensioners and expected age of retirement, and economic assumptions such as inflation rates, investment returns, and growth rates of employee salaries. Based on the Watson Wyatt findings, the Actuary proposed a comprehensive package of changes that would ultimately lead to steep reductions in the 2000 and 2001 contributions.

On the basis of their very substantial impact on the city’s contributions, two of the Actuary’s proposed changes stand out. One is to reduce the expected rate of return or the actuarial interest rate (AIR) on most city pension assets from 8.75 percent to 8.0 percent; if done on its own this would increase the contribution by $866 million in 2000. If the assets are expected to increase in value more slowly, the city’s contributions will have a bigger gap to fill.

Another major change the Actuary proposes is a market value re-start, or the recognition—in order to determine the contribution—of the pension assets at their market value rather than at their current actuarial value. The contribution is typically based on an actuarial asset valuation method in which investment returns above or below the expected level are gradually acknowledged over a five-year span. This method is designed to smooth the city’s contributions, even when investment returns are volatile. This phasing-in, however, combined with four years of greater-than-expected asset growth, has resulted in an actuarial value $17 billion less than market value at the end of 1999. Resetting actuarial value to market value would reduce the 2000 contribution by $1.2 billion.

The city is required to pay the amount that the Actuary announces is necessary, but the Actuary’s calculations must be based on assumptions approved by each plan’s board of trustees. Some of the changes he is proposing require enactment by the state legislature as well. Without those changes in assumptions, the Actuary will be forced to determine contributions for 2000 roughly equal to the amounts proposed in the November financial plan.

Concerns of the City Comptroller. The City Comptroller has expressed concerns about some of the Actuary’s proposed changes, particularly the market value re-start. The Comptroller believes that
the city would be better prepared for the arrival of difficult economic times if larger contributions are made now, in times of surplus. The Comptroller’s Comments on the Preliminary Budget argued that domestic equities are probably overvalued and the plan assets are vulnerable to a decline in value. If the market value of the portfolio, $92 billion at the end of 1999, were to decline to the actuarial value, $75 billion, the November plan contributions would be more appropriate. Furthermore, smaller contributions in 2000 and 2001 would push up pension contributions in future years, since they make the asset level less than originally planned.

The Comptroller recommended accepting some but not all of the Actuary’s proposals. The Comptroller’s recommended package of changes would increase the contributions relative to the November amounts, to $1.5 billion and $1.3 billion in 2000 and 2001. For the two years, these contributions would total $2.8 billion, $375 million more than the November plan amounts, and $1.2 billion more than the January financial plan recommendations.

**Arguments for and against the re-start.** There are several arguments in favor of the re-start. First, the re-start would free up considerable budgetary resources for immediate use. Also, the re-start would likely lead to a more level stream of city contributions that are a fairly constant percent of payroll. This helps promote sound budgeting. Without the re-start contributions would be expected to decline from $1.2 billion to $703 million from 2000 to 2004 as the actuarial valuation gradually recognizes the impressive market value growth of the last four years. Finally, although the re-start alone could be deemed imprudent for its long-term implications, it is being proposed in combination with other conservative changes in the plan assumptions. In the long run, the proposed package will require higher contributions than the assumptions currently used.

There also are arguments against the re-start. First, foregoing the re-start would require higher contributions in the near term, resulting in greater pension assets and reduced future contributions. Second, the city will enjoy a surplus this year so that the significant near-term benefits of a re-start are not as necessary now as they might be at a future date. Finally, a dramatic plunge in the stock market could cause the financial plan’s contribution to appear too small in retrospect. In that case, the re-start would not produce the level contributions expected to be one of its advantages. If a sharp drop in pension assets followed a market value re-start, the required contribution would increase steadily over the next four years, as the actuarial value gradually decreased to the new low market value. Under this scenario, foregoing the re-start could lead to a steadier level of asset valuations and city contribution amounts.

**Labor**

- IBO projects that overtime spending will continue to increase and will reach an all-time high of $550 million in 2001. The increase in overtime spending is primarily due to additional spending on uniformed services.

- The city’s financial plan only incorporates labor costs associated with a two-year agreement with the unions. If the agreement were to cover all four years and provide increases equal to the rate of inflation, city-funded costs would increase by $672 million in 2004.

- Unlike past years when the same percentage base salary increase was provided to all employees of a specific union, the city has proposed to implement a merit pay plan, in which employees would receive salary increases based on performance evaluations.

**Workforce.** The preliminary budget plans for the workforce to total 251,893 on June 30, 2001, which would be its fourth highest level since 1975. It would be the third highest if the workforce does not grow by 3,705 employees, from 249,689 in December 1999, the latest available data, to 253,394 on June 30, 2000 as planned. These figures do not account for the city’s current use of Work Experience Program participants or a likely increase over time in the services that are provided through contracts with private and not-for-profit firms.
Figure 3-16 shows that since the 1970s fiscal crisis the workforce generally has contracted and expanded twice. As the city cut expenditures to recover from the fiscal crisis, the workforce declined to its low of 193,277 in 1977. It then increased during the economic expansion of the 1980s to its high of 253,112 in 1991. During the first half of the 1990s, the workforce declined slightly in the recession and then more significantly when Mayor Giuliani and the unions agreed to severance incentives and workforce redeployment programs that reduced the workforce to 235,069 in 1996. Between 1996 and 2001 the planned net growth in the city’s work force will total 7.2 percent and is attributable to increases in the number of teachers in the Board of Education and the hiring of additional police.

The Administration’s projected workforce decline of 1,501 positions from 2000 to 2001 is due mainly to decreases in the Department of Social Services (278); Department of Sanitation (127 civilians and 127 uniformed personnel); Manhattan District Attorney (207); Department of Health (181); Police Department (180 civilians); Department of Transportation (134); and the Department of Parks and Recreation (97). These declines are partially offset by an increase of 390 teachers in the Board of Education.

Overtime. Overtime costs are affected by many factors including collective bargaining agreements, management initiatives, planned events, and emergencies. Overtime spending is projected to total $539 million in 2000. This spending would be $104 million or 24 percent greater than the funding included in the adopted budget and it also would exceed the overtime high of $532 million reached in 1999.

Over 65 percent of the increased overtime costs in 2000 are due to additional spending in the uniformed agencies. This increase is due mainly to the city’s increased anti-drug initiatives; the Year 2000 celebrations; unplanned events and emergencies; and increases resulting from waste export programs and weekly recycling in the Department of Sanitation. IBO projects that this trend in increased overtime costs will continue, with overtime reaching $550 million in 2001, and $567 million by 2004.

Collective bargaining agreements. The city’s unions have labor contracts that are due to expire in 2000 and 2001. In anticipation of the negotiation of new contracts, the city has provided funds in the labor reserve based on a two-year labor settlement. The city has based its cost estimates of the labor agreements on the projected rate of inflation and has provided $325 million in 2001, $750 million in 2002, and $800 million in 2003 when the cost of the two-year labor settlements are fully annualized. Unlike past contracts that provided the same percentage base salary increase to all employees of a specific union, the city has proposed a merit pay plan. Under the merit pay plan, employees would receive salary increases based on performance evaluations. The best workers would be rewarded with the largest wage increases.

![Figure 3-16. New York City Headcount, 1975-2001](source.png)
increases and those workers who do an adequate job would receive a moderate wage increase. Those workers whose performance is inadequate would not receive a wage increase but would be given the opportunity to improve their performance.

Although the financial plan includes these funds in the labor reserve, in order to present a more realistic picture of agency spending, we allocate them to agencies on the assumption that merit is distributed proportionately across the agencies.

The city has projected its costs associated with the new labor contracts based on a two-year agreement with the unions. Since the city’s financial plan covers the period through 2004, IBO has projected the impact of a wage settlement that covers the full plan period (four years). A collective bargaining settlement based on the projected rate of inflation and beginning after the proposed two year agreement ends would increase city funded costs an additional $327 million in 2003 and $672 million in 2004.

**Productivity.** The financial plan also includes savings attributable to what is termed “labor productivity.” These savings (or reduction to the labor reserve) would total $250 million in 2001, $265 million in 2002, $280 million in 2003, and $300 million in 2004. The city has not provided any details regarding these savings other than to suggest they could come from employee contributions to health insurance or savings in fringe benefit costs. While this type of action would reduce the city’s spending, it does not increase the output per worker. It would not reorganize work processes or use technology, for example, to increase the output or quality of services or reduce their cost. IBO has included these proposed savings in the financial plan. Given the lack of specificity and the need for collective bargaining, however, these productivity savings may not materialize. If these savings do not occur, city spending will be greater than presented.

**Tort Reform**

The Administration projects that $478 million in judgments and claims expenses will be paid in 2000. Moreover, costs are expected to grow to $507 million by 2004. The majority of the claims against the city are the result of personal injury cases. In 2000, for instance, $458 million or 96 percent of the estimated settlements against the city are projected to result from personal injury cases.

In order to control the rapidly rising costs of personal injury claims, the Administration has proposed that the state government enact certain tort reform measures. The proposals would limit awards for pain and suffering and other non-economic losses to $250,000, and would require plaintiffs to prove they incurred medical expenses of at least $5,000 in order to recover damages for non-economic losses. The city is also urging the passage of legislation that would provide the Court of Claims exclusive jurisdiction over personal injury and wrongful death lawsuits against state-created entities such as the Board of Education and the New York City Health and Hospitals Corporation. The Administration anticipates that this shift of personal injury cases from a jury system to the Court of Claims, where cases are tried by a judge sitting without a jury, would save the city money. The preliminary budget includes savings of $35 million from this menu of tort reform initiatives. Because these proposals have been submitted to the state Legislature in the past without success, IBO assumes that the city will not achieve its proposed tort reform savings.

**Stadium Financing**

- The preliminary budget proposes spending $573 million for the construction of major league sports stadiums. There is a great deal of uncertainty, however, regarding exactly how this money would be used.

- The Administration has also proposed spending money for minor league stadiums in Brooklyn and Staten Island, and a sports complex in Coney Island.

The Administration has proposed spending $694 million for construction of stadiums, sports facilities and related infrastructure improvements. Most of these funds, $573 million, are in the miscellaneous budget portion of the operating budget.
to fund major league stadiums on a pay-as-you-go basis. The balance of the funds, $121 million, are provided in the city’s capital budget and the expense budget of the Economic Development Corporation to fund minor league stadiums, related infrastructure work, and a sports complex.

The $573 million for the construction of major league stadiums is $303 million lower than the 2000 adopted budget and financial plan, which provided a total of $876 million for the construction of sports facilities. Projects being discussed include a new major league baseball stadium and sports complex in Manhattan, a new Queens stadium for the Mets, and a new or rehabilitated Yankee stadium in the Bronx. The Manhattan stadium is also envisioned for use as an Olympic stadium should New York City be selected as the site of the 2012 Olympics.

Despite the size of the city’s appropriations for major league stadium construction, a great deal of uncertainty surrounds such basic issues as what projects will be funded, how much they will cost and what share of total costs will be borne by the taxpayers. Since no funds have been spent yet, it is unlikely that the $90 million that has been allocated in the 2000 budget for stadium facilities will actually be spent in 2000. We transfer these expenditures to 2001.

In addition to the major league stadiums, the Administration has proposed spending $20 million for a minor league baseball stadium to be located on the site of the former Steeplechase Park in Brooklyn; $30 million for an amateur sports complex to be located in the Coney Island section of Brooklyn; and $71 million for a Staten Island minor league baseball stadium and the related infrastructure work.

**Notes**

1 Agency expenditures have been adjusted to reflect the allocation of the labor reserve, including the two-years of merit pay that the financial plan locates centrally, as well as expected increases in labor costs.

2 In the Medicaid program, New York City pays 25 percent of non-long-term care expenses and 10 percent of long-term care expenses.

3 Although BOE is receiving $58 million in RESCUE funds this year, only $46 million has been recognized to date in the city’s capital commitment plan.

4 IBO’s spending projections exclude intracity sales and $35 million for the senior colleges that each year are placed in the budget but by design are not spent; the $35 million merely function as accounting placeholders for impending state funds.

5 This includes PS and OTPS budgets for the Office of Housing Maintenance and Sales (units of appropriation 006 and 010), exclusive of the Division of Alternative Management Programs and spending on NYCHA programs.

6 These figures have been adjusted to account for the state’s takeover of CUNY senior colleges and the court system.
Chapter 4

Capital Program and Financing Plan

Overview

- The Mayor’s preliminary budget provides for $24.2 billion in capital commitments for 2000 through 2003, a 44.5 percent increase compared to 1996-1999.

- Environmental protection is the largest and fastest growing area of the city’s capital budget, consuming 25.9 percent of planned capital commitments. Education and hospitals is the next largest category (23.6 percent), followed by transportation (17.5 percent), and housing and economic development (9.1 percent).

- The proposed capital program would be financed with $18.7 billion in long-term debt and lease obligations (including $2.4 billion in tobacco bonds), $1.8 billion in federal and state aid, and $0.5 billion in pay-as-you-go capital spending.

- To support all years of the plan, the city needs additional financing capacity, such as a constitutional debt limit or an increase in the Transitional Finance Authority (TFA) authorization.

This chapter provides a brief overview of the proposed capital investment and financing program for 2000-2003. The capital program funds the physical improvement and new construction of schools, roads, the water and sewer system and other public facilities and infrastructure. Most of the city’s capital investment is financed with long-term debt. The city faces a problem, however, in financing the proposed capital program due to the constitutional limit on the amount of debt the city can issue.

The first section of this chapter provides a brief overview of the capital program. The second outlines how the program will be financed. In the last section of this chapter, we discuss altering how the debt limit is calculated and estimate how much the current limit will reduce available capital funds. The IBO will separately release a more detailed analysis of the capital program later this spring.

The Capital Program

The Mayor’s preliminary budget provides for $24.2 billion in capital commitments for 2000 through 2003, including $21.9 billion funded by city sources (Figure 4-1). This is a 44.5 percent increase compared to the $16.7 billion in commitments made in the preceding four year period, 1996-1999. City funds account for 91.7 percent of planned capital commitments, almost exactly the same share as in 1996-1999.
In the city’s capital budget parlance, a commitment is a comptroller-registered contract between a city agency and a contractor or vendor that obligates funds for the completion of a capital project. The capital commitment plan includes two levels of commitments: authorized commitments and planned commitments (or targets). Since some projects will invariably experience delays that prevent them from being implemented by year’s end, the city authorizes more commitments than the target amount. Planned commitments reflect the intended level of investment; therefore, they are useful in providing an historical perspective as well as a sense of the magnitude of investment. The commitment plan, however, does not show planned commitments at the agency or functional level, so IBO has estimated them based on the total amounts of authorized and planned commitments and individual agency targets.

Environmental protection consumes the largest share of the capital budget plan for 2000-2003—25.9 percent, or $6.3 billion—and also shows the largest increase from the previous four years, 70.2 percent. The majority of this spending is for water pollution control projects ($3.3 billion), and the water and sewer capital program ($2.6 billion).

Education is also a significant share of the capital budget, although it is slated to grow more slowly than most other categories. Most of this category is for the School Construction Authority and other Board of Education capital spending ($5.5 billion). A small amount is for CUNY ($58 million), with the balance of $172 million for public hospitals in the Health and Hospitals Corporation (HHC) system.

Spending for transportation absorbs 17.5 percent of total planned commitments, or $4.2 billion. Construction and rehabilitation of the city’s roads and bridges account for $3.5 billion, while the city’s subsidy to the MTA capital program is projected at $779 million. These figures do not include another $620 million in capital commitments for other Department of Transportation spending on franchise bus and ferry services, streetlight equipment and maintenance, and the like, which is categorized as city operations and facilities. The sum of these allocations equals almost $5.0 billion, or 20.5 percent of planned capital commitments.

The 2000-2003 capital budget for housing is $1.6 billion, 58 percent greater than the 1996-1999 period. Almost one-third of the funds will be devoted to maintenance, renovation, and disposition of the city-owned “in-rem” housing stock. Economic development projects will total another $600 million, including possible funding for a new home for the New York Stock Exchange and development of minor league baseball stadiums.

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**Figure 4-1.**

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<td>9.1%</td>
<td>787</td>
<td>56.0%</td>
</tr>
<tr>
<td>City Operations &amp; Facilities</td>
<td>3,700</td>
<td>22.1%</td>
<td>5,746</td>
<td>23.7%</td>
<td>2,046</td>
<td>55.3%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$16,745</td>
<td>22.1%</td>
<td>$24,199</td>
<td>23.7%</td>
<td>$7,454</td>
<td>44.5%</td>
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</tbody>
</table>

**SOURCES:** IBO: Fiscal Year 2000-2003 Capital Commitment Plan.
**NOTE:** The 2000-2003 totals are adjusted to reflect agency commitment targets.
The remainder of the capital budget falls under the category of city operations and facilities, and includes such important functions as police, fire, courts, parks, libraries, and jails.

Financing the Capital Plan

The city’s capital investment is financed by various sources. The vast majority of the 2000-2003 plan is financed by debt (88.3 percent) with the balance supported by federal and state aid (8.8 percent), pay-as-you-go funds from the operating budget (2.2 percent) and changes in restricted cash balances of the capital projects fund such as interest earnings (0.8 percent).

While projects are tracked in terms of commitments, these represent the contracts entered into and not actual expenditures. Capital expenditures (which are what drive the amounts to be financed) in any given year will not equal the planned commitments. Most capital projects take many months or years to complete. A contract represents a commitment to complete a project, but the contractor will be paid in installments during the project execution as specified in the contract until the project is complete. In any given year, therefore, expenditures include payments on commitments made in previous years and partial payments for commitments made in the current year. It is the flow of expenditures that must be financed through long-term borrowing and other means.

Five kinds of long term debt will be issued to finance the capital plan (see Figure 4-2):

- General Obligation (GO) debt is the primary form of city debt. It is backed by the broad taxing powers of the city government and subject to a New York State constitutional debt limit. The city plans to issue $7.3 billion in GO debt during 2000-2003 to finance the capital plan.

- Transitional Finance Authority (TFA) debt was first issued in 1998 as the city’s existing outstanding debt approached the constitutional limit. Unlike debt service for GO and MAC, TFA debt service is not paid from the city’s general fund. However, its bonds are backed by a dedicated portion of the city’s personal income tax revenues, which are administered by the state and made available to TFA for debt service before the remainder is

| Figure 4-2. SOURCES of Financing for 2000-2003 Capital Commitment Plan | Dollars in millions |
|---|---|---|---|---|---|
| Debt and Capital Leases: | | | | | |
| General Obligation | $820 | $830 | $2,620 | $3,010 | $7,280 |
| Transitional Finance Authority | 1,800 | 1,525 | 0 | 0 | 3,325 |
| Water Authority | 821 | 1,032 | 1,327 | 1,324 | 4,504 |
| DASNY Capital Leases | 125 | 272 | 284 | 309 | 990 |
| TSASC | 600 | 600 | 600 | 600 | 2,400 |
| Subtotal, Debt | 4,166 | 4,259 | 4,831 | 5,243 | 18,499 |
| Changes in Restricted Cash | 101 | 22 | 18 | 18 | 159 |
| Subtotal, “City Funds” | 4,267 | 4,281 | 4,849 | 5,261 | 18,658 |
| Federal & State Aid | 312 | 446 | 554 | 528 | 1,840 |
| Pay-As-You-Go | 216 | 85 | 75 | 80 | 456 |
| Total, All Sources | $4,795 | $4,812 | $5,478 | $5,869 | $20,954 |

SOURCES: IBO; Mayor’s Preliminary Budget for FY 2001.

NOTE: Although the city’s Financial Plan description of five-year capital plan funding sources indicates $216 million in pay-as-you-go funds for 2000, IBO has identified $246 million in Board of Education pay-as-you-go funded projects in the capital commitment plan.
paid to the city. TFA-issued debt will total $3.3 billion during the plan period.

• Water and Sewer System Revenue bonds are issued by the Municipal Water Finance Authority to finance construction and improvements to the city’s water and sewer system. These bonds, $4.5 billion over the four years, are repaid from water and sewer charges to system users.

• Lease-purchase obligations cover the cost of bonds issued by the Dormitory Authority of the State of New York (DASNY) to finance capital improvements to courts, community colleges, hospitals, and family care centers. The facilities are leased by these authorities to the city. The city’s lease payment obligations also come under the debt limit, and will total $990 million between 2000 and 2003.

• Tobacco Settlement Asset Securitization Corporation (TSASC) debt has no claim on city tax revenues and is not subject to the constitutional debt limit. This new debt (issued in the form of Tobacco Flexible Amortization Bonds or TFABs) is serviced by payments received from tobacco companies under the terms of a national legal settlement. This provides the city added capacity to fund its capital program in the coming three fiscal years, a period in which GO borrowing is constrained by the constitutional debt cap. TSASC debt will total $2.4 billion over the four-year period.

Long-term debt obligations for financing the capital program would total $18.5 billion. An additional funding source derives from changes in restricted cash balances in the city’s capital projects fund, including investment earnings and reimbursements. Taken together, $18.7 billion represents what is categorized as the city-funded portion of the plan.

The non-city funded category includes $456 million of capital spending from the Board of Education expense budget on a pay-as-you-go basis (see page 44). Federal and state categorical aid, largely for housing, community development, and transportation will total $1.8 billion. These two sources account for $2.3 billion in what is categorized as non-city sources, for a total financing program of $21.0 billion.

The Debt Limit

A significant constraint on the city’s capital program is its capacity to incur debt. Given the city’s enormous capital needs, in recent years the rapid increases in debt service have received less attention than the institutional limits on the city’s ability to borrow. The city has created structures to provide additional borrowing capacity, even while it bumps up against its debt cap. Still, without additional actions the proposed capital plan cannot be implemented because the city will lose its capacity to enter into new capital commitments during fiscal year 2002.

IBO estimates that were it not for the anticipated $2.4 billion of TSASC bond proceeds, planned capital commitments would overrun the debt limit by almost $1.3 billion in 2002 and $1.1 billion in 2003. As it is, planned commitments are projected to exceed the debt limit by around $75 million in 2002, $500 million in 2003 and almost $1 billion in 2004. Figure 4-3 shows the debt limit (as calculated by IBO) for 2001-2004 and the debt subject to the limit. Thus, the city needs some change—such as to the constitutional debt limit or to the TFA debt authorization—in order to fulfill the 2000-2003 capital plan.

The constitutional debt limit is set at 10 percent of the market value of the city’s taxable real estate averaged over five years. A strong run-up in market values during the 1980s, magnified by the state’s “full value” forecasting formula, doubled the debt limit between 1989 and 1994. The recession of the early 1990s then led (again with a lag) to a precipitous fall—from $55 billion in 1994 to just over $30 billion in 1998. This prompted the creation of TFA, which first issued debt in 1998.
The city’s ability to borrow would expand further if the state legislature increased the TFA authorization. Although TFA’s agreement with its bondholders permits the authority to issue up to $12.0 billion of debt, the state authorized TFA to issue only $7.5 billion. The state legislation that created TFA could be amended to add $4.5 billion to the city’s effective debt limit.

The plunge in the debt limit has also led to calls for amending the state constitution with a newly defined debt limit that better reflects the city’s ability to raise revenues from its broad array of taxes. The city intends to pursue a constitutional amendment this year. Few specifics are available about the amendment the city will propose, but it is evident that the city hopes the change will raise the borrowing limit as well as reduce its sensitivity—or oversensitivity—to economic fluctuations.

Over the long run, market values, personal income, gross product, and other interrelated measures of the scale of economic activity in a tax jurisdiction tend to grow at roughly the same rate. Over shorter periods, however—and particularly over the course of a business cycle—there are significant variances between these series. Thus with property taxes comprising only 36 percent of the city’s total tax revenue (relatively low for a local government budget), it is not surprising that year to year changes in market values—the property tax base—are not a precise indicator of the city’s changing ability to support debt: market values tend to rise somewhat more sharply than overall city tax collections during economic booms and to fall more steeply than overall collections when the economy slumps. And as noted above, the methods used until recently by the state to project “full values” have vastly exaggerated these cyclical swings.

However, if the city’s current debt limit is too volatile, it does not automatically follow that the current limit is also too low. When it is argued that the city’s borrowing capacity should be significantly expanded, this essentially asserts either of two things: that debt service can absorb a greater share of current operating revenues—that is, that funding for other services can be reduced—without excessively burdening city households and businesses, or that taxes can be raised to accommodate higher levels of debt service without excessively burdening city households and businesses.

Either or both of these propositions may be true up to a point. But it does not appear that anyone has a very firm idea of where that point is. It depends, in part, on the efficacy of the capital program funded by additional borrowing. Another factor is the level of the city’s tax effort relative to other cities and regions: if the ratio of debt to total tax revenue is relatively low because the ratio of total taxes to local earnings is exceptionally high, the low debt to tax ratio is not necessarily a sign that borrowing can be prudently expanded. These are all areas that require further research.
Standard & Poor’s recently published four benchmarks categorizing levels of debt of municipal bond issuers as low, moderate, or high. Figure 4-4 shows debt ratios in New York and the cutoff level for “high” according to the S&P benchmark. In each case but one the city’s debt ratio is well above the S&P definition of high. Debt service as a percent of operating expenditures (including debt service) is just slightly above the cutoff, but this is because New York’s overall operating spending is high relative to population, income, and other measures of city capacity, not because indebtedness is low.

Debt levels are among the factors that rating agencies use in determining credit ratings. As S&P noted in 1998 when it upgraded New York City’s rating to A-, “a higher rating is precluded by extraordinarily high debt levels, significant ongoing capital needs, and the city’s persistent inability to translate robust surpluses into more lasting budget relief.”

Note

1 Payments covering the principal and interest on the bonds as well as capital lease costs are made out of the debt service funds, and their main source of revenue is operating transfers from the general fund; other debt service funds revenues include state categorical aid, investment income, and city income tax payments. See page 53 in Chapter 3.
<table>
<thead>
<tr>
<th>Revenues:</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>Average Change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Taxes:</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property</td>
<td>$7,787</td>
<td>$8,033</td>
<td>$8,633</td>
<td>$9,130</td>
<td>$9,531</td>
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</tr>
<tr>
<td>Personal Income (excluding TFA)</td>
<td>4,875</td>
<td>4,766</td>
<td>4,737</td>
<td>5,019</td>
<td>5,327</td>
<td>2.2%</td>
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<tr>
<td>General Sales</td>
<td>3,415</td>
<td>3,404</td>
<td>3,506</td>
<td>3,633</td>
<td>3,776</td>
<td>2.5%</td>
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<tr>
<td>Business Income</td>
<td>2,717</td>
<td>2,665</td>
<td>2,752</td>
<td>2,836</td>
<td>2,918</td>
<td>1.8%</td>
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<tr>
<td>Real-Estate Related</td>
<td>1,154</td>
<td>1,177</td>
<td>1,215</td>
<td>1,274</td>
<td>1,375</td>
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<tr>
<td>Other Taxes (with Audits)</td>
<td>1,485</td>
<td>1,422</td>
<td>1,420</td>
<td>1,432</td>
<td>1,447</td>
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<tr>
<td><strong>Total Taxes</strong></td>
<td>21,433</td>
<td>21,467</td>
<td>22,263</td>
<td>23,324</td>
<td>24,374</td>
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<td><strong>Tax Reduction Program</strong></td>
<td>-</td>
<td>(476)</td>
<td>(1,077)</td>
<td>(1,734)</td>
<td>(2,043)</td>
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<td><strong>STaR Reimbursement</strong></td>
<td>260</td>
<td>472</td>
<td>687</td>
<td>709</td>
<td>737</td>
<td>29.8%</td>
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<tr>
<td><strong>Miscellaneous Revenues</strong></td>
<td>2,942</td>
<td>3,066</td>
<td>2,603</td>
<td>2,558</td>
<td>2,529</td>
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</tr>
<tr>
<td>(net of intra-city revenues)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>All Other Revenues:</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrestricted Intergovernmental Aid</td>
<td>616</td>
<td>564</td>
<td>564</td>
<td>564</td>
<td>564</td>
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</tr>
<tr>
<td>Anticipated State/Federal Revenues</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<td>Other Categorical Grants</td>
<td>421</td>
<td>330</td>
<td>318</td>
<td>314</td>
<td>314</td>
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</tr>
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<td>Inter-Fund Revenues</td>
<td>284</td>
<td>285</td>
<td>283</td>
<td>283</td>
<td>283</td>
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<td>Disallowances</td>
<td>(15)</td>
<td>(15)</td>
<td>(15)</td>
<td>(15)</td>
<td>(15)</td>
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<tr>
<td><strong>Total Other Revenues</strong></td>
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<td>1,164</td>
<td>1,150</td>
<td>1,146</td>
<td>1,146</td>
<td>-3.2%</td>
</tr>
<tr>
<td><strong>Total City Funds</strong></td>
<td>25,941</td>
<td>25,693</td>
<td>25,626</td>
<td>26,003</td>
<td>26,743</td>
<td>0.8%</td>
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<tr>
<td><strong>Dedicated Personal Income Tax (TFA)</strong></td>
<td>270</td>
<td>472</td>
<td>538</td>
<td>565</td>
<td>572</td>
<td>20.6%</td>
</tr>
<tr>
<td><strong>Categorical Grants:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State</td>
<td>7,231</td>
<td>7,421</td>
<td>7,690</td>
<td>7,956</td>
<td>8,109</td>
<td>2.9%</td>
</tr>
<tr>
<td>Federal</td>
<td>4,642</td>
<td>4,416</td>
<td>4,392</td>
<td>4,360</td>
<td>4,304</td>
<td>-1.9%</td>
</tr>
<tr>
<td><strong>Total Revenues</strong></td>
<td>38,084</td>
<td>38,002</td>
<td>38,246</td>
<td>38,884</td>
<td>39,728</td>
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</table>

<table>
<thead>
<tr>
<th>Expenditures:</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>Average Change</th>
</tr>
</thead>
<tbody>
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<td><strong>City Funded (net of intra-city sales)</strong></td>
<td>25,941</td>
<td>25,373</td>
<td>27,756</td>
<td>29,203</td>
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<td><strong>TFA Debt Service</strong></td>
<td>270</td>
<td>472</td>
<td>538</td>
<td>565</td>
<td>572</td>
<td>20.6%</td>
</tr>
<tr>
<td><strong>Categorical Grants:</strong></td>
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</tr>
<tr>
<td>State</td>
<td>7,231</td>
<td>7,421</td>
<td>7,690</td>
<td>7,956</td>
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<td>2.9%</td>
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<tr>
<td>Federal</td>
<td>4,642</td>
<td>4,416</td>
<td>4,392</td>
<td>4,360</td>
<td>4,304</td>
<td>-1.9%</td>
</tr>
<tr>
<td><strong>Total Expenditures</strong></td>
<td>38,084</td>
<td>37,682</td>
<td>40,376</td>
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<table>
<thead>
<tr>
<th>Surplus / (Gap)</th>
<th>$0</th>
<th>$320</th>
<th>$(2,130)</th>
<th>$(3,200)</th>
<th>$(3,433)</th>
<th>N/A</th>
</tr>
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</table>

SOURCE: IBO.
### Economic Forecast: IBO and OMB

#### National Economy

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
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<td><strong>GDP Growth</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
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<td>2.8</td>
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<td>2.7</td>
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<td>3.6</td>
<td>3.1</td>
<td>2.8</td>
<td>3.0</td>
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<tr>
<td><strong>Non-farm Employment Growth</strong></td>
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</tr>
<tr>
<td>IBO</td>
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<td>1.4</td>
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<tr>
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<td>2.4</td>
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<td>2.5</td>
<td>2.7</td>
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<td><strong>Personal Income Growth</strong></td>
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<td>5.8</td>
<td>5.6</td>
<td>5.7</td>
<td>5.5</td>
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<tr>
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<td>5.6</td>
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<td>4.5</td>
<td>4.9</td>
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<tr>
<td><strong>Unemployment Rate</strong></td>
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</tr>
<tr>
<td>IBO</td>
<td>4.2</td>
<td>4.2</td>
<td>4.7</td>
<td>4.9</td>
<td>5.1</td>
</tr>
<tr>
<td>OMB</td>
<td>4.2</td>
<td>4.0</td>
<td>4.2</td>
<td>4.5</td>
<td>4.5</td>
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<td><strong>30-Year Treasury Bond Rate</strong></td>
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<tr>
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<td>6.4</td>
<td>6.5</td>
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<td>6.2</td>
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<td>6.3</td>
<td>6.3</td>
<td>6.1</td>
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<td><strong>Federal Funds Rate</strong></td>
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<tr>
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<td>5.9</td>
<td>6.0</td>
<td>6.0</td>
<td>5.5</td>
</tr>
<tr>
<td>OMB</td>
<td>5.0</td>
<td>5.8</td>
<td>6.0</td>
<td>6.0</td>
<td>5.7</td>
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#### NYC Economy

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<thead>
<tr>
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<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
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<tbody>
<tr>
<td><strong>Gross City Product Growth</strong></td>
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<tr>
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<td>5.0</td>
<td>4.2</td>
<td>5.4</td>
<td>5.5</td>
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<tr>
<td>OMB</td>
<td>5.8</td>
<td>4.1</td>
<td>2.2</td>
<td>3.1</td>
<td>3.4</td>
</tr>
<tr>
<td><strong>Non-farm New Jobs (thousands)</strong></td>
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<tr>
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<td>85.1</td>
<td>62.3</td>
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<td>28.6</td>
<td>24.6</td>
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<td>33.5</td>
<td>39.5</td>
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</tr>
<tr>
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<td>2.4</td>
<td>1.7</td>
<td>0.8</td>
<td>0.8</td>
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<tr>
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<td>2.3</td>
<td>1.7</td>
<td>0.9</td>
<td>0.9</td>
<td>1.1</td>
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<tr>
<td><strong>Inflation Rate (CPI-U-NY)</strong></td>
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**SOURCES:** IBO; OMB.

**NOTES:** All rates reflect year-over-year percentage changes except for unemployment, 30-year Treasury Bond, and Federal Funds. The local price index for urban consumers (CPI-U-NY) covers the New York / Northern New Jersey region.
## Major Contributors

### Revenue

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<thead>
<tr>
<th>Description</th>
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<tbody>
<tr>
<td>Business Taxes</td>
<td>Stephen Mark</td>
<td>(212) 442-8640</td>
</tr>
<tr>
<td>Econometric Modeling</td>
<td>Luan Lubuele</td>
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<td>Hotel Occupancy Tax</td>
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### Capital and Expenditure

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<td>Youth/Community Development</td>
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The mission of the Independent Budget Office is to provide non-partisan budgetary, economic, and policy analysis for the residents of New York City and their elected officials, and to increase New Yorkers’ understanding of and participation in the budget process.

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