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# Tax-and-Spend, Boom-and-Bust: Lessons for Mayor Bloomberg

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# Table of Contents

# INTRODUCTION

In the wake of the attack on the World Trade Center, New York City faces a budget gap of at least $3.6 billion. As a result, Michael Bloomberg will confront the city's most serious financial crisis in a decade.

But even if the events of September 11 had never occurred, the next mayor was destined to confront hard fiscal times. Recurring expenditures were on track to exceed recurring revenues by at least $2 billion in Mayor Rudolph Giuliani's last budget—an operating deficit he temporarily covered with prior year surpluses. Sooner or later, something was going to have to give: spending, or taxes.

The severity of the post-9/11 downturn will make it essential for the new mayor to reduce the budget over the next two years. Nonetheless, he will feel strong pressure to hold permanent spending cuts to an absolute minimum—an approach which will simply postpone the inevitable day of fiscal reckoning.

Ultimately, as fiscal and economic conditions begin to improve, Mayor Bloomberg will find that the political course of least resistance in New York is to resume a cycle of budget increases that can't be sustained without higher taxes. History shows this is a course he must resist.

When city taxes were raised by record amounts under Mayor Dinkins in the early 1990s, New York lost hundreds of thousands of jobs. On the other hand, tax cuts enacted under Mayor Giuliani were responsible for nearly one out of every four new jobs created during the last seven years.

To close the potential budget gaps, the next mayor of New York should curtail spending. Fortunately, this can be done without reducing the quality of basic services. There is ample room for reduction in the city's education, welfare, and law-enforcement bureaucracies, and on the staffs of elected officials. Justifiable reductions in capital expenditures and personnel, and feasible gains in productivity, could generate more than $3 billion in savings to help close the immediate budget gap and permanently adjust the city's bottom line for the future.

# Tax-and-Spend, Boom-and-Bust: Lessons for Mayor Bloomberg

## TAX-AND-SPEND LEADS TO BOOM-AND-BUST

"New York City government is too large; it has grown beyond our ability to afford it."[1] With that statement—the lead sentence of his first financial plan in 1994—incoming Mayor Rudolph Giuliani signaled a fundamental change in municipal fiscal policy.

For decades, New York City had operated under just the opposite philosophy. As Mayor Robert Wagner put it in his 1965 budget message: "I do not propose to permit our fiscal problems to set the limits of our commitments to meet the essential needs of the people of this city." If budget gaps appeared, they were to be solved by raising taxes and by seeking more federal and state aid.

Twice in the last 30 years, that traditional unwillingness to limit spending has put the city on a collision course with economic reality.

The first crash came with the legendary fiscal crisis of the 1970s, when the city ran hopelessly into the red and barely averted bankruptcy. Confidence in New York was badly shaken. More than 43,000 employees were dropped from the city payroll before the budget was finally balanced in 1981.

After years of retrenchment, a leaner New York City government was well positioned to significantly reduce taxes, restructure government, and become more competitive with other major cities and surrounding suburbs. But the opportunity was squandered.

City-funded operating expenditures more than doubled during the 1980s—fueled by a dramatic resurgence in the number of city employees. Some 57,000 full-time positions were added, pushing the number of employees well past the level that had helped to trigger the fiscal crisis. When David Dinkins was elected mayor in 1989, the budget was again dangerously bloated and tipping out of balance.

Dinkins followed the Wagnerian philosophy and tried to close the budget gap primarily with added taxes. He succeeded only in fueling the destruction of 300,000 private sector jobs and further eroding the city's tax base. By the time Mayor Giuliani took over in 1994, the city faced a $2.3 billion budget gap and seemed on its way to crashing again.

Ostensibly armed with a new fiscal philosophy, Giuliani moved quickly to shrink the city payroll through a program of targeted severance. During his first 18 months in office, Giuliani eliminated 14,000 full-time jobs from the payroll. This reduction made it possible to deliver a fiscal 1995 budget that reduced spending by $194 million, or about 1 percent in nominal terms. His next two budgets continued to reduce spending. But it was not to last.

Temporarily tamed in the mid-1990s, city government once again is growing beyond New York's ability to afford it. More than $2 billion in surplus funds will be needed to balance the 2002 budget. By the first year of Mayor Bloomberg's tenure, if Giuliani's own projections hold, the gap between expenditures and revenues will be wider than it has been for nearly a decade.

Why is the city's fiscal condition deteriorating again after eight years of a mayor who initially embraced such a fiscally conservative agenda? After a promising start, where and how did his policies go wrong? And what should Mayor Bloomberg learn from Giuliani's experience?

## THE RETURN OF THE *STATUS QUO*

A fiscally conservative mayor must do three things. First, he must reduce New York City's high taxes. Second, he must reduce the scope of what the city government does. Third, he must run what remains much more efficiently.

Over the course of his eight years as mayor, Giuliani did cut taxes. The city's economy boomed, and revenues increased. (See "Cutting Taxes, Creating Jobs," below). But in reducing the scope and increasing the efficiency of government, Giuliani was far less successful.

The scope of government was not reduced at all. The mayor abandoned his most visible initiative in this sphere—the proposed sale of the city hospital system—after a struggle with the unions and defeats in the courts. He did cut costs in social services; even before the new federal welfare reforms took effect in 1997, the city had begun to significantly reduce caseloads. But money saved on social services has only helped to subsidize big increases in other categories. Today the array of social services sponsored and partially funded by the city—from day care to virtually guaranteed housing—is as wide as ever.

In the final analysis, Mayor Giuliani sought to make the city deliver services more efficiently—not to make the city deliver *fewer* services. Gains in efficiency were offset, however, by a spike in the costs of outsourced contracts (see point 2 below). Thus, in two areas where inroads might have been made, the city instead failed to reduce spending.

**1. Personnel Increases.** In 1995–96, the city entered into a series of collective bargaining agreements with its public-employee unions. In addition to granting pay increases that ended up roughly equaling inflation, the city promised not to lay off any workers for the life of the contracts. These agreements were expected to add $2.2 billion to the budget by fiscal 2001. But that estimate didn't reckon with renewed growth in the number of city employees. After dipping in Giuliani's first two years, the full-time headcount rose from 235,069, in June 1996 to over 253,000 by November 2000. Thanks largely to this growth in the workforce, the total increase in personnel service costs since 1995 has been $4 billion.[2]

**2. Outsourced Services.** The failure to shrink the scope of city government made it all the more imperative that Mayor Giuliani vastly increase its efficiency. In the attempt to increase productivity, the mayor farmed out some city services to private contractors. But as the number of outsourced contracts doubled under Giuliani, contractual expenses also nearly doubled—from $3 billion to $5.8 billion. While it may be argued that the city saved money by outsourcing these services, the net savings turned out to be marginal at best. In practice, outsourcing proved to be more of a bargaining chip in negotiations with unions than a serious means of pruning expenses.

The city's lack of discipline in the above two areas is the root cause of its looming fiscal dilemma—a dilemma which will demand decisive action from Mayor Bloomberg.

## RAISING TAXES, LOSING JOBS

If history is any guide, he will be tempted to balance the budget not by cutting spending, but by raising taxes. Indeed, many observers note that the size of the budget gap is not much more than the size of Giuliani's aggregate tax cuts. A close examination of the link between tax policy and job creation in New York City over the last 20 years, however, suggests that raising taxes would be an unwise course.

Mayors Wagner and Lindsay enacted a plethora of new taxes and tax increases to keep up with their largesse on the spending side of the budget. For a time, the creation of the commercial rent tax (1963) and the personal income, general corporation, and unincorporated business taxes (1966) stemmed the tide of red ink. But these new taxes proved insufficient as the city continued to meet perceived social needs without considering the effect on its economic health. When Lindsay increased tax rates dramatically after 1969, the city began losing jobs at an alarming rate. As employers fled to less oppressive tax climates, the city lost almost 600,000 private sector jobs—about one in six—between 1969 and 1977.

This decline was enough to shock city leaders into action. Beginning in the late 1970s, New York enacted a series of relatively small but symbolically important business tax cuts, which helped position the city to reap the benefits of the national economic recovery that began in 1983. Tax cuts on both the city and state level freed private capital for job-creation, encouraging more businesses to remain or expand in New York. As a result, the base of taxable income broadened. Between 1980 and 1990, even though some tax *rates* were down, tax *revenues* soared.

As noted in the preceding section, however, the city squandered its opportunity by plowing these revenues back into city spending—and hiring even more city employees—rather than cutting tax rates more significantly. By 1990, the budget was again teetering badly out of balance.

Mayor Dinkins, like Wagner and Lindsay before him, responded to red ink by raising taxes. Although the actual increases were smaller than those the mayor sought, they still generated strong objections from property owners and warnings of negative economic consequences. A particularly prescient analysis,[3] issued in early 1991 by then-City Comptroller Elizabeth Holtzman, warned that the city would lose 10,000 private sector jobs for every $100 million in tax increases. As the Dinkins tax-increases eventually totaled $1.2 billion, the Holtzman study would suggest that these changes caused the loss of 120,000 jobs in the city between 1989 and 1993 (a third of the total decline). And, as noted earlier, the tax increases still did not balance the budget.

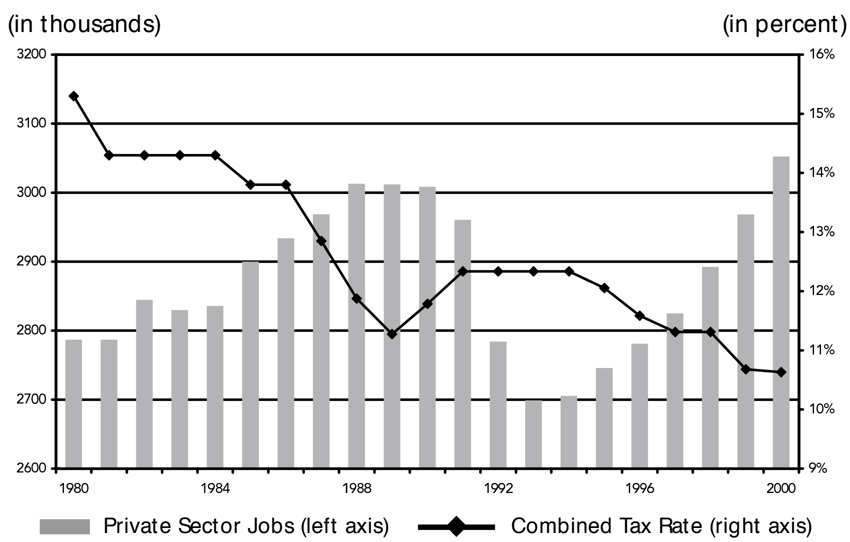
## CUTTING TAXES, CREATING JOBS

New York City residents and businesses are now saving $2.2 billion a year from tax cuts initiated by the mayor and City Council since 1994, including tax cuts enacted as part of the 2002 city budget.[4] If state tax reductions are considered part of the mix, New York City has experienced the deepest and broadest tax cuts in its history—a savings to city taxpayers of at least $6 billion a year in current terms.[5]

The record supports Mayor Giuliani's assertion that tax reductions have played an important role in the city's economic resurgence. Throughout the past three decades, increases in city taxes have coincided with major private sector job losses. When the state and local tax burden on city residents has been reduced, New York has experienced strong, sustained job growth.

As illustrated in Figure 1, below, private sector job growth in the city has generally surged following tax cuts.[6] Since 1995, the combined state and city personal income tax rate has been reduced from 12.3 percent to 10.5 percent—its lowest point since the city first imposed its own income tax in 1966. Conversely, the city income tax increases of the early 1990s coincided with large job losses.

Figure 1: Income Tax Cuts Coincide With City Employment Gains




The link between tax rates and job growth is further detailed in a recent study of urban finances issued by the National Bureau of

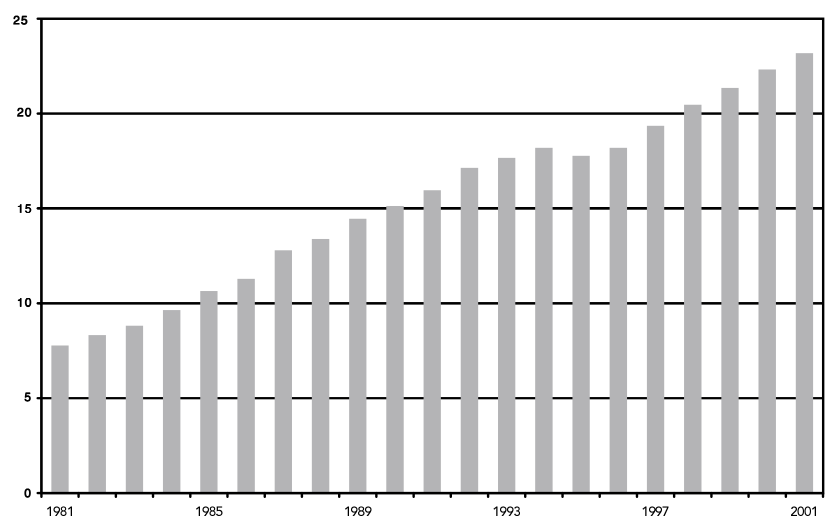
Economic Research (NBER).[7] An econometric model developed by the study's authors suggests that cuts in New York's top personal income tax rate since 1998 would result in the creation of 55,500 jobs—or about one quarter of the city's job growth since 1998. The same model indicates that, taken together, all of the city's tax cuts enacted since 1995 have boosted private employment by 4 percent—which would represent nearly one out of every four new jobs created since 1993.[8]

If city budget gaps had developed in line with the most pessimistic projections for the next four years, proponents of higher spending (and higher taxes) prior to September 11 would no doubt have claimed that Giuliani's tax cuts were excessive. The main problem with this argument is that *lower* tax rates actually correlate to *higher* net revenues (see Figure 2). Since 1995, total collections have increased 27 percent—half again as fast as inflation. Net collections from the personal income tax, which has accounted for over half of the city's tax cuts since 1994, increased by a whopping 65 percent during the same period—considerably faster than the growth in personal income.

An examination of taxation and job creation trends in New York over the past two decades underscores the need for Mayor Bloomberg to ensure that spending does not rise fast enough to force tax rates up again. But spending cannot be controlled without curbing the growth of the largest single item in the budget—employee salaries and benefits, which account for over half of New York's operating expenditures. The challenge is to reduce those costs while delivering services more effectively and efficiently, producing better value for taxpayer dollars.

Figure 2: New York City Tax Collections, 1981–2001

(in billions of dollars)




## REDUCING CITY SPENDING: IT *CAN* BE DONE

Mayor Giuliani took office with the stated intent of imitating the "competition and costing" program of Stephen Goldsmith, mayor of Indianapolis from 1993 to 1998. Goldsmith carried out one of the more successful large-scale demonstrations of how city governments can save money by opening services to competitive bid by both private firms and their own public agencies.

The powerful effect of even suggesting that city services will be competitively bid was vividly illustrated early in Giuliani's tenure, when the mayor moved seriously in the direction of putting garbage collection services out to bid by both city workers and private firms. The sanitation workers' union responded by agreeing to productivity improvements they had previously resisted.

The Giuliani administration has won smaller productivity gains by promoting competition in a limited number of other areas, such as the posting of traffic signs by the Transportation Department. In practice, however, such innovations have been few and far between—just enough to offer a tantalizing taste of what the city might yet accomplish with a systematic, broad-scale effort to promote competition by bidding city services.

How much more could New York save with a more persistent, truly systematic policy of "competitizing" services susceptible to such an approach? Plenty, if Goldsmith's experience is any guide. Indianapolis cut its operating costs by 5 percent (equivalent to $1.25 billion in New York terms) in the first three years the program was in operation. Its public sector payroll dropped by 25 percent—with no layoffs.[9]

The Citizens Budget Commission (CBC) has estimated that the city could save $3.5 billion from changes in contractual work rules that would increase productivity, and another $781 million from reforms of its health insurance program.[10] Even after sharing much of the gains with remaining employees, in the form of merit pay and performance incentives, CBC estimated the net savings would be $1.4 billion.

Increased productivity, however achieved, has the same result: providing at least the same level of services, and quite possibly better services, with fewer workers.

### Renewed workforce growth leaves room for savings

Before the World Trade Center attack forced cutbacks in the fiscal plan, Giuliani's final budget projected the full-time employee headcount would exceed 255,000 positions by the spring of 2002.[11] The total projected increase since 1996 has been concentrated in two areas: the Police Department, which will have grown by 6,000 uniformed and civilian personnel, and the Board of Education, which will have added 17,216 employees. Employment in all other areas of city government will have decreased by about 3,000 employees during the same period.

There is still room for reduction in many areas of city government—including some that were substantially reduced in the mayor's first attempt at workforce reduction in 1994-96, and at least one category that Giuliani has expanded.

*The welfare bureaucracy*

The mayor's largest personnel cutbacks have been concentrated among the city's welfare agencies—the Administration for Children's Services, Department of Social Services, Department of Homeless Services, and the Human Resource Administration/Department of Employment. The headcount for those agencies for 2002 is projected at 22,165 workers—down 10,122 employees since 1990.

These reductions certainly seem justified, in light of the changes wrought by welfare reform. The public assistance caseload has dwindled to about 500,000 people, just over half the 1990 level. Moreover, the Giuliani Administration has dramatically expanded the contracting out of welfare services to non-profit providers.

Twenty years ago, however, the city's welfare agencies employed even *fewer* staffers—22,009 as of the end of fiscal 1980—to deal with a caseload of 850,000 public assistance recipients. The city's failure to more significantly downsize its welfare bureaucracy over the longer term is especially striking given two factors: the great leaps in office information technology over the past 20 years, which presumably would make the processing of welfare records more efficient; and the increased reliance on private service providers.

*Elected officials and their staffs*

One area largely untouched by Giuliani's targeted workforce reductions has been the staff of elected officials. While the official headcount for the Office of the Mayor has declined to its lowest level in at least a quarter-century, the staff assigned to the city's other elected officials has grown by more than 2,000 over the past 20 years.

There's little to justify this expansion—especially when five of the most visible officials, the borough presidents, have been left with little real power or responsibility in city government since the elimination of the Board of Estimate over a decade ago. The office of public advocate also serves little purpose but to fill sudden mayoral vacancies; the role could be filled by the speaker of the city council.

*Education: More bodies for a broken system*

Conventional political wisdom in New York—unproven in practice but upheld in this year's school financing decision by state Supreme Court Justice Leland Degrasse—holds that any increase in spending on public schools is an unalloyed good that cannot fail to bring positive results. However, by standards that would apply to other public services (not to mention the private sector), it is difficult to justify the addition of 15,000 teachers and teacher aides to the Board of Education payroll over the past four years, a time when pupil enrollment in Board-run schools grew by less than 7,000 students. The staffing increase had the decidedly less-than-dramatic effect of reducing the number of pupils per pedagogue from 13.4 to 11.4 as of 2001—the lowest such ratio in at least 20 years.

Staffing apparently is complicated by absenteeism; up to 13,000 of the city's 81,000 teachers reportedly are absent before long holiday weekends, and teachers are absent, on average, two weeks of their 37-week year.[12] Moreover, at a time when the Board is bemoaning a shortfall of certified teachers, more than 1,000 experienced teachers were assigned to administrative duties, according to one newspaper account.[13]

As a result of the hiring binge since 1996, average class sizes have dropped in elementary levels—from an average of 26 to 22 students in third grade, for example. However, there is no evidence that this has had any impact on student achievement.

In fact, credible research indicates weak linkage, at best, between class size and performance.[14] A stronger case can be made for the argument that the greatest need of New York's public schools isn't *more* teachers but *better* teachers, more effectively deployed where they are most needed, and provided with financial incentives for improved performance. Of course, another option for improving pupil performance and relieving pressure on the city budget is to allow real consumer choice in education, through the use of vouchers as endorsed by Mayor Giuliani. Studies have found that parochial schools produce better educational results at significantly lower costs.[15]

*Police: Building on success with greater productivity*

In striking contrast to public elementary and secondary education, public safety is an area marked by significant, sustained and measurable performance gains for the city over the past eight years. Crime rates have dropped to the lowest levels in more than 30 years—and the policies implemented under Giuliani and his police commissioners generally get a good share of the credit.

City officials and their constituents would naturally be reluctant to tamper in any way with this tremendous success. Nonetheless, there is substantial reason to question the overall productivity and efficiency of the Police Department. For example, between June 1996 and February 2001, the department grew by 3,109 uniformed officers, from 36,278 to 39,837. But its "operational strength"[16] increased by only 1,585 officers, or just over half as much. This is one indication that the police have still not sufficiently increased their reliance on civilian employees to perform administrative support functions.

Like teachers, police officers are pressing for an enormous pay increase to match their suburban counterparts. But, as in the education area, this proposal demands closer scrutiny of current work rules. For example, New York police actually work an average of only 200 days a year—compared to 261 days for typical workers in other occupations.[17] Moreover, for all the success of the computerized crime-tracking system, the department has otherwise been slow to adopt new technologies, such as hand-held digital devices for checking and entering crime records. It seems clear that police productivity could be greatly enhanced—effectively permitting the city to accomplish more with fewer officers—without undermining New York's huge gains in the war on crime.

Above all, in collective bargaining agreements with teachers, police and other unions, the next mayor should be wary of granting "job security" guarantees. The potential threat of layoffs has proven to be an important management tool and bargaining chip.

### A budget reduction sampler: How to close the near-term gap

Mayor Giuliani's original headcount reduction target of 35,000 was certainly ambitious—but hardly beyond the pale, politically or practically speaking. For example, shortly before Giuliani took office, an advisory panel appointed by Mayor Dinkins to recommend ways of closing the city's budget gap concluded that the headcount should be reduced by 25,000.[18]

Starting with workforce reductions, here are some examples of how expenses can be reduced in coming years:

- Trimming 25,000 full-time positions from the city payroll – reducing the headcount to just above the 1986 level – would generate at least **$1.44 billion** in annual savings.[19]
- Adjusting for the proposed smaller workforce, the health insurance reforms suggested by the Citizens Budget Commission would ultimately save about **$700 million** a year.[20]
- Freezing city-funded non-personnel costs (excluding debt service) at 2001 levels would save an additional **$614 million** by 2003.[21]
- Capping annual city-funded capital expenditures at $4 billion—roughly equal to the level of capital spending between 1996 and 2001—would generate **$440 million** in annual debt service savings over the next three years.[22] (Moreover, as the state Financial Control Board repeatedly has pointed out, additional spending on preventive maintenance in the short term could much more significantly reduce long-term capital costs.)
- Reducing city cultural affairs grants to their 1991 level would save **$50 million** a year—and still leave New York among the leaders in municipal government arts funding.[23]

These steps would generate a total of **$3.2 billion** in annual savings—a large portion of the projected fiscal 2003 budget gap. Significant additional savings for the City budget could be quickly generated by long-overdue reforms on the state level.[24]

But that's just a start.

### Deeper savings require more fundamental policy reforms

Over the long term, the city needs to curb spending by billions more to close its structural deficit and make room for more significant tax reductions. Two areas in particular stand out for their potential cost savings:

**1. Housing.** Including foregone taxes, capital financing and direct operational costs, the city spends over $1 billion a year to compensate for the private sector's inability to provide sufficient low- and moderate-income housing—an inability that is the direct result of New York's rent regulation policies. To revive a free market in housing—the same kind of market that provides decent, competitively priced homes for tens of millions of Americans in cities of all sizes—New York should phase out rent regulation and modify land use and zoning procedures that discourage and add expense to housing construction.

As a result of its current policies, the city's spending on housing is enormous, including:

- nearly $800 million in annual tax abatements and exemptions for low- and moderate-income residential property;
- about $2 billion in planned capital commitments for housing grants and reconstruction financing over the next five-year cycle; and
- $67 million in annual city-funded operation expenses for the Department of Housing Preservation and Development.

Including debt service, the total annual budget savings within a few years of full deregulation would easily exceed $250 million a year, climbing steeply as property tax abatements expire.

**2. Economic development subsidies.** New York has put itself in a classic predicament: its high taxes drive businesses away, so city government scrambles to retain them by offering tax breaks. The approach is inherently unfair—favoring big, established employers over the thousands of smaller businesses that are the backbone of the economy. And the strategy is often unsuccessful even on its own terms, since many of the companies favored by retention deals have subsequently laid off employees, moved other operations out of the city, or disappeared through mergers and acquisitions.

The biggest pending retention deal of all involves a package of $600 million in government incentives to help finance a new headquarters for the New York Stock Exchange. But while the NYSE's presence has been vitally important to the city's financial sector for decades, its future shape is very much open to question as it shifts from pit-based to electronic trading.

It is widely assumed that an exceptionally generous package of city tax abatements and incentives will be needed to jump-start redevelopment of Lower Manhattan. To a great extent, this would simply replicate costly policies set in motion 30 years ago. Strictly speaking, the entire "ground zero" area did not develop naturally in response to market factors, but as a product of Rockefeller-era state capitalism. The World Trade Center and the neighboring World Financial Center were covered by "in-lieu-of-tax" agreements that generated much less revenue for the city than standard property taxes would have for the same buildings. The two complexes also received other generous public subsidies, such as low-cost public power. Expanding city tax abatements to more downtown properties beyond the most immediately affected area would, in effect, require already heavily taxed businesses in other parts of New York to subsidize a neighborhood hampered by larger problems, especially a critical lack of mass transit access.

Meanwhile, before the terrorist attack, a panel of business, labor and civic leaders assembled by U.S. Senator Charles E. Schumer has proposed a $500 million plan to have government assemble and grant tax abatements to promote commercial development in underused areas. While details were not immediately available, the plan reflects the traditional New York assumption that government planning and financing is the key variable in economic development.[25]

Here the city needs to make a simple tradeoff:

- Phase out $500 million a year on economic development tax abatements as soon as existing agreements expire;
- Radically scale back the $709 million in planned new capital commitments for economic development over the next five years, and;
- Use the savings to finance deep reductions in broad-based business taxes.

Finally, if and when surpluses do reappear, the next mayor should not hoard them in the form of recurring budget-balancing "rollovers." He should deposit a prudent amount in reserve, pay off high interest bonds, and use whatever is left to finance permanent, broad-based cuts in taxes that impose uniquely heavy tax burdens on New Yorkers compared to other jurisdictions. Examples of these are the commercial rent tax and the personal income tax surcharge.

## CONCLUSION

In the 1980s, the city enjoyed a sustained economic recovery and a surge of revenue growth, only to end up facing large and growing budget gaps once the economy slumped. A little more than a decade later, even before Sept. 11, history appeared to be repeating itself.

The Trade Center attack has exacerbated this trend, causing an immediate fiscal and economic downturn comparable to that which occurred during David Dinkins' first 18 months in office, in 1990-91. The consensus of early forecasts is that the city will lose 125,000 jobs in the downturn and recover about half that loss by the end of 2003. Between 1989 through 1992, by contrast, the city lost 300,000 jobs—and took seven years to recover them.

Viewed in this light, the economic situation is actually less dire than it was 10 years ago. But it could quickly get far worse—especially if Mayor Bloomberg responds to budget pressures as Dinkins did.

Inevitably, once the city economy shows the slightest sign of new life, there will be a chorus of voices crying for more money, no matter what it takes.

But if New York's tumultuous fiscal record demonstrates anything, it's that "more" is never enough. No amount of revenue is sufficient to permanently satiate New York's voracious public sector. Unsustainable spending, not insufficient taxes, is what traps New York in the cycle of extremes—from boom to bust and back again.

The city imposes the nation's heaviest big-city tax burden on the nation's largest concentration of urban wealth.[26] During the six years leading up to September 11, New York experienced an incredible economic resurgence that touched off a tidal wave of new revenues. But the city *still* couldn't permanently balance its budget—a situation that will persist if the immediate crisis is addressed with short-term gap-closing measures. That ought to tell us something: It's time to set some limits, and stick to them.

# Notes

1. City of New York, *Financial Plan, Fiscal Years 1994-1998*, Volume 1.

2. The workforce growth was enough all by itself to account for almost $1 billion in additional costs not anticipated when the contracts were signed. Another added cost factor was the compounding effect of annual salary increases and pay raises based on seniority—which are especially frequent in the early years for newly hired police and teachers. For example, as of 2000, police officers were eligible for a 57 percent pay increase during their first five years on the force, merely by moving up the seniority ladder. A contract that awards a pay increase of 16 percent over five years can end up costing much more when thousands of newly added employees are simultaneously receiving annual, seniority-based increments, a common feature of public employee contracts throughout New York State.

3. "Report by the Chief Economist, Comptroller's Budget Office, on the Impact of the Local Tax Burden on New York City," Stephen Kagann, Ph.D, Chief Economist and Zheng Gu, Ph.D, Senior Economist, April 1991.

4. That number needs to be kept in context. On the city's 2001 tax base, the Dinkins-era increases cost the city's resident taxpayers and property owners at least $1.8 billion. Including $400 million in increased property tax rates, and $1.4 billion from the two income tax surcharges. The net, self-initiated change in city taxes since 1990 has been, at best, a token cut of $400 million, including the fiscal 2002 reduction in the personal income tax surcharge. An additional $500 million in targeted property and city personal income tax relief has been generated by the state-financed School Tax Reduction (STAR) program. The state Legislature's repeal of the city commuter tax generated $500 million in savings, but not for city residents.

5. The *combined* state and city personal income tax rate in New York has dropped for five out of six years since 1995. Solely as a result of state actions, the combined corporate income tax rate in the city has dropped almost every year since 1994. The state in the last six years also has killed several taxes that fell especially heavily on New York City, including the "Cuomo tax" on large real-estate transactions, the state hotel-room tax, and the estate and gift tax.

6. The state and city income tax cuts phased in between 1987 and 1990 were not quite as steep as depicted on the chart, because the lower rates applied to a much broader taxable income base.

7. Andrew Haughwout, Robert P. Inman, "Fiscal Policies in Open Cities With Firms and Households," Working Paper 7823, National Bureau of Economic Research, August 2000.

8. Estimate as described in comments by Prof. Robert P. Inman at Manhattan Institute Conference, "New York at the Crossroads: Visions of a Better City," June 14,2001.

9. *The New York Times*, "In Privatizing City Services, It's Now 'Indy-a-First-Place'," March 2, 1995, A-14.

10. "The Citizens' Stake in Collective Bargaining," A Report of the Citizens Budget Commission, December 13, 2000.

11. How does the size of New York's municipal workforce compare to those of other major cities? The question is difficult to answer, because New York, unlike most other big cities, effectively incorporates the functions of both county and municipal government. According to the Census Bureau, all levels of local government in the United States employed 38 full-time workers per 100,000 population in 1997. New York's ratio, by the same measure, was 56 per 100,000. To illustrate further, using the same Census data series, it is possible to compare New York to at least two

other city-counties—Philadelphia and San Francisco. Adjusting for functional differences, relative to population, New York in 1997 had about 10 percent more employees than Philadelphia and about 7 percent fewer employees than San Francisco. Like New York, these cities are known for their relatively high local government costs and tax burdens.

12. *New York Daily News*, "Rudy Rips Into Teachers," April 30, 2001.

13. *New York Post*, Old Pros Pulled From Class; Veterans Teachers' Skills Go to Waste," April 29, 2001.

In mid-August, Chancellor Harold Levy announced an administrative staff reduction and reallocation program that reportedly would return many of these teachers to classrooms. Further details were not immediately available, however.

14. See, for example, Eric A. Hanushek, "The Evidence on Class Size," Occasional Paper 98-1, W. Allen Wallis Institute of Political Economy, University of Rochester, February 1998.

15. The latest and most locally relevant data on Catholic vs. public school performance are documented in "Catholic Schools in New York City," a report prepared by Raymond Domanico for the New York University Program on Education and Civil Society in March, 2001, which found Catholic school students scoring higher than public schools students on math and reading tests even after adjusting for racial and socioeconomic differences.

16. As defined in the annual Mayor's Management Report, operational strength counts "uniformed personnel of all ranks performing patrol or enforcement functions, or other operational duties that require uniformed expertise; it also includes personnel assigned to the detective, internal affairs, patrol services, and organized crime control bureaus, as well as the newly established transit and housing police bureaus."

17. Citizens Budget Commission, "The State of Municipal Services in the 1990s: The New York Police Department," p. 38.

18. "Presentation to the Mayor on Eliminating the Structural Budget Imbalance," Dec. 1, 1993, Donald D. Kummerfeld, Dall W. Forsythe, William H. Gray III.

19. Based on an average salary and benefit cost per full-time city employee of $57,462 as of February 2001, as estimated by the Independent Budget Office. Since this does not include pension fund contributions, the total estimate is, if anything, understated.

20. This estimate is pro-rated from the $780 million estimate in CBC's collective bargaining report, as cited above.

21. Figures derived from City of New York, *Financial Plan, Fiscal Years 2001-2005*, citywide totals and line sorts as dated April 25, 2001.

22. This estimate is based on the generally accepted rule of thumb that, at current interest rates, every $1 billion in long-term capital borrowing generates $80 million in annual debt service costs. Prime candidates for elimination would include capital spending on housing, cultural institutions, sports stadiums and various economic development projects—preserving core infrastructure investments. City-funded capital expenditures totaled $15 billion between 1997 and 2001, so the proposed reduction would still yield an enormous net increase in this category over the next four years.

23. The Department of Cultural Affairs spent $135 million in fiscal 2001. That's about 30 percent more than the entire budget of the National Endowment for the Arts and more than twice as much as New York State spends through its own Council on the Arts — which funds many of the same institutions as the city.

24. For example, suing the City has become a highly profitable pursuit for negligence lawyers—at a cost to taxpayers of over $450 million last year. Mayor Giuliani estimates this figure could be greatly reduced by requiring lawsuits against the City to be heard in the non-jury Court of Claims, which now has jurisdiction over cases against the state government. Another perennial concern is the City's share of Medicaid costs, which now exceeds $3.6 billion and is slated to hit more than $4 billion by 2005. Further efforts to reform New York State's extravagant Medicaid program would produce dollar-for-dollar savings in the city budget.

25. See, for example, *The New York Times*, "Schumer Proposals Address Shortage of Office Space," June 11, 2001, B-3.

26. New York City's taxes are extraordinarily high, even by the standards of the heavily taxed Northeast. The city imposes more than 20 different taxes, many of them on top of relatively high New York State tax levies. New York's overall "tax effort" as of 1999 was 79 percent higher than that of the average for the next nine largest of the nation's top-10 cities, according to a study by the city's Independent Budget Office (City of New York, Independent Budget Office, "Taxing Metropolis: Tax Effort and Tax Capacity in Large U.S. Cities," February 2000).

Even excluding its uniquely heavy local share of Medicaid costs, New York City's tax burden was the heaviest. New York City's real estate taxes are extremely high for non-residential property. As of 1998–99, the city's median commercial property tax was 73 percent above the median for neighboring towns and cities in the metropolitan area (Dick Netzer and Thomas Conoscenti, "New York Metropolitan Area Effective Real Property Tax Rates," 1997–98 and 1998–99, sponsored by *Crain's New York Business*, New York University, Robert F. Wagner Graduate School of Public Service, Taub Urban Research Center, March 2001).

For a family of four with income of $75,000 a year (squarely within the struggling middle class, by local standards) New York City's state-local tax burden is $1,470 more than Boston's, $1,936 more than Detroit's, $2,288 more than that of Los Angeles, and $2,809 higher than Chicago's. At higher income levels, the tax gap between New York and other cities gets much wider (Government of the District of Columbia, Chief Financial Officer, *Tax Rates and Tax Burdens in the District of Columbia—A Nationwide Comparison, 1999*, www.dccfo.com/services/studies/99STUDY2.pdf).

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