# Review of the Four-Year Financial Plan for the City of New York

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# I. Executive Summary

After recording large budget surpluses during fiscal years 1997 through 2001, the City's fiscal condition began to deteriorate during the second half of FY 2001 as a result of the economic slowdown, which was exacerbated by the attack on the World Trade Center. While the City balanced the budget during fiscal years 2002 and 2003, it did so by relying heavily on nonrecurring resources, which did little to address the out-year budget gaps. In June 2002, the City adopted a balanced budget for FY 2003, but still projected a budget gap of $3.7 billion for FY 2004. As FY 2003 progressed, the City's fiscal condition deteriorated further because of unexpected weakness in the economy and other factors, which opened a substantial budget gap in FY 2003 and caused the FY 2004 gap to grow to $7.2 billion, excluding the Governor's proposed budget cuts.

Through a combination of City and State actions that raised taxes and reduced planned spending, as well as through assistance from the federal government, the financial plan (the "June Plan") shows a $1.3 billion surplus for FY 2003 and a balanced budget for FY 2004 (see Table 1). Since many of these actions will produce recurring benefits, the City made progress in restoring structural balance and the out-year budget gaps were reduced to $2 billion in FY 2005 and to about $3.3 billion in subsequent years.

City actions are projected to generate $3.8 billion in FY 2004—excluding the FY 2003 surplus—and similar amounts during fiscal years 2005 through 2007. More than half of the resources will come from an 18.5 percent increase in property taxes that was enacted in January 2003 ($1.7 billion)—the first increase in 11 years—and other revenue initiatives ($300 million). Reductions in planned agency spending will save $1.8 billion, with most of the reductions concentrated in the Department of Education and the Police Department. Agency actions are expected to reduce the City-funded workforce by 12,000 employees (both part-time and full-time) by the end of FY 2004, including 4,700 layoffs.

The State Legislature took actions, despite the Governor's vetoes, that were instrumental in helping the City avoid draconian budget cuts. The Legislature restored most of the cuts in education and health care that were proposed by the Governor to balance the State budget, and funded them with an increase in State personal income and sales taxes. The Legislature also approved a City aid program that allowed the City to increase personal income and sales taxes on City residents. In total, tax and fee increases are projected to add $3 billion to the City's coffers in FY 2004, but the impact of higher State and City personal income taxes on upper-income residents will be more than offset by a recently enacted federal tax reduction program. In addition, the Legislature agreed to annually transfer $170 million to the City over the next 30 years, which could effectively relieve the City of about $500 million in annual debt service costs through FY 2008 by refinancing outstanding bonds issued by the Municipal Assistance Corporation.

Our review of the City's financial plan identified budget risks of $367 million in FY 2004, $806 million in FY 2005, and about $400 million in each of fiscal years 2006 and 2007 (see Table 2). The largest risk is the anticipated receipt of additional airport lease payments from the Port Authority of New York and New Jersey—$200 million in FY 2004 and $583 million in FY 2005. While the FY 2004 budget includes sufficient reserves to handle these risks should they materialize, the out-year gaps could increase to $2.8 billion in FY 2005 and about $3.7 billion in each of fiscal years 2006 and 2007 because the tax increases authorized by the State are temporary.

The size of the out-year budget gaps will also depend on whether future wage increases for municipal employees will be funded entirely with productivity savings as assumed in the June Plan, which is a strategy the City has been unable to implement since the 1970s fiscal crisis. Wage increases at the projected inflation rate without any offsetting productivity improvements would widen the City's projected budget gaps by $750 million in FY 2004 and by as much as $2.3 billion by FY 2007.

In addition, the New York State Court of Appeals recently ruled that New York State has failed to fulfill its constitutional mandate to provide a sound, basic education to New York City schoolchildren and set July 30, 2004, as the deadline for implementing reforms. While these reforms are likely to substantially increase State funding to the Department of Education, it remains to be seen whether the City will be called upon to increase its contribution and whether an increase in State education aid will come at the expense of State funding for other programs. Moreover, the State faces a large budget gap next year, which could be closed in part from a reduction in aid to localities.

Despite the improvement in the City's fiscal outlook, the City will continue to face budgetary constraints for the foreseeable future. Although the local economy seems to be bottoming out and Wall Street profits are improving, an expectation for an improved economy is already factored into the City's revenue forecasts. City-funded spending is projected to grow at an average annual rate of 5 percent during the Plan period, but most of the growth is concentrated in areas largely outside the City's direct control. Pension costs are projected to grow at an annual rate of 29 percent, which reflects pension fund investment shortfalls; debt service costs, despite deep cuts to the capital program, are projected to grow at an annual rate of 10 percent; and health insurance costs for both municipal employees and the indigent continue to grow faster than revenues.

The City has demonstrated its ability to manage the budget during difficult times and to obtain needed assistance from the State and federal governments. While the City's budget crisis has eased, the City will continue to face significant out-year budget gaps. The City should use this opportunity to implement management improvements to reduce costs without affecting basic municipal services as it continues to seek assistance from the federal and State governments and the municipal unions.

# Table 1
# Four-Year Financial Plan

(in millions)

| | FY 2004 | FY 2005 | FY 2006 | FY 2007 |
|---|---|---|---|---|
| **REVENUES** | | | | |
| Taxes | | | | |
| General Property Tax | $ 11,317 | $ 11,621 | $ 12,046 | $ 12,491 |
| Other Taxes[1] | 14,125 | 13,823 | 14,319 | 14,875 |
| Tax Audit Revenue | 525 | 505 | 505 | 505 |
| Miscellaneous Revenue | 4,287 | 4,605 | 4,095 | 4,048 |
| Unrestricted Governmental Aid | 555 | 555 | 555 | 555 |
| Anticipated Federal & State Aid | - - - | - - - | - - - | - - - |
| Less: Intra-City Revenues | (1,094) | (1,080) | (1,079) | (1,079) |
| Grant Disallowances | (15) | (15) | (15) | (15) |
| *Subtotal: City Funds* | $ 29,700 | $ 30,014 | $ 30,426 | $ 31,380 |
| Other Categorical Grants | 842 | 764 | 785 | 800 |
| Inter-Fund Revenues | 321 | 313 | 312 | 312 |
| Total City & Inter-fund Revenues | $ 30,863 | $ 31,091 | $ 31,523 | $ 32,492 |
| Federal Categorical Grants | 4,622 | 4,467 | 4,452 | 4,462 |
| State Categorical Grants | 8,173 | 8,179 | 8,159 | 8,232 |
| **Total Revenues** | $ 43,658 | $ 43,737 | $ 44,134 | $ 45,186 |
| **EXPENDITURES** | | | | |
| Personal Service | | | | |
| Salaries and Wages | $ 16,319 | $ 16,281 | $ 16,284 | $ 16,288 |
| Pensions | 2,615 | 3,239 | 4,051 | 4,458 |
| Fringe Benefits | 4,795 | 5,048 | 5,343 | 5,640 |
| Subtotal - Personal Service | $ 23,729 | $ 24,568 | $ 25,678 | $ 26,386 |
| Other Than Personal Service | | | | |
| Medical Assistance | $ 3,871 | $ 4,372 | $ 4,516 | $ 4,520 |
| Public Assistance | 2,054 | 2,054 | 2,057 | 2,058 |
| All Other | 12,315 | 11,974 | 12,181 | 12,386 |
| Subtotal - Other Than Personal Service | $ 18,240 | $ 18,400 | $ 18,754 | $ 18,964 |
| Debt Service | 3,162 | 3,563 | 3,719 | 3,900 |
| Budget Stabilization & Prepayments[1] | (679) | - - - | - - - | - - - |
| MAC Debt Service | - - - | - - - | - - - | - - - |
| General Reserve | 300 | 300 | 300 | 300 |
| Subtotal: Expenditures | $ 44,752 | $ 46,831 | $ 48,451 | $ 49,550 |
| Less: Intra-City Expenses | (1,094) | (1,080) | (1,079) | (1,079) |
| **Total Expenditures** | $ 43,658 | $ 45,751 | $ 47,372 | $ 48,471 |
| **Gaps To Be Closed** | **$ - - -** | **$ (2,014)** | **$ (3,238)** | **$ (3,285)** |

[1] Budget stabilization and prepayments in FY 2003 total $679 million, including prepayments of subsidies of $313 million, lease debt service of $73 million, and budget stabilization of $293 million. In addition, a TFA grant in FY 2003 increased FY 2004 tax revenue by $624 million, bringing the total FY 2003 prepayment benefit to $1.3 billion.

## Table 2
## OSDC Risk Assessment of NYC Financial Plan

(in millions)

| | *Better/(Worse)* | | | |
|---|---|---|---|---|
| | **FY 2004** | **FY 2005** | **FY 2006** | **FY 2007** |
| **Gaps per June 2003 Plan** | **$ - - -** | **$ (2,014)** | **$ (3,238)** | **$ (3,285)** |
| **OSDC Budget Risks** | | | | |
| **Outside the City's Direct Control** | | | | |
| Port Authority Airport Lease Payments | (200) | (583) | (96) | (99) |
| Private Bus Subsidy | (75) | (147) | (150) | (154) |
| **Subtotal** | **(275)** | **(730)** | **(246)** | **(253)** |
| **Estimation** | | | | |
| Police Overtime | (100) | (125) | (125) | (125) |
| Medicaid | - - - | - - - | (75) | (100) |
| Debt Service | - - - | 29 | 10 | - - - |
| Pension Contributions | 8 | 20 | 35 | 55 |
| **Subtotal** | **(92)** | **(76)** | **(155)** | **(170)** |
| **OSDC Risk Assessment** | **(367)** | **(806)** | **(401)** | **(423)** |
| **Remaining Gaps to be Closed** | **$ (367)** | **$ (2,820)** | **$ (3,639)** | **$ (3,708)** |
| **Other Risks and Offsets** | | | | |
| General Reserve | 300 | 300 | 300 | 300 |
| Wage Increases at the Projected Inflation Rate[1] | (750) | (1,200) | (1,700) | (2,300) |
| Campaign for Fiscal Equity Reforms | NA | NA | NA | NA |

[1] Labor agreements with the City's employees expired during FY 2003 and the Mayor maintains that future wage increases will be funded entirely with productivity savings. The City has set aside $200 million for collective bargaining in FY 2003, recognizing that even labor agreements that provide for productivity improvements may have a net cost in the first year. Wage increases without any offsetting productivity improvements would increase the projected gaps by the amounts shown in the table.

## II. Economic Overview

The national recession in 2001 put an end to the spectacular growth in City tax collections that occurred during the late 1990s and into 2000. Modest GDP growth had resumed by the end of 2001, but national employment continued to decline in 2002, falling by 1.1 percent on an average annual basis. These losses were accompanied by a rise in the average annual unemployment rate to 5.8 percent, from 4.7 percent in 2001. Locally, average annual employment declined by 3.2 percent—117,400 jobs—in 2002, while the annual unemployment rate rose by almost two percentage points, to 7.9 percent.

Many of the jobs lost in the City in 2002 were in sectors that had grown rapidly in the 1990s, and many had relatively high salaries. Some of the industries with the largest job losses in 2002 included professional and business services (35,700 jobs), financial activities (27,300 jobs), information (23,800 jobs), manufacturing (15,700 jobs), and trade (13,300 jobs). Within the financial sector, employment in the securities industry declined by 18,200 jobs.

With its high income-producing capacity, Wall Street is the engine that drives much of the economic activity in the City, and thus drives growth in City revenues. In addition to the job losses on Wall Street, the incomes of those who retained their jobs dropped substantially. Much of that income is paid through bonuses. When securities profits peaked at $21 billion in 2000, we estimated that securities bonuses totaled $19.4 billion, representing 40 percent of all Wall Street wages. Wall Street bonuses, in turn, accounted for 80 percent of all financial sector bonuses paid in the City that year (and two thirds of all bonuses paid in the City). The City estimates that total financial sector bonus payments declined by 28 percent in 2001 and by an additional 21 percent in 2002, substantially reducing personal income tax collections for fiscal years 2002 and 2003. The City also estimates that the declining stock market reduced capital gains realizations by 44 percent in 2001 and 38 percent in 2002, lowering local tax collections even further.

While the City's economic forecast shows a slow improvement over the economy's performance in 2002, the forecast is not as optimistic as it was earlier in the year—especially for calendar year 2003. The City expects GDP growth in 2003 to be less than in 2002 (1.9 percent instead of 2.4 percent). Indeed, during the first quarter of 2003, GDP growth totaled only 1.4 percent as uncertainties surrounding the war in Iraq became more acute. The City's forecast of GDP growth for 2003 is more conservative than the July forecast from the Blue Chip Economic Consensus (2.3 percent), but is similar to the July Global Insight forecast (2 percent).

Beyond 2003, the City forecasts the GDP to grow by 4 percent in 2004, 3.4 percent in 2005, 3.1 percent in 2006, and 2.8 percent in 2007. In the near-term, these projections are close to those of Global Insight, which expects GDP growth of 3.8 percent in 2004 and 3.4 percent in 2005. However, the City's out-year GDP forecasts are lower than Global Insight's forecasts of 3.6 percent in 2006 and 3.4 percent in 2007. The City also expects that national employment will remain unchanged this year, and that annual gains will resume in 2004. During the first five months of 2003, employment in the nation declined by 0.3 percent compared to the same period last year.

While the City expects improvements in the local economy to lag behind those of the nation, it forecasts a lower decline for employment in 2003 than in 2002 (2.1 percent compared to 3.2 percent). Indeed, the City's job market, though still declining, appears to be improving a little faster than the City anticipated, as total City employment declined by 1.5 percent, or 55,100 jobs, during the first five months of 2003. Although there are signs of improvement in the private sector, they could be offset by increased layoffs in government. Both personal income and wages, however, are projected to increase in 2003 after declining in 2002.

Wall Street profits are forecast to rise modestly, from just under $7 billion in 2002 to $7.5 billion in calendar year 2003, eventually reaching $12.7 billion in 2007. Profits for the first quarter of 2003 rose 16.8 percent compared to the same period last year, to $3.5 billion, and the financial markets rallied sharply in the second quarter. Also, the rate of job decline in the securities industry, while still substantial through May 2003 at 5.4 percent, is well below the rate of 12.2 percent seen in the first five months of last year.

The City expects that the local economy will emerge from its recession in 2004 and continue to grow through 2007, with employment increasing by 0.6 percent in 2004, 1.1 percent in 2005, 1.3 percent in 2006, and 1.1 percent in 2007. These rates of growth are well below the rates experienced in the boom years of both the mid-1980s and late 1990s, but are greater than the 0.7 percent average annual gain experienced between 1992 and 1996 at the start of the last economic expansion. Employment growth will in turn contribute to an annual average growth of 5.3 percent in wages between 2004 and 2007, and an annual average growth of 5.2 percent in personal income in those years.

# III. Fiscal Year 2003

The FY 2003 budget was balanced in June 2002 with savings from agency actions and assistance from the State and federal governments and the municipal unions. The budget also relied on $4 billion in nonrecurring resources, including $1.5 billion in bond proceeds (i.e., deficit financing) from the Transitional Finance Authority (TFA) to offset revenue losses related to the attack on the World Trade Center.[2] Although nonrecurring resources helped to balance the FY 2003 budget last June, it left the City with a projected budget gap of $3.7 billion for FY 2004. As FY 2003 progressed, the City's financial situation deteriorated, and adverse developments opened a substantial budget gap in FY 2003, which narrowed to $730 million during the last few weeks of the fiscal year after tax collections were higher than planned. The out-year gaps grew by about $3.5 billion (see Table 3), with the FY 2004 gap reaching $7.2 billion, (excluding the potential impact of $853 million in budget cuts proposed by the Governor in January 2003), and the FY 2007 gap rising to more than $8.1 billion.

The major factor behind the increase in the budget gaps was the continued weakness in the economy and Wall Street profits and bonuses that were lower than expected. Revenue collections fell short of the City's projections last June, by nearly $900 million in FY 2003 and by an average of more than $2 billion beginning in FY 2004. The revenue shortfall was higher earlier in the fiscal year, but an improvement in revenues, primarily tax collections, during the last few weeks of the fiscal year reduced the shortfall by $306 million.

In addition, the City obtained less than half of the $500 million in recurring savings that was anticipated from the municipal labor unions. The City was also unable to complete a planned lease-financing arrangement to convey title to a private entity for tax benefits in FY 2003, and Medicaid and agency spending exceeded the City's estimates. In addition, the City increased the size of the general reserve by $100 million to $300 million. While pension costs were $110 million less than initially planned in FY 2004 due to actuarial reestimates, pension fund investment earnings fell short of the actuarial assumption for the third consecutive year, which increased the size of the out-year budget gaps by $541 million by FY 2007.

To maintain budget balance in FY 2003 and to narrow the ballooning out-year budget gaps, the City implemented a mid-year property tax increase of 18.5 percent in January 2003 and cut planned agency spending. These actions generated $1.7 billion in FY 2003 and recurring resources of about $4 billion beginning in FY 2004. In addition, the federal government provided the City with $420 million in FY 2003 to reimburse the

[2] See Appendix A for a detailed listing of nonrecurring resources used in the FY 2003 budget.

City for costs related to the attack on the World Trade Center, and the City also obtained one-time savings from debt refundings and by drawing down reserves. These actions more than offset the impact of the adverse developments in FY 2003, leaving $200 million to establish a reserve for collective bargaining in FY 2003 and $1.3 billion in surplus resources to help balance the FY 2004 budget.

## Table 3
## Financial Plan Reconciliation
## Cumulative Changes since the June 2002 Plan

(in millions)

| | *Better/(Worse)* | | | |
|---|---|---|---|---|
| | **FY 2003** | **FY 2004** | **FY 2005** | **FY 2006** |
| **Surplus/(Gaps) per June 2002 Plan** | **$ - - -** | **$ (3,729)** | **$ (4,224)** | **$ (4,590)** |
| **Revenues** | | | | |
| Tax Revenues | (567) | (1,642) | (1,871) | (1,920) |
| Cancellation of the Planned Sale of OTB | - - - | (250) | - - - | - - - |
| Non-tax Revenues | (210) | (391) | (329) | (60) |
| Delay in the Sale of Tax Benefits | (100) | - - - | - - - | - - - |
| **Subtotal** | **(877)** | **(2,283)** | **(2,200)** | **(1,980)** |
| **Expenditures** | | | | |
| Shortfall in Anticipated Savings from Municipal Unions | (223) | (296) | (291) | (412) |
| Net Change in Planned Pension Contributions | 110 | (213) | (369) | (541) |
| Medicaid Costs | (28) | (74) | (76) | (77) |
| Judgments and Claims | (25) | (25) | (25) | (25) |
| Debt Service | 223 | (21) | (51) | (70) |
| Education | 11 | (91) | (42) | (43) |
| Prior Payables | 200 | - - - | - - - | - - - |
| General Reserve | 160 | (100) | (100) | (100) |
| Agency Spending | (281) | (386) | (281) | (294) |
| **Subtotal** | **147** | **(1,206)** | **(1,235)** | **(1,562)** |
| **Net Change During FY 2003** | **(730)** | **(3,489)** | **(3,435)** | **(3,542)** |
| **Surplus/(Gaps) per June 2003 Plan** | **$ (730)** | **$ (7,218)** | **$ (7,659)** | **$ (8,132)** |

Sources: NYC Office of Management and Budget; OSDC analysis

# IV. Fiscal Year 2004 Gap-Closing Program

As discussed in the previous chapter, adverse developments during FY 2003 increased the size of the FY 2004 budget gap from $3.7 billion in June 2002 to $7.2 billion, excluding the potential impact of $853 million in budget cuts proposed by the Governor in January 2003 to help balance the State budget. To close the gap, the City relied on a combination of City, State, and federal actions (see Table 4).

**Table 4**
**FY 2004 Gap-Closing Program**
(in millions)

| | *Better/(Worse)* | | | |
|---|---|---|---|---|
| | **FY 2004** | **FY 2005** | **FY 2006** | **FY 2007** |
| **Projected Budget Gaps** | **$ (7,218)** | **$ (7,659)** | **$ (8,132)** | **$ (7,949)** |
| **FY 2004 Gap-Closing Actions** | | | | |
| **City Actions** | | | | |
| Agency Actions | 2,092 | 2,106 | 2,177 | 2,227 |
| Property Tax Increase | 1,727 | 1,800 | 1,875 | 1,963 |
| FY 2003 Surplus Transfer | 1,303 | - - - | - - - | - - - |
| **Subtotal** | **5,122** | **3,906** | **4,052** | **4,190** |
| **Impact of State Actions** | | | | |
| Personal Income Tax | 644 | 545 | 315 | 13 |
| MAC Debt Refinancing | 531 | 491 | 491 | 494 |
| Education Aid | (238) | (253) | (315) | (315) |
| Sales Tax | 387 | 390 | 285 | 292 |
| Battery Park City Authority | 150 | - - - | - - - | - - - |
| Medicaid Cost Containment | 134 | 16 | 16 | 16 |
| Private Bus Subsidy | 75 | 147 | 150 | 154 |
| Other | 151 | 97 | 80 | 4 |
| **Subtotal** | **1,834** | **1,433** | **1,022** | **658** |
| **Federal Medicaid Relief** | **232** | **- - -** | **- - -** | **- - -** |
| **Port Authority Airport Lease Payments** | **200** | **583** | **96** | **99** |
| **Total Gap-Closing Actions** | **$ 7, 388** | **$ 5,922** | **$ 5,170** | **$ 4,947** |
| Sales Tax Clothing Exemption | (70) | (277) | (276) | (283) |
| Pay-As-You-Go Capital Spending | (100) | - - - | - - - | - - - |
| **Gaps to be Closed per June 2003 Plan** | **$ - - -** | **$ (2,014)** | **$ (3,238)** | **$ (3,285)** |

Sources: NYC Office of Management and Budget; OSDC analysis

The gap-closing program not only helped balance the FY 2004 budget and narrow the out-year budget gaps, but also allowed the City to exempt clothing purchases under $110 from the sales tax for two weeks during FY 2004, reinstate the exemption for the full year beginning in FY 2005, and to allocate $100 million in operating resources in FY 2004 to help fund the capital program. In total, the out-year budget gaps, which had ranged from almost $7.7 billion in FY 2005 to about $8 billion in fiscal years 2006 and 2007, were reduced to $2 billion in FY 2005 and about $3.3 billion in each of fiscal years 2006 and 2007.

City actions are projected to generate $3.8 billion in FY 2004 (excluding a surplus transfer of $1.3 billion from FY 2003), and $4 billion in subsequent years. About $2 billion of the resources to be generated in FY 2004 are expected to come from an 18.5 percent increase in property taxes that was enacted in January 2003 ($1.7 billion) and other revenue initiatives ($300 million); the remainder will come from agency actions that reduced planned spending ($1.8 billion).

State actions were instrumental in helping the City avoid draconian budget cuts that were proposed by the Mayor in response to the Governor's proposed budget in January 2003. The State Legislature was opposed to the large cuts in education and health reductions proposed by the Governor and approved its own budget over the Governor's vetoes with support from the Mayor, which restored most of the cuts and funded them with new taxes. The State Legislature also approved an aid program for New York City that allowed the City to raise the sales tax and add an upper-income surcharge on personal income taxes, and that could effectively relieve the City of the debt service costs on bonds issued by the Municipal Assistance Corporation. The Governor contends, however, that certain elements of the Legislature's budget are unconstitutional, and therefore there is some risk that elements of the budget could be overturned by the courts or impeded by other obstacles.

In total, tax and fee increases are projected to generate $3.2 billion in FY 2004. More than half of the resources would come from the increase in real property taxes—the first increase in 11 years—and most of the balance would come from increases in personal income taxes on upper-income residents, a one-eighth of one percent increase in the sales tax, and the elimination of the sales tax exemption on clothing purchases under $110. In addition, the City raised fines and fees for the second consecutive year. The amount of revenue from fines and fees is projected to decline to $2.4 billion by FY 2007 as the increases in personal income and sales taxes are phased out.

## A. City Actions

City actions, including agency actions and an increase in property taxes, are expected to generate $3.8 billion in FY 2004 and similar amounts in subsequent years. In addition, a projected FY 2003 surplus of $1.3 billion will be used to help balance the FY 2004 budget, which brings the total for City actions in that year to $5.1 billion.

### 1. Agency Actions

The FY 2004 gap-closing program includes nearly $2.1 billion in agency actions (see Table 5). Of this amount, about $1.8 billion will come from a reduction in planned agency spending and another $300 million will come from revenue initiatives.

## Table 5
## FY 2004 Agency Gap-Closing Program

(in millions)

| | Expense Reductions | Revenue Initiatives | Total |
|---|---|---|---|
| **Uniformed Forces** | | | |
| Police Department | $ 247.8 | $ 85.0 | $ 332.8 |
| Fire Department | 73.7 | 9.3 | 83.0 |
| Dept. of Correction | 116.7 | .3 | 117.0 |
| Dept. of Sanitation | 67.2 | 23.6 | 90.8 |
| **Subtotal** | 505.4 | 118.2 | 623.6 |
| **Health and Welfare** | | | |
| Admin for Children's Services | 121.4 | - - - | 121.4 |
| Dept. of Social Services | 85.7 | - - - | 85.7 |
| Dept. of Homeless Services | 40.1 | - - - | 40.1 |
| Dept of Aging | 35.9 | - - - | 35.9 |
| Dept. of Health & Mental Hygiene | 53.1 | 6.7 | 59.8 |
| Social Services Restructuring | 75.0 | - - - | 75.0 |
| **Subtotal** | 411.2 | 6.7 | 417.9 |
| **Covered Organizations** | | | |
| Department of Education | 494.7 | - - - | 494.7 |
| Health and Hospitals Corp. | 20.2 | - - - | 20.2 |
| **Subtotal** | 514.9 | - - - | 514.9 |
| Libraries & Cultural Affairs | 37.9 | - - - | 37.9 |
| Dept. of Finance | 5.7 | 93.1 | 98.8 |
| Dept. of Transportation | 36.5 | 25.8 | 62.3 |
| Debt Service Initiatives | 77.4 | - - - | 77.4 |
| All Other | 202.5 | 57.1 | 259.6 |
| **Total** | **$ 1,791.5** | **$ 300.9** | **$ 2,092.4** |

Source: NYC Office of Management and Budget

*Expense Reductions*

Half of the agency program's expense reductions will affect basic municipal services through service reductions, cuts in City subsidies to libraries and cultural institutions, and through reduced City spending on education. The remainder of the spending cuts come mostly from reestimates in spending, workforce reductions where the impact on services is uncertain, and actions that shifted costs to other levels of government.

Agency actions reduced planned spending by $1.8 billion, with most of the burden falling on the Department of Education and the uniformed agencies. City funding to the Department of Education has been reduced by $495 million to nearly the lowest level permitted under State law, just as the department is trying to meet stricter State and federal educational standards. Similarly, City funding to the uniformed agencies, which include the Police and Fire departments, was reduced by $505 million at a time when concerns about terrorism and safety are especially acute. The Police Department intends to reduce the size of the police force by 2,100 officers during FY 2004 and curtail overtime, while the Fire Department closed six engine companies and intends to reduce the number of fire marshals by half from the FY 2002 level.

Most libraries will be open five days a week instead of six. In addition, the City plans to lay off one third of the cleaning staff in the City's homeless shelters and also to reduce, by more than 50 percent, funds that provide aftercare services to help families avoid returning to shelters. About half of the $121 million reduction in City funding for the Administration for Children's Services will affect services, including reducing the number of foster care beds and laying off workers that provide crisis services and manage foster care placements. The remaining $202 million in spending reductions encompasses a wide range of initiatives, including $85 million in procurement, pension, and miscellaneous budget savings.

The only significant management improvement is the Mayor's initiative to reorganize social services to reduce administrative duplication. This reform, subject to City Council approval but scheduled to be in place during FY 2004, is projected to save $75 million annually and would not reduce the current level of services. The proposal would effectively eliminate the Department of Employment, a charter agency; would restructure the Administration for Children's Services so that it provided only child welfare services; and would transfer eligibility determination for day care, child support enforcement, home care, employment programs, substance abuse programs, and financial assistance for home energy costs to the Human Resources Administration.

*Revenue Initiatives*

The agency program also includes a number of actions that increase projected revenues by $300 million in FY 2004, including $158 million in higher fines and fees. The City plans to hire 300 additional traffic enforcement agents to increase ticket issuances and thereby raise $85 million, and the Department of Transportation will bring in $17 million in additional parking meter revenue by raising parking rates and expanding meter charges to Sundays. The Department of Finance plans to increase audit revenues to bring in another $75 million. The City had previously received State approval in FY 2003 to increase traffic fines ($62 million) and surcharges on landline and cellular phones ($45 million).

### 2. Property Tax Increase

Early in FY 2003 the Mayor asked the City Council to approve a mid-year property tax increase of 25 percent. The Council eventually approved an 18.5 percent increase, which raised revenue by $837 million in FY 2003 and by about $1.8 billion annually thereafter. Under State law, about half of the additional revenues will be paid by owners of commercial and utility properties, while about 35 percent of the increase is to be levied on owners of large residential properties (more than three units). The remaining share will be paid by the owners of one-, two-, and three-family homes (i.e., class one properties). The tax rate on these properties will be set at $14.55 per $100 of assessed value in FY 2004, compared with $11.61 in FY 2002, an increase of 25 percent. Combined with increases in assessed value, the average real property tax bill for class one homeowners has increased to $2,490, which is $591 (or 31.1 percent) higher than in FY 2002.

### 3. FY 2003 Surplus

The City currently projects a surplus of $1.3 billion for FY 2003, which represents almost 4.3 percent of City fund revenues. The surplus was made possible by a combination of actions taken by the City during FY 2003 to offset adverse developments, such as an increase in real property taxes, as well as the receipt of federal aid and a recent improvement in tax collections. The budget adopted by the City in June 2002, however, also included $1.5 billion in bond proceeds (i.e., deficit financing) from the Transitional Finance Authority to offset the projected loss in revenue from the attack on the World Trade Center. The inclusion of bond proceeds in the operating budget overstates the improvement in the City’s financial condition.

## B. State Actions

The enacted State budget restored most of the budget cuts proposed by the Governor, most notably education aid, and the State Legislature approved a City aid program that allowed the City to raise personal income and sales taxes, and authorized the State to relieve the City of the debt service costs on outstanding debt of the Municipal Assistance Corporation. While the actions taken by the State differ from those assumed in the Mayor’s Executive Budget, the City met its target for State assistance in FY 2004.

**1. Personal Income Tax**

The State Legislature authorized the City to raise the personal income tax for upper-income taxpayers. The increase is retroactive to January 1, 2003, and will remain in effect until December 31, 2005. Two new rate brackets have been added, and a rate benefit recapture provision (similar to one used by the State) eliminates the benefit of the lower rates at the bottom of the rate table, thereby converting higher-income taxpayers to a flat-rate system. This recapture begins at adjusted gross income levels of $150,000 for married couples filing jointly; $125,000 for heads of households; and $100,000 for single taxpayers and married couples filing separately. The current 14 percent surcharge, which was scheduled to expire on December 31, 2003, has been extended and incorporated into the new rate structure. These changes will generate an estimated $645 million in FY 2004, $546 million in FY 2005, $345 million in FY 2006, and $15 million in FY 2007.

The City's surcharge parallels the new three-year surcharge enacted by the State Legislature to help balance the State budget. In general, we estimate that higher State and City personal taxes on City residents will cost about $1 billion, but will be more than offset by reductions in federal personal income taxes enacted by Congress (see "Federal Actions" for further discussion).

**2. Municipal Assistance Corporation**

The State Legislature passed legislation that provides $170 million in annual assistance over a 30-year period to New York City through the Local Government Assistance Corporation beginning in FY 2004. The City intends to create a new local development corporation that would issue debt to defease nearly all of the $2.2 billion of outstanding Municipal Assistance Corporation (MAC) debt. MAC was created in June 1975 to provide financing assistance to the City during the 1970s fiscal crisis, when the City had lost access to the credit markets. The $170 million is about equal to the annual debt service costs of refinancing the outstanding MAC debt over a 30-year period. Under this plan, the State would effectively relieve the City of about $500 million in annual MAC debt service costs through FY 2008. While this transaction would benefit the City budget by $2.5 billion over five years, the cost to the State would total $5.1 billion. The Governor claims that the law is unconstitutional because the bill attempts to bind the State to pay $170 million annually for the next 30 years and did not expressly provide that the payment is subject to annual appropriations. The City believes that the legislation is constitutional and that current law already requires an appropriation for payment to be made. Under the legislation the first payment is required to be received by June 30, 2004. The City intends to market the bonds of the local development corporation and to complete the transaction before September 2003. The Governor is strongly urging the City not to go forward with the transaction until the constitutional, legal, and other issues are clarified. The Comptroller believes that refinancing debt from the City's fiscal crisis for another 30 years is a costly and inappropriate way to provide budget relief to the City, and that alternatives should be considered.

**3. Education Aid**

In January 2003, the Governor proposed reducing State education aid by $1.4 billion, including $478 million in reduced aid to the City. In addition, in his budget the Governor did not include $275 million to continue an extension of the school day, which the State funded in FY 2003; this brought the total cut to the City to $753 million. The State Legislature restored $403 million of the Governor's proposed budget cuts and took other actions that provided the City with $112 million in additional aid. In total, the City received $515 million in State education aid in FY 2004, or $238 million less than anticipated. The City, however, was able to offset this shortfall with other resources authorized by the State Legislature, which allowed the City to avoid further cuts in educational services.

**4. Sales Tax**

The State Legislature authorized the City to raise its sales tax by one eighth of a percentage point beginning June 1, 2003 and ending May 31, 2005.[3] As part of the sales tax increase included in the budget adopted by the State Legislature, the exemption on individual clothing items that cost less than $110 was suspended from June 1, 2003 through May 31, 2004, although localities were given the option of approving two one-week exemption periods. The rate increase is estimated to be worth about $115 million in FY 2004 and $111 million in FY 2005, and the elimination of the clothing exemption would generate another $262 million in FY 2004. These and other actions bring the total increase in sales tax revenues to $387 million in FY 2004. The City Council also approved two one-week exemption periods, which will reduce collections by an estimated $47 million in FY 2004. In addition, the City Council approved the reinstatement of the clothing exemption as of June 2004, which will reduce sales tax revenues by $23 million in FY 2004 and by about $280 million annually thereafter.

The City sales tax increase parallels an increase in the State sales tax also approved by the Legislature. The Statewide sales tax rate would be increased by one quarter of a point, to 4.25 percent, for the two-year period ending May 31, 2005. The suspension of the sales tax exemption for individual clothing items that cost less than $110 would also apply. For City residents, the combined State, City, and Metropolitan Transportation district sales tax rate would now be 8.625 percent, compared to the current

[3] The cigarette tax was also included in the sales tax base.

8.25 percent. The combined rate results in $3.75 in additional tax for every $1,000 of taxable purchases. The elimination of the clothing exemption, however, has a much greater impact: Every $1,000 spent on smaller, formerly tax-exempt items will now cost an additional $86 in sales tax.

### 5. Financing Initiatives

The City anticipates resources of $203 million in FY 2004 from State financing reforms. Battery Park City Authority will restructure certain housing-related bonds, which will facilitate the purchase of City-owned land and provide the City with $150 million in FY 2004. In addition, the City will be able to continue the use of swaps and floating rate debt, which will reduce debt service costs by $35 million in FY 2004. In addition, the Dormitory Authority has refinanced debt on behalf of the City University of New York, which generated savings of $15 million in FY 2003 and another $18 million in FY 2004. The Legislature did not approve changes in the tax code that would enhance the lease-financing arrangements relating to the sale of tax benefits to a private entity. The City was unable to complete this transaction during FY 2003 as planned, and the June Plan does not anticipate resources from this transaction.

### 6. Medicaid Cost Containment

The Governor proposed and the State Legislature approved cost-containment measures that will reduce City-funded Medicaid expenditures by $134 million in FY 2004. While the Plan assumes that only $16 million in savings will recur in future years, it is possible that the State will reauthorize these initiatives next year. The initiatives include increased drug reimbursements, enhanced rebates from pharmaceutical companies, shifting eligible health care expenditures to Medicare, higher premiums for Family Health Plus recipients, and a reduction in the number of part-time clinics.

### 7. Private Bus Subsidy

The June Plan assumes that the City and the Metropolitan Transportation Authority (MTA) will reach an agreement by January 1, 2004, which would allow the City to reduce its funding to private bus subsidies by $75 million in FY 2004 and by about $150 million annually thereafter. The current agreement between the City and the seven private bus lines expires next year and the City would like to transfer operational and financial responsibility to the MTA. While the MTA has indicated a willingness to operate the private bus lines, it is opposed to assuming the financial responsibility. Until an agreement is reached between the MTA and the City that allows the City to reduce its subsidy, the anticipated savings are uncertain.

## C. Federal Actions

The tax reduction bill recently passed by Congress and signed into law by the President provides $20 billion in budget relief over two years to states and localities. The first $10 billion is targeted for Medicaid relief, and it is estimated that New York City will receive $290 million over the 15-month period ending June 30, 2004. The second $10 billion will be provided to states in the form of revenue-sharing, and New York State will receive an estimated $650 million. Whether New York City and other localities will share the benefit remains to be seen. The federal government also recently approved an appropriation of $700 million in counterterrorism funds for high-risk cities. The June Plan assumes that the City will receive $25 million in FY 2003 and $125 million in FY 2004, but assumes that only the first $25 million will be used for gap-closing purposes. The balance will be used to fund new counterterrorism measures.

The recently enacted federal tax reduction program is valued at $330 billion over a ten-year period and will accelerate rate reductions, expand the child credit, and allow some alternate minimum tax and marriage penalty relief. Dividend income will now be taxed like capital gains, at a preferential rate. This rate will be 15 percent, with a 5 percent rate for those in the lowest rate bracket. To keep the ten-year cost of the overall bill within agreed dollar limits, several provisions will expire between 2005 and 2009, including the reduction in the tax rate on dividend income.

The federal tax cuts will not affect City tax collections, because the City’s personal income tax is linked to the federal definition of income, and this has not changed. While earlier proposals to exempt dividends from taxable income would have affected the City, the final bill keeps the current definition of dividend income and only changes the tax rate. Federal enhancements to business deductions will also not affect the City, since it has decoupled from federal law.

We estimate that the collective effect of the dividend/capital gains reduction, the acceleration of the planned rate reductions, marriage penalty relief, and expansion of the 10 percent rate bracket will save City residents approximately $3.2 billion in the first year, which will more than offset State and City personal income tax surcharges. In addition, the federal reduction will also benefit taxpayers with incomes lower than $100,000. Table 6 presents examples of average taxpayers at various income levels to illustrate the combined impact of the State and City personal income tax increases and the offsetting federal tax benefit.

**Table 6**
**Impact of Changes in Federal, State, and City Personal Income Taxes on City Residents**

| New York State Adjusted Gross Income | Change in State Tax Liability | Change in City Tax Liability | Change in State and City Tax Liability | Change in Federal Tax Liability | Net Change Tax Liability |
|---|---|---|---|---|---|
| **Single, no dependents** | | | | | |
| $100,000 | $ 0 | $ 0 | $ 0 | $ (1,504) | $ (1,504) |
| $150,000 | 210 | 195 | 405 | (2,762) | (2,357) |
| $200,000 | 1,147 | 1,180 | 2,327 | (5,297) | (2,970) |
| $250,000 | 1,434 | 1,446 | 2,880 | (7,625) | (4,745) |
| $600,000 | 4,498 | 4,362 | 8,860 | (21,182) | (12,322) |
| **Married filing jointly, 2 dependents** | | | | | |
| $100,000 | $ 0 | $ 0 | $ 0 | $ (1,442) | $ (1,442) |
| $150,000 | 0 | 0 | 0 | (2,534) | (2,534) |
| $200,000 | 1,123 | 1,252 | 2,376 | (4,318) | (1,942) |
| $250,000 | 1,409 | 1,517 | 2,926 | (6,078) | (3,152) |
| $600,000 | 4,458 | 4,418 | 8,876 | (19,355) | (10,479) |

Note: In general, there is no increase in either State or City personal income tax liability for taxpayers of any filing status with adjusted gross incomes of $100,000 or less. The change in federal liability also reflects the impact of increased itemized deductions due to higher State and local taxes.
Source: OSDC analysis

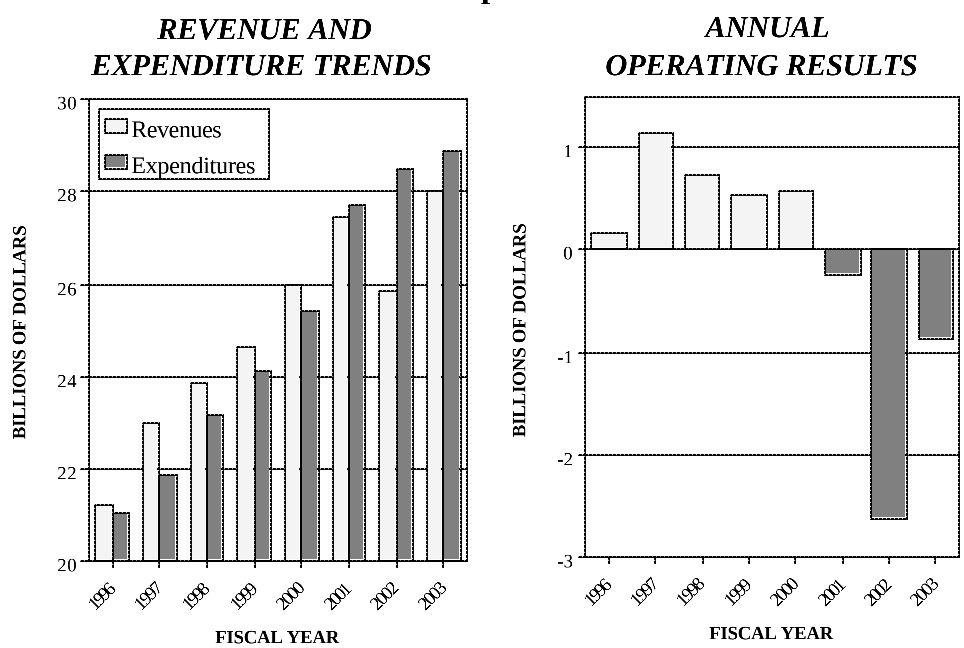
## D. Port Authority of New York and New Jersey

For years, the City has sought additional payments from the Port Authority of New York and New Jersey for leasing LaGuardia and Kennedy airports. The Port Authority is a bistate agency, which is effectively controlled by the governors of New York and New Jersey. Newark Airport recently reached a settlement with the Port Authority for a retroactive payment and an increase in future payments. The Governor promised to obtain $500 million for the City, and in the event that an agreement is reached with the City the Port Authority has set aside $350 million in its capital budget. The June Plan anticipates $200 million in FY 2004, $583 million in FY 2005, and nearly $100 million annually thereafter. It remains to be seen whether the City and the Port Authority will reach an agreement.

# V. Revenue and Expenditure Trends

Between fiscal years 1996 and 2000, City-funded spending grew by 21 percent, an annual average growth rate of 4.8 percent—more than twice the local inflation rate.[4] Under normal circumstances, the City would have been unable to support such a rapid rate of growth, but revenues fueled by the Wall Street boom grew even faster (see Graph 1). While expenditures continued their rapid rate of growth in FY 2001—increasing by 9 percent—revenues grew more slowly, by only 5.7 percent. Consequently, expenditures exceeded revenues by more than $200 million in FY 2001—a clear sign of fiscal stress, which was masked by the City's practice of transferring the prior year's surplus to the following year.

**Graph 1**




Sources: NYC Office of Management and Budget; NYC Comptroller's Office; OSDC analysis

Ignoring this warning, the City called for spending to increase by 5.5 percent in the adopted budget for FY 2002. The budgetary impacts of the economic slowdown and the attack on the World Trade Center, however, resulted in a decline in revenues—the first such reduction since FY 1995 and the largest in more than 20 years. The City balanced the FY 2002 budget, but only after taking into account surplus transfers from prior years and bond proceeds from the Transitional Finance Authority to cover costs that

[4] City-funded expenditures have been adjusted for the City's practice, which can distort expenditure patterns, of transferring the surplus from one year to the next by prepaying a portion of the following year's expenses.

the City would have incurred regardless of the attack on the World Trade Center, such as the base salaries of emergency personnel. In the absence of these resources, the City would have incurred a deficit of $2.6 billion from current-year operations[5] (see Graph 1).

The City was on course in November 2002 to incur a current-year deficit of $3.5 billion in FY 2003, as a result of lower revenue forecasts, rising pension costs, and other factors. Since November, the City Council enacted a mid-year property tax increase, and the City took other actions that will generate recurring benefits. These actions reduced the current-year deficit to $874 billion, which was funded with $1.5 billion in bond proceeds (i.e., deficit financing) from the Transitional Finance Authority to cover revenue losses related to the attack on the World Trade Center. The size of the out-year deficits will depend to a great extent on the pace of the economic recovery, future collective bargaining agreements, and the implementation of the recent Court of Appeals ruling that the State formula for distributing State education aid is unconstitutional. The Department of Education is likely to benefit from a significant increase in State funding, but the City could also be required to increase its own contribution.

## A. Revenue Trends

After declining sharply in FY 2002 due to the recession and the terrorist attack on the World Trade Center, City fund revenue growth resumed in FY 2003. Aided by the mid-year property tax increase, increased intergovernmental aid from the federal government to reimburse the City for expenses related to the World Trade Center attack, and significant levels of one-time resources, most notably the sale of TFA bonds used for deficit financing, City fund revenues are expected to grow by 12.7 percent or $3.4 billion in FY 2003, reaching $30.1 billion (see Graph 2).[6]

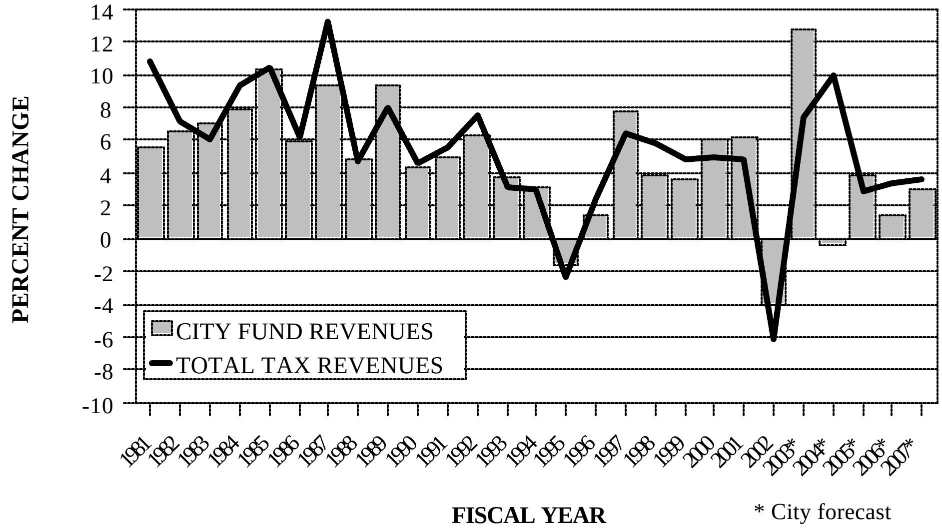
City fund revenues are projected to decline by 0.4 percent in FY 2004, as the loss of the one-time resources in FY 2003 will be almost completely offset by tax increases approved by the City (for a detailed discussion of State and City actions, see Chapter IV). With the economy projected to recover by calendar year 2004, revenue growth will resume in subsequent years of the Plan period, although gains will be limited as some of the temporary tax increases authorized in the State aid package begin to expire. Thus, projected City fund revenue growth reaches 3.9 percent in FY 2005, before slowing to 1.4 percent in FY 2006 and 3 percent in FY 2007.

[5] Current-year operations measure revenues and expenditures generated in the current fiscal year and exclude the benefits of prior years' surpluses and deficit financing.

[6] Our estimates of City fund revenues include the portion of personal income tax revenues dedicated to pay debt service on bonds issued by the Transitional Finance Authority, and tobacco settlement revenues dedicated to pay debt service on tobacco bonds.

**Graph 2**

***ANNUAL CHANGE IN CITY FUND REVENUES***




Sources: NYC Comptroller's Office; NYC Office of Management and Budget; OSDC analysis

*Tax Revenues*

Tax revenues, the largest source of City fund revenues, are projected to grow by 7.4 percent in FY 2003 (aided by the mid-year property tax increase), reaching $23.8 billion. Growth is projected to reach 9.9 percent in FY 2004 as the property tax increase becomes effective for a full year, the upper-income personal income tax surcharge takes effect, the sales tax is raised, and other smaller tax increases all combine to boost collections (see Table 7). As some of these tax increases expire, growth falls to 3 percent in FY 2005 before gradually rising again to 3.6 percent in FY 2007.

## Table 7
## Annual Change in Tax Revenues

(percent change)

| | FY 2003 | FY 2004 | FY 2005 | FY 2006 | FY 2007 |
|---|---|---|---|---|---|
| Property Tax | 15.0 | 13.8 | 2.7 | 3.7 | 3.7 |
| Nonproperty Taxes | 2.5 | 7.1 | 3.2 | 3.2 | 3.5 |
| Personal Income Tax | 0.5 | 15.9 | 3.7 | 1.1 | 1.4 |
| Sales Tax | 5.1 | 9.6 | -0.3 | 2.4 | 5.2 |
| Business Income Taxes | -5.8 | 2.5 | 12.9 | 7.3 | 4.6 |
| Real Estate–Related Taxes | 12.2 | -17.0 | 3.2 | 4.8 | 6.6 |
| Other Taxes | 10.0 | 6.9 | -5.8 | 3.4 | 2.2 |
| **Total** | **7.4** | **9.9** | **3.0** | **3.4** | **3.6** |

Sources: NYC Office of Management and Budget; OSDC analysis

Collections from the real property tax are forecast to reach $11.3 billion in FY 2004, an increase of $1.4 billion (13.8 percent) from the FY 2003 level. This gain reflects the full effect of the increase in tax rates passed in the middle of FY 2003 and a 5.7 percent increase in assessed values. With no further increase in the average Citywide property tax rate anticipated during the Plan period, projected growth in assessed values—about 3.5 percent annually—is the driving force behind the growth in property taxes during the remaining years of the Plan period.

As FY 2003 drew to a close, the economically sensitive nonproperty tax revenue collections appeared to be stabilizing. Personal income tax withholding collections were stronger than expected, and the June estimated payment was the first quarterly installment since early 2001 that did not show a decline compared to the prior year. Collections also benefited from several small administrative efforts, such as the State amnesty program and acceleration of some payment schedules.

During FY 2004, nonproperty tax collections are expected to grow by 7.1 percent to $14.9 billion. Although an expected improvement in the local economy will aid collections, much of the improvement will be due to tax increases. About $1 billion will be raised from increases in several major taxes, primarily the personal income and sales taxes. In addition, $150 million will be available from a one-time increase in Battery Park City Authority payments-in-lieu-of-taxes (PILOTs). Without these increases, nonproperty tax collections would fall by 1.8 percent. Our analysis indicates that FY 2004 tax collections, primarily from the business and personal income taxes, could be somewhat higher than projected by the City.

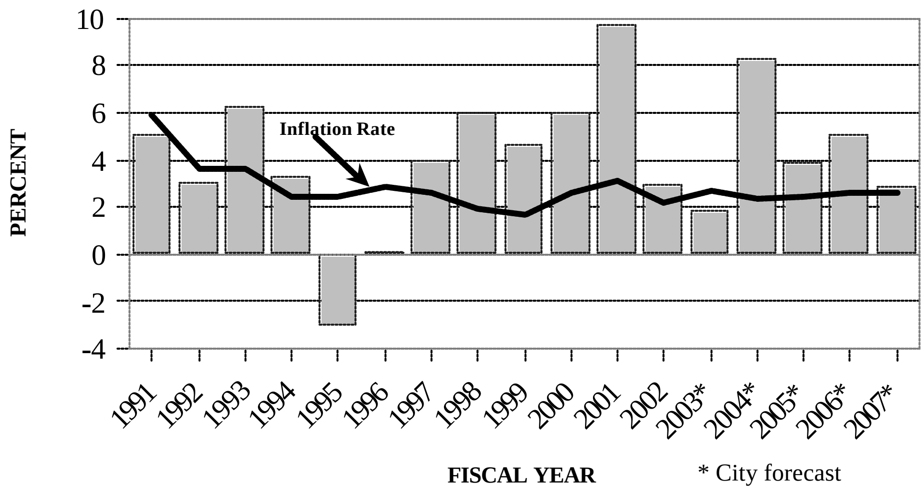
Nonproperty tax growth is forecast to slow to 3.2 percent in FY 2005 as the value of the upper-income personal income tax surcharge begins to phase out, the one-time PILOT increase is not replaced, and the sales tax exemption on individual clothing items that cost less than $110 is reinstated. Although the economy is expected to continue to improve, nonproperty tax revenue growth is expected to remain at 3.2 percent again in FY 2006 as the personal income tax surcharge continues to phase out and the temporary increase in the sales tax expires. Likewise, growth in FY 2007 is expected to stay at 3.5 percent as the personal income tax surcharge finally expires (however, the 14 percent surcharge, originally instituted in the early 1990s and incorporated in the new surcharge, is expected to be extended).

## B. Expenditure Forecasts

After increasing far more quickly than the local inflation rate during fiscal years 1997 through 2001, City-funded expenditures (adjusted for surplus transfers and including debt service on bonds issued by TSASC and the Transitional Finance Authority) during fiscal years 2002 and 2003 averaged 2.4 percent, which is slightly less than the average inflation rate for those years (see Graph 3). City-funded spending, however, is projected to increase by 8.2 percent in FY 2004, 3.9 percent in FY 2005, 5.0 percent in 2006, and 2.9 percent in FY 2007. Overall, expenditures are projected to grow at an annual average rate of 5 percent during fiscal years 2004 through 2007.

**Graph 3**

***CHANGE IN CITY-FUNDED EXPENDITURES***




Sources: NYC Office of Management and Budget; OSDC analysis

The major factors behind the growth in spending are mostly beyond the City's direct control (see Table 8). Debt service costs[7] are projected to increase by $663 million or 20 percent in FY 2004 and by $1.6 billion during the Plan period (an average annual rate of growth of 10.4 percent), despite cuts to the capital budget. Pension costs are projected to grow by $927 million (61 percent) in FY 2004 alone, and by nearly $2.8 billion during the Plan period—an average annual growth rate of 29 percent—because the City will have to make up for pension fund investment losses during fiscal years 2001 through 2003. Medicaid costs are projected to decline by $14 million in FY 2004, primarily because of federal aid to help governments cope with rising costs. However, during the balance of the Plan period Medicaid expenditures will increase by nearly $650 million, or an average of 5.5 percent a year. Health insurance costs for municipal employees are projected to increase at an average annual rate of 9.8 percent during the Plan period.

[7] Debt service estimates include City general obligation bonds, revenue bonds of the TFA, MAC, and TSASC, and lease payments. The Plan assumes that MAC bonds will be refinanced, which will generate annual savings of $500 million beginning in FY 2004.

**Table 8**
**Growth in City-Funded Expenditures**
*(Adjusted for Surplus Transfers)*
(in millions)

| | FY 2003 | FY 2004 | Annual Change | FY 2005 | FY 2006 | FY 2007 | Four Year Average |
|---|---|---|---|---|---|---|---|
| | | | | Increase/(Decrease) | | | |
| Salaries and Wages | $ 10,002 | $ 9,555 | (4.5)% | $ 9,599 | $ 9,641 | $ 9,608 | (1.0)% |
| Medicaid | 3,738 | 3,724 | (0.4)% | 4,222 | 4,366 | 4,370 | 4.0% |
| Debt Service | 3,330 | 3,993 | 19.9% | 4,559 | 4,757 | 4,941 | 10.4% |
| Health Insurance | 1,964 | 2,109 | 7.4% | 2,374 | 2,614 | 2,859 | 9.8% |
| Pensions | 1,532 | 2,459 | 60.5% | 3,083 | 3,893 | 4,300 | 29.4% |
| Other | 8,958 | 10,118 | 13.0% | 9,365 | 9,601 | 9,797 | 2.3% |
| **Total** | **$ 29,524** | **$ 31,958** | **8.2%** | **$ 33,202** | **$ 34,872** | **$ 35,875** | **5.0%** |

Sources: NYC Office of Management and Budget; OSDC analysis

### 1. Personal Service Costs

City-funded personal service costs are projected to increase by $3.5 billion between fiscal years 2003 and 2007, which is an average annual increase of 5.2 percent and more than twice the projected inflation rate. These estimates reflect rapidly growing costs for fringe benefits, such as pensions and health insurance. Salary and wage costs remain relatively stable during the Plan period, reflecting a reduction in staffing levels and the assumption that future collective bargaining agreements will be funded entirely with savings from productivity improvements.

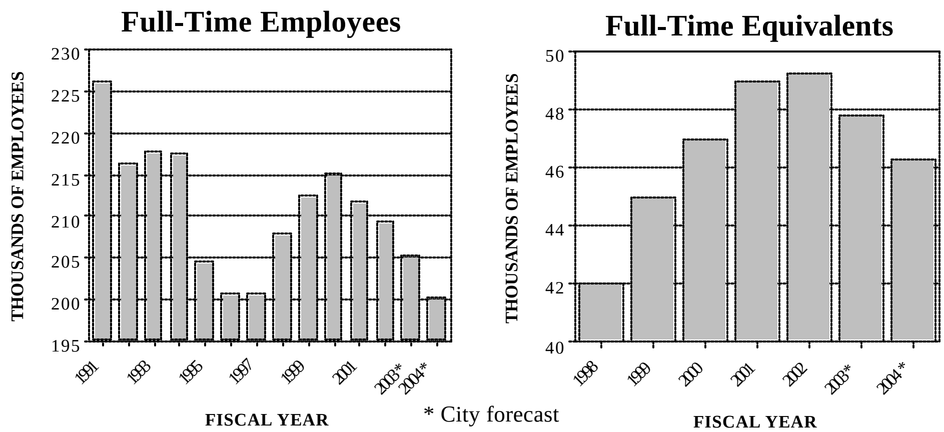
*Salaries and Wages*

City-funded salary and wage costs are projected to decline by $447 million in FY 2004, which reflects both the impact of the actions taken by the City to close large projected budget gaps, and the Plan assumption that future wage increases will be funded with productivity improvements.

The full-time City-funded workforce is scheduled to contract by 9,016 employees between June 2002 and the end of FY 2004, which would reduce the workforce to 200,276 employees—slightly below the level before the recent buildup began in FY 1997, and the lowest level since June 1985 (see Graph 4). The part-time workforce is expected to decline by 2,981 full-time equivalents between June 2002 and June 2004, a reduction of 6 percent. In total, the June Plan assumes that the mayoral agencies, the Department of Education, and the City University of New York will reduce their full-time and part-time workforces by 11,997 employees between June 2002 and June 2004 (see "Appendix B"), or 1,857 fewer than assumed in the April Plan due to the restoration of planned budget cuts.

**Graph 4**

## *CITY-FUNDED WORKFORCE*




Note: Full-time and part-time employee projections for FY 2004 have been adjusted for recent reclassificiations between categories, for purposes of comparability with prior years.

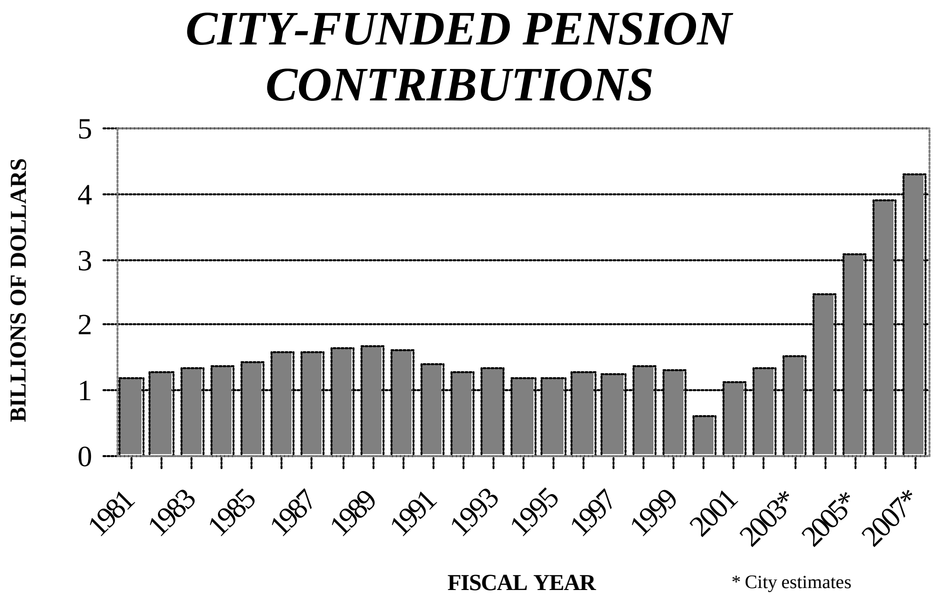
Sources: NYC Office of Management and Budget; OSDC analysis

### *Pension Fund Contributions*

Rapidly rising pension contributions present a significant obstacle to long-term budget balance. The City's contribution to the pension funds averaged $1.4 billion during fiscal years 1981 through 1999, but contributions are projected to increase by $927 million in FY 2004, to nearly $2.5 billion, and then grow to $4.3 billion by FY 2007, reflecting shortfalls in anticipated pension fund investment performance during fiscal years 2001 through 2003 (see Graph 5). The pension funds lost 8 percent on their investments in each of fiscal years 2001 and 2002, and the June Plan assumes a gain of only 2 percent in FY 2003 compared with an actuarial assumption of an 8 percent gain.

The April Plan had assumed that the pension funds would lose 8 percent on their investments during FY 2003, but the improvement in the stock market during the last quarter of the fiscal year allowed the City to raise its forecast to a gain of 2 percent. While still less than the actuarial assumed rate of return of 8 percent, the projected improvement allowed the City to reduce projected pension contributions in the June Plan by $441 million by 2007. In addition, the pension funds actually earned 3 percent, which could reduce future contributions by $8 million in FY 2004, $20 million in FY 2005, $35 million in FY 2006, and $55 million in FY 2007.

**Graph 5**




Sources: NYC Office of Management and Budget; OSDC analysis

Nevertheless, pension contributions are projected to increase at an average annual rate of 29 percent during fiscal years 2004 through 2007, 12 times faster than the local inflation rate and 6 times faster than other City-funded expenditures. About 90 percent of the increase is attributable to poor investment performance during fiscal years 2001 through 2003. Despite the recent improvement in the stock market, higher pension contributions will place an increasing burden on the City's budget, leaving fewer resources for other municipal services. Pension costs consumed only 4 percent of City fund revenues in FY 2001, but will consume 13.7 percent by FY 2007. Similarly, pension contributions are projected to reach 27 percent of salaries and wages by FY 2007, compared with an average of 11 percent during fiscal years 1992 through 2001.[8] The City has hired an actuarial consultant, as required under the City Charter, to conduct a biennial review of the methodologies and assumptions used to calculate pension contributions. The consultant's report will be completed during the next few months. The City's Actuary will review the recommendation and could suggest changing existing actuarial methods and assumptions that affect projected pension contributions.

[8] Pension contributions as a percentage of salaries and wages is a widely used measure to determine the burden that pension costs place on the budget. In FY 2000, pension contributions represented less than 5 percent of salaries.

*Collective Bargaining*

The City had limited success during the past year in obtaining assistance from the municipal labor unions to help balance the budget. The June 2003 adopted budget counted on more than $500 million in annual assistance from the municipal unions, but the City realized only $277 million in FY 2003 and declining amounts in subsequent years. These savings were achieved with the support of the unions and State legislation that permitted the City to extend, over ten years, planned pension contributions to fund cost-of-living allowances for retirees. The November Plan assumed $600 million in annual assistance from the municipal unions beginning in FY 2004. To realize these savings, the City suggested that employees pay a portion of their health insurance premiums, limit increases in health insurance costs to increases in the Medical Consumer Price Index, lengthen the workweek to 40 hours for all employees, reduce vacations and holidays, and reduce pension benefits for new employees. The municipal unions instead offered low-interest loans from the Health Insurance Stabilization Fund and some health insurance savings, and recommended that the City defer contributions to the pension funds and implement another early retirement program. The City rejected most of these proposals because most would only defer costs and not result in recurring savings.

Labor agreements with the unions that represent the City's employees have all expired and the Mayor maintains that future wage increases must be funded entirely with productivity savings. The City has established a collective bargaining reserve of $200 million for FY 2003, recognizing that even labor agreements that provide for productivity improvements may have a net cost in the first year. Wage increases at the projected inflation rate would increase costs by $275 million in FY 2003, $750 million in FY 2004, $1.2 billion in FY 2005, $1.7 billion FY 2006, and $2.3 billion in FY 2007.

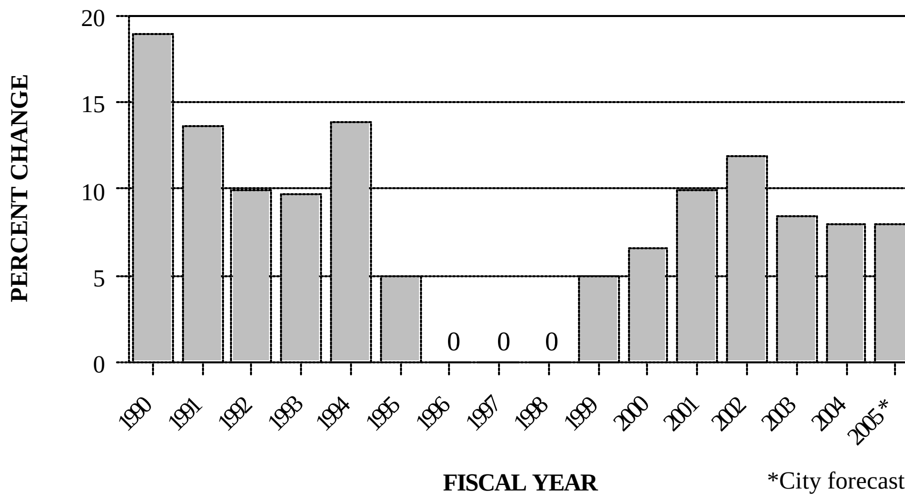
*Health Insurance*

City-funded health insurance costs are projected to grow from $2 billion in FY 2003 to nearly $2.9 billion by FY 2007, reflecting rapidly rising health insurance premiums. Premiums grew at a double-digit pace during the early 1990s, but the City then negotiated a three-year freeze in rates for fiscal years 1996 through 1998 as part of a package to help the City balance its budget during a period of fiscal stress. Since then, health insurance premiums have increased at a rapid rate, reflecting national medical and hospital care cost trends (see Graph 6). The Health Insurance Plan of Greater New York (HIP) increased premiums by 9.9 percent in FY 2001, 11.9 percent in FY 2002, and 8.5 percent in FY 2003.[9] HIP will increase its rates by 7.9 percent in FY 2004 and the June Plan assumes that premiums will increase by 8 percent annually thereafter.

[9] Under agreements between the City and its unions, premiums paid to HIP determine the City's cost for all municipal insurance providers.

**Graph 6**

***ANNUAL CHANGE IN HEALTH INSURANCE PREMIUMS***




Sources: NYC Office of Management and Budget; HIP

A January 2001 agreement between the City and the Municipal Labor Committee calls for negotiations on restructuring the funding sources for municipal health insurance, with the goal of reducing the City's contribution by $100 million in FY 2003 and $100 million in FY 2004.[10] The agreement guarantees the savings and states that if the parties are unable to restructure benefits, the committee will provide these savings through another source. The June Plan assumes that the parties will not restructure benefits and the City will draw upon $200 million in assets in the Health Insurance Stabilization Fund, leaving about $150 million. The fund was established to relieve employees who were paying health insurance premiums for Group Health Insurance and Blue Cross coverage that were higher than the premiums charged by HIP. As part of the restructuring agreement, the City and Municipal Labor Committee agreed that the Health Insurance Stabilization Fund would fund an expansion in drug coverage. These expenses have been higher than planned and could deplete the fund in the near future.

*Police Overtime*

During fiscal years 2001 through 2003, the Police Department spent an average of $350 million for overtime, exceeding planned levels by wide margins. A number of

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[10] For a detailed discussion of this issue see OSDC Report 9-2001, *Review of the Financial Plan for the City of New York: Fiscal Years 2001-2005*, issued March 2001.

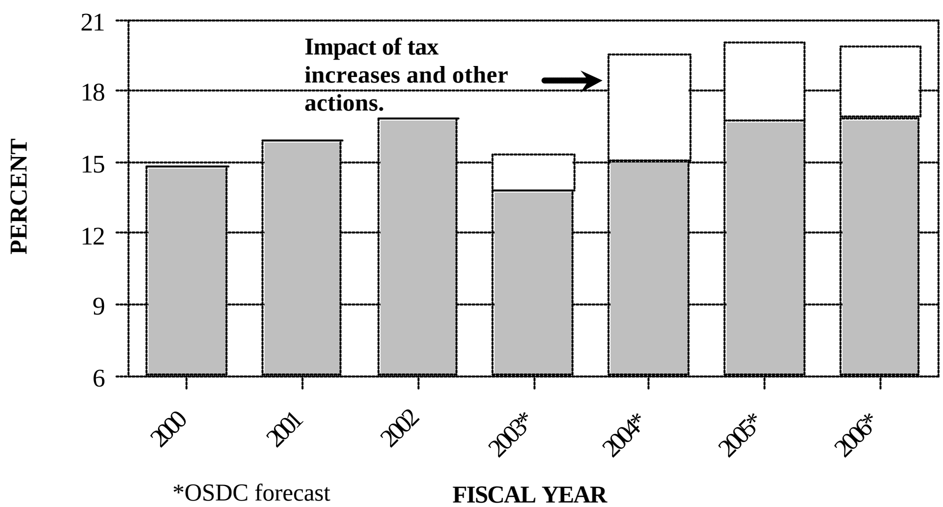
factors contributed to the high overtime levels, including heightened security and reductions in the size of the police force, which declined from a peak level of 40,754 in October 2000 to about 36,120 in June 2003, and will fall to 34,774 by the end of FY 2004. The June Plan assumes that overtime costs will average $189 million during the Plan period, far less than recent experience would indicate. We estimate that overtime costs are likely to exceed planned levels by a net of $100 million in FY 2004, and by $125 million thereafter.

### 2. Debt Service

Debt service costs are projected to reach nearly $4 billion in FY 2004, which is $663 million or 20 percent more than the FY 2003 cost of $3.3 billion. By FY 2007, debt service is projected to reach $4.9 billion, rising by $949 million—more than 7 percent annually and more than two times the projected rate of inflation. While these estimates reflect savings of about $28 million in FY 2004 from a recent bond refunding, the June Plan does not reflect additional savings of $29 million in FY 2005 and $10 million in FY 2006. The rapid growth in debt service costs will result in fewer resources for discretionary programs. The annual forecasts for debt service assume savings of about $500 million from refinancing outstanding bonds of the Municipal Assistance Corporation bonds (see Chapter IV for a detailed discussion of this proposal).

**Graph 7**

***NEW YORK CITY***
***DEBT SERVICE BURDEN***




Sources: NYC Office of Management and Budget; OSDC analysis

The debt service burden (debt service as a percent of tax revenues and offsetting revenues, including amounts to support TFA and TSASC debt service) is projected to peak at 16.9 percent by FY 2006. The City's projected debt service burden has been greatly reduced over the last year through the refunding of bonds, cuts to the City-funded[11] portion of the capital program, an increase in property and personal income taxes, and anticipated early retirement of MAC bonds. Without these actions, the debt service burden would have reached 20 percent by FY 2005 (see Graph 7).

The June Plan assumes that a portion of the City's capital program will be funded with proceeds from the sale of TSASC bonds, which are backed by revenues from the national tobacco settlement with the major cigarette manufacturers. Recent developments, however, could make that plan more costly and perhaps impractical. Moody's Investor Service recently downgraded R.J. Reynolds to below investment grade, which triggered a "trapping event" in TSASC bonds that requires the City to reserve an amount equal to 25 percent of outstanding principal, which is about $315 million. The City is considering options that would mitigate the budgetary impact.

### 3. Medical Assistance

City-funded Medicaid expenditures are projected to total $3.7 billion in FY 2004 (see Graph 8), $14 million less than the FY 2003 forecast. A temporary increase of $232 million in the federal share of Medicaid costs, and a one-time savings of $134 million from State cost-containment measures account for the small reduction in City-funded Medicaid costs in FY 2004, although the overall cost of the program continues to grow.

The upward spiral in City-funded Medicaid expenditures will resume in FY 2005 when such costs are projected to increase by 13.4 percent. This large increase reflects both normal growth and the elimination of the temporary increase in federal funding. During the remainder of the Plan period, the City assumes its costs will increase by 3.4 percent in FY 2006 and then remain flat in FY 2007. Between fiscal years 1998 and 2002, the average rate of growth in City-funded Medicaid expenditures was 7.1 percent. While the rate of growth assumed for FY 2004 was in line with that average (after adjusting for the extraordinary infusion of funds), the growth rates assumed for FY 2005 and beyond are well below the established pattern. In the absence of additional cost-containment initiatives or additional federal assistance, we estimate that City-funded Medicaid costs could exceed the levels in the June Plan by $75 million in FY 2006 and $100 million in FY 2007.

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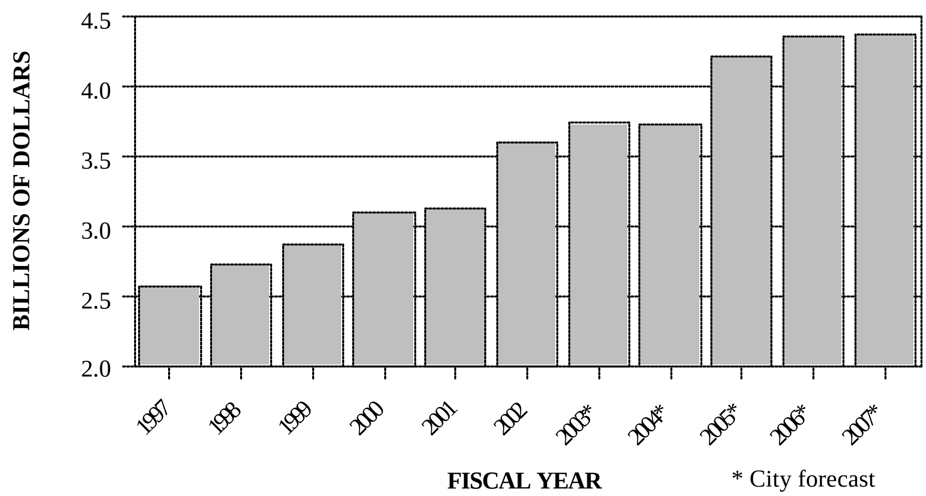
[11] City-funded capital projects are financed with general obligation, TFA, TSASC, and lease appropriation debt.

Even using the lower estimates assumed in the June Plan, City-funded Medicaid expenditures are expected to consume a larger share of City-fund revenues, rising from 12.5 percent in FY 2004 to 14 percent in FY 2005, leaving fewer City resources for other services. This expansion results from the escalating cost of medical services and a 15 percent increase in enrollment (to more than 2.2 million persons) as a result of outreach efforts during the twelve-month period ending March 2003. Enrollment is now at the highest level ever recorded in New York City. During the first 11 months of FY 2003, drug expenditures alone increased 20.8 percent; acute care costs rose by 6.7 percent; and long-term care costs rose by 9.8 percent compared to FY 2002.

**Graph 8**

***CITY-FUNDED MEDICAID EXPENDITURES***




Sources: NYC Office of Management and Budget; OSDC analysis

The State is now considering reforms in Medicaid financing to help ease the fiscal burdens on local governments. New York State is one of the few remaining states that still require localities to fund such a substantial portion of Medicaid expenses. The New York State Senate formed a bipartisan commission to propose strategies for managing the largest and fastest-growing categories of Medicaid spending—long-term care, acute care, and pharmaceuticals—while attempting to maintain service levels. The commission is expected to report to the State Legislature in the fall of 2003.

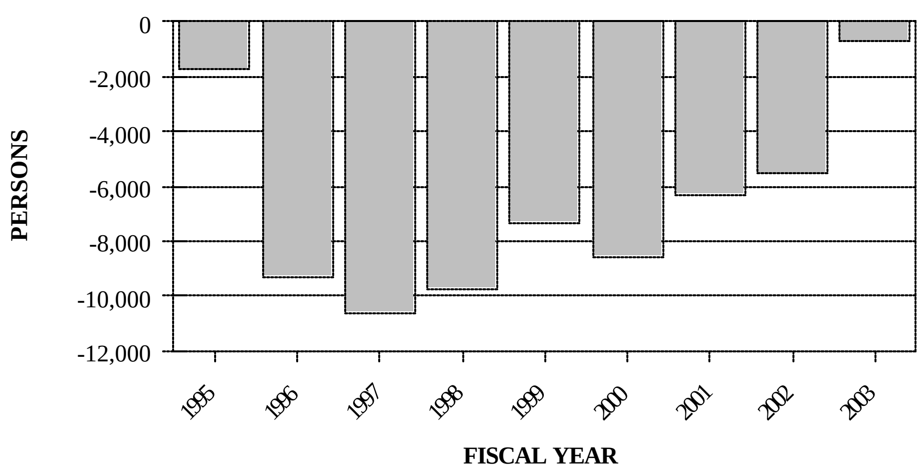
### 4. Public Assistance

Public assistance is essentially comprised of three programs. The largest is the Family Assistance program, which is administered by the State and assists families for a maximum of five years with federal funds from an annual block grant. The two other programs are components of the State's Safety Net Assistance program. One program primarily serves single adults and the other serves families who exhaust their federal benefits. Benefit levels for all three programs are the same, but the average grant per person can vary based on the needs of recipients. The State and City generally share equally in the cost of the two Safety Net Assistance programs.

Since FY 1995, New York City's public assistance caseload has declined by over 60 percent, but the rate of decline has slowed dramatically. In FY 1997, over 10,000 persons left the caseload each month, but the rate of decline averaged only 739 persons per month during FY 2003 (see Graph 9). The June Plan assumes that the caseload will consist of 420,765 persons by the end of FY 2004, which is 2,303 fewer persons than the FY 2003 average.

**Graph 9**

***AVERAGE MONTHLY DECLINE IN PUBLIC ASSISTANCE RECIPIENTS***




Sources: NYC Human Resources Administration;
NYC Office of Management and Budget; OSDC analysis

The Family Assistance caseload, including families that exhaust their federal benefits and who then receive benefits under Safety Net Assistance, continues to decline, but at nowhere near the levels achieved in prior years. In FY 2003, 39,000 persons left Family Assistance; in each of the seven years preceding FY 2003, annual caseload declines averaged 68,000 persons. We also note that the adult Safety Net Assistance caseload increased by 7 percent between fiscal years 2002 and 2003. Unemployment rates for the City's low-income workers and poverty rates have been increasing since calendar year 2000. These trends are likely to continue and could drive up costs in the Safety Net Assistance program, the most costly component of public assistance.

Congress has put off implementing changes to the landmark welfare reform legislation enacted in 1996, as well as other programs serving people whose incomes are below poverty level. The changes under consideration could have a significant impact on the City's budget and on those who depend on these programs. For example, Congress is debating whether to raise mandatory minimum work participation rates, which will require the provision of additional employment services such as training, child care, and transportation subsidies. The President has proposed block grants for Section 8, a federal program providing housing subsidies, which would shift the costs of rising rents and rising demand for housing subsidies to the City and to the State. This could exacerbate the problems already faced by low-income families seeking affordable housing in New York City.

### 5. Children's Services

The Administration for Children's Services (ACS) provides child welfare services and child care, and administers child-support enforcement. The June Plan includes a total of $2.1 billion for ACS in FY 2004—$227 million less than the FY 2003 level. New York City would contribute $527 million; New York State would provide $503 million; and the federal government would provide the remaining $1.1 billion.

Since FY 2002, ACS has absorbed the largest reduction in City funding of all the City's social service agencies, both in absolute dollars and in percentage terms. Between July 2001 and April 2003, the City reduced planned funding in FY 2004 for child welfare services by $54 million, and for child care by $107 million, which was partially offset by an increase of $19 million in community development block grant funds. The June Plan restores $11.6 million in City funding for child welfare and $10.9 million for child care.

In January 2003, a New York City union of child care workers filed a lawsuit that alleged that New York City violated State and federal regulations when it reduced funding for child care services offered by ACS. The case was dismissed, but the issues raised in the case are likely to persist. City funds budgeted for child care are vulnerable to cuts because the City already spends far more than the minimum amount required by the State. Moreover, child care workers employed by vendors under contract to the City have gone without a raise since their contracts expired in December 2000. Under the existing contracts with the City, these agencies assert that the City is not providing sufficient funds for them to reach a new labor agreement with their employees.

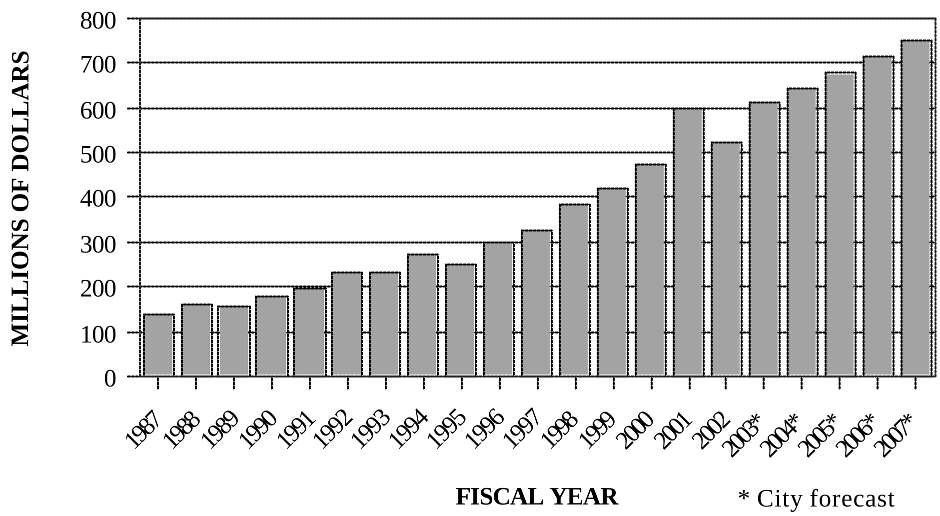
### 6. Judgments and Claims

The June Plan assumes that costs for judgments and claims will increase from $613 million in FY 2003 to $752 million by FY 2007, an average growth rate of 5 percent (see Graph 10). Costs for judgments and claims have grown rapidly since

FY 1995, with the sole exception of FY 2002 because of delays caused by the attack on the World Trade Center. The major factors behind the rapid growth are an increase in the number and size of cases that cost $1 million or more, and high medical malpractice costs. Cases that cost over $1 million have more than doubled, rising from $123 million in FY 1998 to an estimated $260 million in FY 2003. Medical malpractice cases, which have the highest average cost per case at about $600,000, constitute about one third of judgments and claims expenditures, and have increased by 52 percent since FY 1998. The State Legislature recently revised the formula for awarding damages and fees in medical malpractice cases. The Legislature expects the new formula to produce savings for public hospitals on medical malpractice awards, but would affect only new cases.

**Graph 10**

***JUDGMENTS AND CLAIMS EXPENDITURES***




Sources: NYC Comptroller's Office; NYC Office of Management and Budget

The City's estimates do not reflect its potential liability arising from the attack on the World Trade Center. The City has received 1,653 lawsuits and 423 notices of claim, with an aggregate value of nearly $15 billion; about 80 percent of this amount relates to claims filed by firefighters and other emergency workers. The ultimate outcome and fiscal impact on the City, if any, is not currently predictable. City estimates also do not reflect the impact of recent legislation that shifts responsibility for sidewalk accidents from the City to private property owners (but would not apply to one-, two-, and three-family residential homes). The City estimates that the savings from the new legislation will increase each year and could reach nearly $50 million annually by FY 2009.

# VI. Covered Organizations

Covered organizations are semi-autonomous agencies subject to the Financial Emergency Act, which include but are not limited to the Board of Education,[12] the Health and Hospitals Corporation, and the New York City Transit Authority. The City has a financial relationship with these agencies and may be called upon to provide additional funding to help balance their budgets.

## A. Department of Education

The New York State Court of Appeals recently overturned an appellate court and ruled that New York State failed to fulfill its constitutional mandate to provide a sound, basic education to New York City public school students. The Court gave the State until July 30, 2004, to implement reforms to ensure that City schools have the necessary resources. While these changes are likely to result in a substantial increase in funding to the Department of Education, possibly as soon as FY 2005, it is still unknown whether the City will be called upon to increase its contribution and whether the increase in State education will come at the expense of State funding for other programs.

The FY 2004 budget provides $13.9 billion for the Department of Education, including $1.4 billion for pensions and debt service. The federal government will contribute nearly $1.6 billion; New York State will contribute $5.7 billion; New York City will contribute $6.5 billion; and the remaining $27 million will come from sources such as fees and private contributions.

To help close projected City budget gaps, the City reduced planned education funding by $867 million between January 2002 and April 2003. Current State law prohibits the City from reducing its funding for education (excluding pensions and debt service) from one year to the next, unless there is a reduction in City revenues. The FY 2004 budget includes $5.1 billion in City funding, only $30 million more than the level forecast for FY 2003.

The department avoided laying off classroom teachers by shifting expenditures to the State and federal governments or to the capital budget; laying off the equivalent of 1,813 full-time paraprofessionals, aides, and counselors; reorganizing central and district-level administrative functions; implementing a centralized purchasing system; and realizing savings from higher-than-planned attrition. Preliminary data indicate that twice

[12] The Board of Education has been renamed the Department of Education by the Mayor, although the legal name remains unchanged.

as many teachers could retire in FY 2004 compared to FY 2003, which could generate higher–than-projected savings from teacher turnover.

In June 2002, the State increased mayoral accountability for New York City's public schools. Since then, the Mayor embarked on an ambitious reform program, asking to be judged on whether there is an improvement in educational performance. According to City officials, the Mayor's reforms could redirect existing resources to the classroom. The Chancellor has stated that the Mayor's reorganization of community school-district management will produce 5,000 new seats by September 2003, and 3,000 more seats by June 2004; free $125 million in existing resources for other purposes; and transfer a large number of teachers back to the classroom. Although parents and State legislators initially opposed the Mayor's district management reorganization, in June 2003 they agreed to settle a lawsuit that would have blocked the reforms.

On June 20, 2003, the State Legislature approved a replacement for community school districts. The approval allows the State Legislature to create community district education councils for each community school district, and one Citywide special education council, with each council comprised mostly of parents of current students. District education councils would advise the Chancellor on the capital budget, school district zoning, and the hiring of superintendents and other administrators. The special education council would advise the Chancellor on special education policy and the process of establishing special education committees and subcommittees, and would hold monthly public meetings and report annually on the effectiveness of Citywide special education services. The State Legislature's bill directs the Chancellor to establish a process by which council members would be chosen. The Governor signed the bill, but the changes are subject to the approval of the federal Justice Department.

## B. Health and Hospitals Corporation

The Health and Hospitals Corporation (HHC) ended FY 2002 with a cash balance of $340 million, but is expected to end FY 2003 with a smaller cash balance of $280 million. The FY 2003 cash balance is significantly higher than previously expected, due largely to a reimbursement for cash advances to capital projects for which permanent financing has now been secured. While HHC's fiscal position remains strong for FY 2004, there are large and increasing budget gaps on the horizon. HHC will need to combine the resources it carried forward into FY 2004 with savings from gap-closing actions in order to balance its budget and maintain existing service levels in FY 2005 and beyond.

HHC projects budget gaps of $521 million in FY 2005 and about $665 million in each of fiscal years 2006 and 2007. Moreover, these gaps do not reflect any potential increased costs for collective bargaining. The collective bargaining agreements for most

HHC employees expired in June 2002. To close these budget gaps, HHC assumes it will be able to obtain additional State or federal funding of $135 million in FY 2005 and $450 million annually in 2006 and 2007, but this appears unlikely. HHC's gap-closing program also counts on annual savings of $40 million in FY 2004 growing to $100 million in FY 2007, primarily from increased productivity and workforce reductions. Another $95 million annually is expected from cost-containment measures and revenue enhancements, such as higher-than-planned enrollment in public health programs. The challenge for HHC will be to maintain fiscal stability without diminishing the safety net that assures access to quality health care services for the indigent.

HHC has contracted with the Primary Care Development Corporation to improve service provision and customer satisfaction in order to retain and expand its patient base. The Ambulatory Care Restructuring Initiative has already achieved some encouraging results. Harlem Hospital reduced the time needed to complete a clinic visit by 61 percent, from 166 minutes to 65 minutes. At the same time, the number of patients seen hourly by a physician nearly doubled. On average, clinics at the Kings County Hospital Center reduced the time needed to complete a clinic visit by 56 percent, from 116 minutes to 51 minutes. Ambulatory care improvements will be fully implemented at all hospital-based clinics and at six diagnostic-treatment centers by June 2005. According to HHC officials, it is too early to estimate the potential fiscal impact of these changes.

## C. New York City Transit Authority

The New York City Transit Authority is the largest operating agency that comprises the Metropolitan Transportation Authority (MTA). On November 22, 2002, the MTA announced that it would end 2002 with a budget surplus of $24.6 million and that it faced a two-year budget gap of $2.8 billion for 2003 and 2004. On December 18, 2002, the MTA Board approved a financial plan for 2003 and 2004 that included $1.8 billion of MTA internal actions that reduced the combined budget gaps for 2003 and 2004 to $951 million; proposed raising subway, bus, and commuter railroad fares by as much as 33 percent; and proposed raising tolls on the MTA's largest bridges and tunnels by $0.50.

Amid mounting questions from elected officials, transit advocates, and union representatives about the MTA's finances, the State Comptroller-elect requested a review of the December 2002 financial plan even before assuming office on January 1, 2003. On January 3, 2003, members of the Comptroller's staff met with MTA budget officials, but many of the Comptroller's questions were not answered. Although responses to questions in subsequent correspondence yielded some useful information, overall the MTA's responses were unsatisfactory. On February 19, 2003, the State Comptroller took the extraordinary step of issuing subpoenas for records and testimony from officials of the

MTA for information regarding the financial plan that was approved by the MTA Board on December 18, 2002 (the "December Plan").

An examination of internal records and testimony from budget officials found that the MTA had two versions of its December Plan: the one it showed the public and the one it kept to itself. A review of the internal version of the December Plan revealed previously undisclosed transactions that moved resources off budget and from one year to another (see *An Examination of the Finances of the Metropolitan Transportation Authority*, Report 4-2004, for further details.)

These secret transactions had the effect of grossly reducing the projected size of the 2002 surplus by shifting resources to 2003 and 2004. If not for these transactions, the 2002 surplus would have totaled $537.1 million, $512.5 million more than acknowledged by the MTA. Of the undisclosed surplus, $248.3 million was transferred to 2003 and $264.2 million was transferred to 2004. MTA budget officials testified that they did not consider it a surplus if the resources were used up during the financial plan period. The end result of the MTA's actions, however, was to conceal the size of the 2002 surplus and to stifle the fare debate. An audit of the New York City Transit Authority conducted by the New York City Comptroller concluded that errors in the Transit Authority's financial statements combined with the shortcomings in the operating budget made it impossible to assess the financial position of the Transit Authority and make an informed judgment about the necessity for a fare increase.

The resources that were shifted to 2004, combined with other undisclosed resources, would have been sufficient to avoid a fare hike in 2003. Use of these resources in 2003, however, would have widened the 2004 budget gap by an equal amount. While it would have been imprudent to use all of the surplus resources in 2003, there was far more flexibility in the size and timing of the fare hike than was acknowledged by the MTA. MetroCard and E-ZPass enable an endless combination of fare and toll increases and discounts, and the MTA itself offered seven fare options and ultimately delayed the implementation of the fare hike from March to May 2003.

The failure to disclose the availability of these resources to the public foreclosed any consideration of fare options other than those proffered by the MTA. In subsequent events, a State Supreme Court judge found that the public hearings on the fare and toll increases "were based on the false and misleading premise that the MTA was in worse financial condition than it knew itself to be" and ordered the MTA to hold new hearings based on accurate information and to roll back the increases. A second State Supreme Court judge ruled similarly on the toll increases for MTA bridges and tunnels. The MTA appealed both rulings and the Appellate Division of the State Supreme Court recently overturned the lower court decisions. The Appellate Division concluded that the MTA's public notices of a fare increase were not misleading and noted that governing statutes require very little with regard to the content of the notices and nothing to the amount or kind of information underlying the MTA's budget processes or rationales that must be provided to the public. The plaintiffs intend to appeal, but must first receive permission from the Court of Appeals.

After a series of public hearings, the Assembly Committee on Corporations and Authorities proposed legislation to reform the MTA and make its operations more transparent and accountable to the public. The State Comptroller supports the Assembly's reforms, which include the creation of an independent budget office and closer scrutiny of its contracting process. The MTA has put forward its own legislative proposal to restructure the agency and is making changes to improve financial reporting. Meanwhile, the State Comptroller intends to promulgate regulations that will require the MTA to adopt budgetary practices that will ensure clear, comprehensive, and open reporting on its financial affairs.

# Appendix A
# Nonrecurring Resources In Fiscal Year 2003

The FY 2003 budget includes more than $4 billion from nonrecurring and other short-term actions (see Table 9). These actions helped the City balance the budget but will provide no long-term benefit. Borrowing in one form or another will free $3.6 billion for use in the operating budget during the course of fiscal years 2003 though 2007, with 86 percent of the proceeds dedicated to fiscal years 2003 and 2004. Future taxpayers will have to repay these "loans" at a cost of $5.4 billion and will receive no services in return.

**Table 9**
**Nonrecurring and Other Extraordinary Actions**
(in millions)

| | |
|---|---|
| Deficit Financing | $ 1,500 |
| Federal Aid | 799 |
| Debt Refunding | 565 |
| Phase-In Pension Costs | 277 |
| MAC Reserves | 250 |
| Municipal Bond Bank Loan | 198 |
| Education Resources | 190 |
| Health Insurance Savings | 100 |
| TSASC | 100 |
| State Aid | 73 |
| **Total** | **$ 4,052** |

Source: OSDC analysis

Our estimate of nonrecurring resources includes the following.

- $1.5 billion in TFA bond proceeds to reimburse the operating budget for revenue losses associated with the attack on the World Trade Center.
- $799 million in federal aid to reimburse costs related to the attack on the World Trade Center.
- $565 million from debt refundings, including those that generated one-time savings, but at the expense of higher costs in the future.
- $277 million and declining amounts in subsequent years from phasing in certain pension costs over a ten-year period, which will be repaid with 8 percent interest.
- $250 million from the Municipal Assistance Corporation by accelerating the receipt of reserve funds that were established with bond proceeds.
- $198 million in loans from the New York Municipal Bond Bank. The City intends to borrow against State education aid owed to the City from prior

years. These loans would be repaid over a 20-year period at an interest rate of 5 percent.

- $190 million for educational programs, including nonrecurring State education aid and resources set aside in a trust account to settle a lawsuit but no longer needed.
- $100 million from drawing down assets of the Health Stabilization Fund, pursuant to a January 2001 agreement with the municipal unions.
- $100 million in bond proceeds from TSASC (tobacco bonds) to fund the operating budget of closing the Fresh Kills landfill. Accounting principles prevent the City from using TFA or general obligation bonds to capitalize the cost of eliminating an asset, but a State law allows TSASC to fund these costs with bond proceeds.
- $73 million in accelerated State per capita aid.

# Appendix B
# City-Funded Staffing Levels

The June Plan assumes that the mayoral agencies, the Department of Education, and the City University of New York will reduce their full-time and part-time workforces by 11,997 employees between June 30, 2002 and June 30, 2004 (see Table 10). The most significant changes in staffing levels are described below.

- The Department of Education plans to reduce its City-funded workforce by 1,859 employees in FY 2004. The reduction primarily entails cuts in the number of school aides, family paraprofessionals, and counselors, which would be achieved largely through layoffs.
- The Police Department cut the cadet class scheduled for July 2003 by 1,900, reducing the police force to 34,774 officers by the end of FY 2004. This represents a reduction of 5,980 officers since a peak of 40,754 police officers in October 2000, which effectively returns the police force to the FY 1993 level. The department plans to add 300 traffic enforcement agents in FY 2004 in an effort to generate more ticket revenue, but attrition and early retirement would reduce the civilian workforce by a net amount of almost 300 employees.
- The Fire Department will reduce the number of firefighters by 225, primarily by closing 6 engine companies and by reducing manning in 23 engine companies.
- The Department of Correction will cut the number of uniformed employees by 1,122 because of a decline in inmate population. The department anticipates that about 400 employees, mostly correction officers, would be laid off.
- The June Plan assumes that the Department of Sanitation would reduce the number of uniformed employees by 615, primarily by curtailing recycling collections and by suspending glass recycling. The Mayor and the City Council, however, have agreed to resume weekly recycling and glass pickups in April 2004, which could restore half of the planned staff reductions.
- The Department of Parks and Recreation will reduce its workforce by about 3,100 employees, a reduction of nearly 50 percent from the June 2002 level. These actions could negatively impact park cleanliness and maintenance efforts.
- The Administration for Children's Services (ACS) will reduce its staff by 1,559 employees. One third of the reduction will come from transferring

employees to the Department of Social Services, one third will come from layoffs, and the balance will come from attrition and early retirement.

- The Department of Social Services reduced its workforce by 950 employees in FY 2003, primarily through attrition and early retirement. The workforce is projected to increase in FY 2004 by about 1,050, but more than half of the increase (568 employees) is attributable to the transfer of employees from ACS.
- The Department of Health and Mental Hygiene will reduce its staff by 406 positions, including 324 layoffs, which will reduce the number of public health assistants and eliminate Hepatitis B immunizations in City schools.

# Table 10
## City-Funded Staffing Levels

*Increase/(Decrease)*

| | | Fiscal Year | | | Annual Change | | Two-Year Change |
|---|---|---|---|---|---|---|---|
| | | FY 2002 | FY 2003 | FY 2004 | FY 2003 | FY 2004 | |
| **Public Safety** | | **83,778** | **81,539** | **79,359** | **(2,239)** | **(2,180)** | **(4,419)** |
| Police Dept. | Uniformed | 36,790 | 36,878 | 34,774 | 88 | (2,104) | (2,016) |
| | Civilians | 14,521 | 13,775 | 14,227 | (746) | 452 | (294) |
| Fire Dept. | Uniformed | 11,314 | 11,327 | 11,089 | 13 | (238) | (225) |
| | Civilians | 4,530 | 4,423 | 4,311 | (107) | (112) | (219) |
| Correction | Uniformed | 9,893 | 8,836 | 8,771 | (1,057) | (65) | (1,122) |
| | Civilians | 1,511 | 1,435 | 1,451 | (76) | 16 | (60) |
| District Attys. & Prosecutors | | 3,864 | 3,374 | 3,376 | (490) | 2 | (488) |
| Probation Department | | 912 | 1,025 | 946 | 113 | (79) | 34 |
| Other | | 443 | 466 | 414 | 23 | (52) | (29) |
| **Health and Welfare** | | **25,137** | **22,916** | **23,164** | **(2,221)** | **248** | **(1,973)** |
| Social Services | | 10,258 | 9,308 | 10,356 | (950) | 1,048 | 98 |
| Children's Services | | 7,889 | 7,407 | 6,330 | (482) | (1,077) | (1,559) |
| Health and Mental Hygiene | | 4,564 | 3,842 | 4,158 | (722) | 316 | (406) |
| Homeless Services | | 2,054 | 2,096 | 1,988 | 42 | (108) | (66) |
| Other | | 372 | 263 | 332 | (109) | 69 | (40) |
| **Environment & Infrastructure** | | **18,777** | **17,353** | **14,559** | **(1,424)** | **(2,794)** | **(4,218)** |
| Sanitation | Uniformed | 7,680 | 6,872 | 7,065 | (808) | 193 | (615) |
| | Civilians | 2,067 | 1,824 | 1,843 | (243) | 19 | (224) |
| Dept. of Transportation | | 2,320 | 1,993 | 2,011 | (327) | 18 | (309) |
| Parks & Recreation | | 6,323 | 6,255 | 3,231 | (68) | (3,024) | (3,092) |
| Other | | 387 | 409 | 409 | 22 | 0 | 22 |
| **General Government** | | **8,269** | **8,461** | **8,442** | **192** | **(19)** | **173** |
| Finance | | 2,364 | 2,264 | 2,310 | (100) | 46 | (54) |
| Law Department | | 1,312 | 1,239 | 1,220 | (73) | (19) | (92) |
| Citywide Admin. Services | | 1,406 | 1,425 | 1,470 | 19 | 45 | 64 |
| Taxi & Limo. Commission | | 424 | 475 | 481 | 51 | 6 | 57 |
| Investigations | | 322 | 291 | 266 | (31) | (25) | (56) |
| Board of Elections | | 356 | 324 | 328 | (32) | 4 | (28) |
| Info. Technology & Telecomm. | | 392 | 694 | 598 | 302 | (96) | 206 |
| Other | | 1,693 | 1,749 | 1,769 | 56 | 20 | 76 |
| **Housing** | | **1,467** | **1,444** | **1,489** | **(23)** | **45** | **22** |
| Buildings | | 863 | 829 | 908 | (34) | 79 | 45 |
| Housing Preservation | | 604 | 615 | 581 | 11 | (34) | (23) |
| **Department of Education** | | **112,687** | **112,664** | **110,805** | **(23)** | **(1,859)** | **(1,882)** |
| | Pedagogues | 91,110 | 92,367 | 92,387 | 1,257 | 20 | 1,277 |
| | Non-Pedagogues | 21,577 | 20,297 | 18,418 | (1,280) | (1,879) | (3,159) |
| **City University of New York** | | **5,750** | **6,066** | **6,069** | **316** | **3** | **319** |
| | Pedagogues | 3,465 | 3,972 | 3,972 | 507 | 0 | 507 |
| | Non-Pedagogues | 2,285 | 2,094 | 2,097 | (191) | 3 | (188) |
| **Elected Officials** | | **2,667** | **2,726** | **2,648** | **59** | **(78)** | **(19)** |
| **Total** | | **258,532** | **253,169** | **246,535** | **(5,363)** | **(6,634)** | **(11,997)** |

Sources: NYC Office of Management and Budget; OSDC analysis