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In early 1975, budgetary crises necessitated both State and Federal intervention to maintain New York City's financial operations. An Emergency Financial Control Board was created, giving the State an active role in city affairs, and Federal loans of \$2.3 billion were authorized. Findings/Conclusions: The fiscal and economic base of New York City continues to deteriorate, and this deterioration is at the root of the city's problems. It will continue to be difficult for the city to cut expenditures. To achieve a balanced budget in fiscal year 1978 will probably require major administrative actions and policy shifts at the Federal and state levels. Barring such shifts, 1977-1985 will be an extremely difficult period for the city. Declaring municipal bankruptcy will not solve the city's problems. The Federal Government should explore ways to generate better municipal fiscal information for better decisionmaking at all levels of government. A number of city efforts to improve its economic base have already occurred, and alternative Federal policies toward urban areas are suggested. (DJM)

00302

# *REPORT TO THE CONGRESS*



*BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES*

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## The Long-Term Fiscal Outlook For New York City



COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-185522

To the President of the Senate and the  
Speaker of the House of Representatives

This report assesses New York City's long-term fiscal and economic prospects. It is being released concurrently with our report entitled "Assessment of New York City's Performance and Prospects Under Its 3-Year Emergency Plan."

The main conclusions of this report are that:

- The rapid deterioration in the City's fiscal and economic base is the root of the City's problems.
- The City will continue to find it difficult to cut expenditures.
- Unless there are major State and Federal policy shifts, 1977-85 will be an extremely difficult period for the City, one that could be aggravated by national recession or inflation.
- Declaring bankruptcy will not solve the City's problems.
- Better budgetary and fiscal information on cities is needed, and the Federal Government should explore ways to improve the generation of information for better decisionmaking.

A number of Federal policy alternatives could be implemented to alleviate long-term decline in the older urban centers and to counteract the short-term swings in national economic activity that exacerbate the cities' problems.

The contents of this report have been discussed with City and State officials, and their comments were considered in preparing it.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), the Accounting and Auditing Act of 1950 (31 U.S.C. 67), and the New York City Seasonal Loan Act (P.L. 94-143).

B-185522

We are sending copies of this report to the Secretary of the Treasury and the Director, Office of Management and Budget.

A handwritten signature in black ink, appearing to read "Thomas P. Stearns". The signature is written in a cursive style with a large, prominent initial 'T'.

Comptroller General  
of the United States

## SUMMARY:

### THE LONG-TERM FISCAL OUTLOOK

#### FOR NEW YORK CITY

#### THE CITY'S FINANCIAL PROBLEMS

Until early 1975, New York City was able to pay its bills by borrowing in the capital markets whenever tax receipts fell short of operating expenditures. This practice was financially unsound, but New York had a unique ability to convince the financial community that this approach was feasible. In April 1975, the financial community was no longer willing to accept the City's money market instruments. The ensuing budget crisis necessitated both State and Federal government intervention to maintain the City's financial operations.

An Emergency Financial Control Board was created, giving the State an active role in City affairs, and Federal Government loans to the City up to \$2.3 billion were authorized to alleviate part of its cash-flow problems and to give it time to set its financial house in order. A 3-Year Financial Plan was formulated by City officials and approved by the Control Board. The plan calls for the City to eliminate operating deficits, balance its budget in fiscal year 1978, and consequently be eligible to reenter the capital markets at that time. The City is now midway through that 3-year effort.

#### REASONS FOR THE STUDY

Under the terms of the New York City Seasonal Loan Act (Public Law 94-143), we are to monitor the City's financial activities over the period fiscal year 1976 to fiscal year 1978 and report to the Congress. A report entitled "Assessment of New York City's Performance and Prospects Under Its 3-Year Emergency Financial Plan," is being issued under separate cover.

In addition to the immediate problems, however, we think that the Congress should be informed about the City's long-run economic prospects and that it be made particularly aware of the interrelationships between short-run budgetary decisions and the City's long-run economic and social viability. Accordingly, the study, "The Long-Term Fiscal Outlook for New York City" (PAD-77-1), looks beyond the

3-Year Financial Plan to assess the City's prospects under several different national and City economic and financial scenarios.

To accomplish this task, we had to analyze the short-run economic and budgetary problems facing the City and assess the economic costs and benefits associated with alternative courses of action. The study analyzes the City's economic base, changes in that base, and the impact of those changes on City revenue sources over the period 1977-85. The report attempts to identify unique aspects of the City's economic problems and to distinguish those unique factors from the common characteristics of declining urban centers. The study indicates that over the long run, barring major State and Federal policy changes, the City's ability to deliver services to its citizens is constrained by trends in its tax revenue base. The actions taken during the current 3-Year Financial Plan can have both positive and negative effects on that longer term base. The study attempts to isolate that portion of the City's problems that can be attributed to the general demographic and economic movement to the South and Southwest. Finally, long-run assessments, based on past, present, and probable future City actions, form the basis for our conclusions.

## CONCLUSIONS

Based on available information and an assessment of the City's recent budgetary and economic history, we conclude that:

1. The fiscal and economic base of New York City continues to deteriorate, and this deterioration is at the root of the City's problems. The City's economic base has been deteriorating because people, jobs, and businesses have been moving out of the City and into the South, Southwest, and West for a number of years. The reasons for that movement are complex; they include important changes in costs of living and doing business, the availability of land and labor, possible changes in tax burdens for firms and individuals, and the desire of many people for the outdoor lifestyle available in warmer climates.

Nevertheless, the impact on the City's economy has been notable and severe. During the 1960s, private sector employment in the City grew only 2 percent, compared to almost 27 percent in the entire country. During that decade, U.S. employment in manufacturing grew about 7

percent, but it declined in New York City by 19 percent (representing a loss of 180,000 jobs). Since 1970 the City has experienced a drastic decline in employment with a loss of 468,000 jobs; since 1969 manufacturing employment has fallen at an average annual rate of 48,000 jobs. The prospects for halting this trend are not bright. City policies that directly or indirectly influence its economic base are limited in number and scope. Governmental policies (at any level) have generally not been effective in revitalizing the fiscal base of a city or a region. Deterioration of large cities is a new experience in this country, and appropriate remedies have not been developed to refurbish a city like New York.

2. New York City will continue to find it difficult to cut expenditures. Accordingly, if the City is to achieve a balanced budget in fiscal year 1978, it will probably require major administrative actions and policy shifts at the Federal and State levels. The City, under its 3-Year Financial Plan, has made many cuts in its programs. Nevertheless, its budget has continued to grow. Further cuts are planned, but they will probably be difficult to identify and execute. Nonetheless, many more expenditure reductions will be necessary to balance the budget by 1978. Expense-cutting is made especially difficult for the City because it is unable to control large segments of its budget, such as welfare and Medicaid. Expenditures in these program areas represent a large fraction of the City's budget, yet the City has little budget control over them. Thus, new arrangements between the City and higher levels of Government may be necessary to alter the magnitude of uncontrollable expenses in the City's budget. The City's deteriorating economic base is not likely to allow the City to raise enough revenues to cover its expenditures by 1978.

In the City of New York's Financial Plan published January 6, 1977, entitled "Program to Eliminate the Budget Gap: Fiscal Year 1978," the City presented a program to restore a balanced budget by the summer of 1978. Much of that program involves action requiring State support and a great deal of Federal assistance that would provide budget relief.

3. Barring major policy shifts at the State and Federal levels, 1977-85 will be an extremely difficult period for the City. The City's budget is sensitive to economic factors. Our assessment of the influence of these factors on the budget indicates that, under the best of circumstances, the City will face extraordinary financial pressures in the late 1970s and the 1980s. Expenditure levels for the City are difficult to

cut, and revenue growth is limited by the City's deteriorating economic base and the insensitivity of certain sources of revenue to inflation.

4. Declaring municipal bankruptcy will not solve the City's problems. Although the municipal bankruptcy option is available to the City, none of the City's basic problems would be dealt with expeditiously under this option. Municipal bankruptcy would not solve the budgetary and financial problems or bolster the deteriorating economic base.

5. Better budgetary and fiscal information on cities is needed, and the Federal Government should explore ways to generate such information for better decisionmaking at all levels of government. In recent years, cities have made considerable progress in improving their accounting systems and budgetary information. Better fiscal, budgetary, and accounting information is needed by decisionmakers at all levels of government. Our studies in New York City and elsewhere have indicated that sufficient management and budgetary information does not exist for most cities. More and better data would allow cities to address their present and potential financial problems more comprehensively.

#### NEW YORK CITY EFFORTS TO IMPROVE ITS ECONOMIC BASE

The City has recognized that its economic base is an important element of its future financial viability. The City's newly founded Department of Economic Development has recently completed a detailed study aimed at securing a fundamental change in the City's policies as they affect its economic base. The proposed 5-year economic recovery plan includes capping the real estate tax, reducing the commercial occupancy tax, eliminating the sales tax on machinery and equipment through a tax credit process, and generally reducing business taxes when possible. Many other steps designed to improve the local business climate are also set forth. The program has been launched by the City administration. Various implementing steps will require the approval of the Emergency Financial Control Board and State or local legislation. We believe that these and future City efforts to firm up its economic base are steps in the right direction. However, it is not known whether these actions, by themselves, are sufficient to counteract the dramatic declines the City has experienced in its economic base.

#### ALTERNATIVE FEDERAL POLICIES TOWARD URBAN AREAS

Our analysis indicates that New York City's long-term problems reflect a long-term decline in economic activity

exacerbated by cyclical swings in national economic activity. During periods of recession, New York City, like many other older urban centers, experiences higher unemployment rates than the Nation as a whole. During periods of inflation, the City must finance rapid increases in the cost of public services with a revenue base that is relatively less sensitive to price changes. Thus, recession and inflation have added to the City's financial problems. In the absence of effective countermeasures, a recurrence of recession and inflation similar to the 1974-75 situation would make the City's budget problems even more severe.

The impact of recession and inflation on city finances is not unique to New York City; it is common to many, perhaps most, State and local governments. The effect on cities of fluctuations in the national economy is one of many reasons for the Federal Government to pursue effective economic stabilization policies. Reducing the national rate of inflation and unemployment would greatly benefit the Nation's cities.

One policy would be to introduce standby measures to offset the effects of economic downturns and periods of rapid inflation. One such approach might be antirecessionary aid to State and local governments which could be targeted to their needs. The difficulties of this approach include developing valid indicators of need, distinguishing problems resulting from national economic fluctuations from those resulting from long-term declines in particular regions or localities, and assuring that such aid does not undermine fiscal discipline at the State and local levels.

In addition to the problems created by recession and inflation, New York City is burdened by long-term economic decline. The City's economic base has eroded severely in the last decade, partly reflecting the relative decline of the Northeast region. Long-run fiscal prospects for the City are critically related to the direction of future changes in the local and regional economy. The Federal Government could move in several directions in trying to deal with urban and regional economic decline.

If the Federal Government chose to soften the blow of the economic movement from the Northeast, revenue sharing formulas could be altered to give additional weight to factors that are indicators of the declining economic base of cities. The Federal Government could also provide assistance aimed at alleviating the social costs imposed upon new and rapidly growing centers of economic activity. For this course of action, it would be difficult to draw a line between easing the adjustment process and becoming

committed to supporting a permanent level of services that cities would otherwise be unable to finance from local revenues. This approach risks undermining fiscal discipline at the State and local levels.

The Federal Government might try to retard the adjustment process by encouraging new or expanded economic development in the regions suffering from economic decline.

Efforts could also be made to design a set of incentives to encourage investment in declining localities and regions. Areas might also be revitalized through multi-state or regional organizational arrangements to coordinate plans and agree on development priorities. It should be noted, however, that the record of regional development efforts is spotty, both here and abroad. There have been few real successes and many instances where accomplishments have been limited. If this approach were to be chosen, emphasis should be placed on those economic activities for which the region is specially suited rather than on a broad effort to rebuild the region's traditional economic base.

We emphasize that this discussion is intended to illustrate the available options and the difficulties involved in any approach. Much more analysis will be required to provide a basis for choosing among those options or for devising an appropriate combination of them.

#### COMMENTS OF CONCERNED OFFICIALS

We received comments on this report from officials of the City and the Emergency Financial Control Board. The Office of the State of New York Special Deputy Comptroller for New York City was requested to provide comments, which it provided at the staff level. We requested, but did not receive, written comments from the Federal Office of Management and Budget and the Department of the Treasury.

The written comments which were received are summarized below.

#### City comments

City officials said our report was a comprehensive and thoughtful examination of the broader aspects of the City's current and long-term fiscal difficulties. The City reaffirmed its intent to balance its budget for fiscal year 1978, but indicated that its economic recovery will be possible only if the coalition of interests in the unions,

the financial community, the State and Federal governments, and the public continues to work together.

In its comments, the City indicated that several approaches that the Federal Government could adopt within the general framework of fiscal Federalism would aid the City. The City agreed with the major thrust of our conclusions.

#### Emergency Financial Control Board comments

The Board's executive director observed that, if the City cannot meet all of its credit needs privately after fiscal year 1978, it has no choice but to turn to the Federal Government for assistance. He was pleased that this issue was being raised in a new forum.

Federal assistance to the City could take various forms. There is a long history of Federal assistance to stimulate and support State and local programs, but direct Federal aid to a city, which the Federal Government has provided in the form of seasonal loans, presents a different policy question. Direct Federal Government aid to a local government with the explicit objective of enabling the local government to meet its overall fiscal needs may require certain safeguards to insure that the government has adequate incentives to efficiently manage its own financial affairs.

#### SUMMARY OF THE CONTENTS OF THE REPORT

The report reviews the City budgets for the past 15 years and describes important changes in the composition of its expenditures and revenues. It also reviews in detail the mayor's fiscal 1976 budget proposal and the budgetary implications of the 3-Year Financial Plan and its modifications.

The report also contains projections of City revenues and expenditures to fiscal year 1985 under various sets of assumptions about the performance of the national economy, State and Federal contributions to the City, and the City's ability to execute its 3-Year Financial Plan and attain budgetary balance in 1978. These alternative projections, which cover a range of possible outcomes, are intended to illustrate the types of fiscal problems the City might be confronted with after the completion of the 3-Year Financial Plan. Even under the best circumstances, the extraordinary current financial pressures on the City are likely to persist into the 1980s.

## Budgets past and present

New York City budget data indicates that the City has not had a surplus in its operating budget since 1960 and that the operating deficit has in recent years risen to \$500 million or more. Major factors contributing to this deficit have been the rapid growth in expenditures on social services, education, and health services--which make up about 60 percent of expenditures in the mayor's proposed 1976 budget. The 5-year period 1971-75 has seen debt increase from 11 to 15 percent of total expenditures.

The mayor's proposed 1976 budget was modified by the 3-Year Financial Plan, which in turn was revised several times. Major modifications occurred in debt service, social services, higher education, and in the various smaller agencies included under the "other" category. The result of these modifications was a projected 1976 deficit of \$1.05 billion. The City and the Control Board are apparently trying to constrain the fiscal 1977 budget expense totals to the fiscal 1976 levels. This suggests that the City may have substantial difficulty in attaining the balanced 1978 budget proposed in the most recent plan revision.

## Future budgets

Attempts to achieve a balanced budget will be affected by economic factors, such as persistent inflation and high rates of unemployment, as well as administrative factors, such as the City's ability to plan, initiate, and execute budgetary cuts.

The expenditure and revenue projections are based on two different inflation and national economy growth rates, combined with an assumption about whether the City will meet its 1978 Financial Plan balanced budget goal. Under the most optimistic set of assumptions (sustained economic growth, City attains goal), a very small deficit of \$15 million is estimated for 1985. Under the most pessimistic set of assumptions (cyclical economic growth, City falls short of goal), the deficit is estimated to be much larger.

## The concept of budget controllability

The report identifies four major sources of difficulty in the City's controlling its expenditures. These controllability problems, subject to solution over time or with changes in law, arise from the following sources:

1. Expenditures that reflect the City's long-term contractual obligations.
2. Programs legally mandated by other levels of government.
3. Independent boards within the City government structure itself.
4. General obligations to the public to maintain an orderly environment.

The first source of uncontrollable expenditures reflects the City's present and future obligations and includes such items as debt service and pensions. Public welfare and medical assistance are examples of the second category of uncontrollable expenditures. These are mandated at the State level, and the City, acting alone, cannot cut the benefit levels to participants. The third source of uncontrollable expenditure, independent boards and related nonprofit corporations within the City, is an area for which budget cuts have been proposed under the 3-Year Financial Plan. The report discusses some of the reasons for this success. The fourth source of uncontrollability is best illustrated by reference to the Police and Fire Departments--areas in which cutbacks are difficult because of the necessity of maintaining public order. The various ways in which all these constraints combine to limit City budgetary initiatives are analyzed as preparation for a more detailed discussion of budgetary issues and options within the various expenditures/program areas.

The report also reviews each major area of program expenditure and details the various budgetary options available to the City, acting on its own. Health and welfare are discussed together, and a close link is shown between levels of expenditures in these areas. Medicaid forms the basis for that link. The areas of welfare, health, education, debt, pensions, transportation, police, fire, sanitation, and public housing are discussed in detail. In addition, the various options and alternatives open to the City are summarized. The picture that emerges is that the City acting alone is severely constrained. It has made many of the "easier" cuts and is close to the point at which it cannot cut or even hold the line without help from other levels of government. If the City severely cuts certain segments of its budget, there is a real danger that the quality of City life will deteriorate.

## The municipal bankruptcy option

There is considerable disagreement about whether immediate default and bankruptcy would solve the City's financial and economic crises. Some argue that formally declaring bankruptcy would drastically disrupt the City's functioning; have severe spillover effects at the local, national, and perhaps international levels; and merely postpone the financial crises. Others suggest that the potential local, national, and international effects have been overstated; that bankruptcy would have a permanently favorable effect on the maturity composition of the City's debt; and that it would also help revitalize the City's economic base.

Our assessment indicates that chapter IX of the Federal Bankruptcy Act, as applied to the New York City situation, would not be the best way to solve the City's financial and economic difficulties. First, it does not address the City's economic problems and may, in fact, have harmful effects on the City's long-run economic viability if court-imposed solutions limit policy options aimed at revitalizing the economic base. Second, as a means of lengthening the maturity of the City's debt, bankruptcy should be viewed only as a last resort after normal market processes and other types of intervention have failed. For, although municipal bankruptcy might accomplish some of the same objectives, it:

1. May postpone the time at which the City can reenter the capital market both because of legal constraints and because of its potential for limiting rather than creating policy options aimed at solving the City's economic problems.
2. Is more likely to reduce investment values in New York City and the ability of other State and local governments to externally finance expenditures.

## Prospects for the City's long-term economic base

The City has experienced a migration of people and jobs to the suburbs and a movement of households and employment to the Southern and Western States. Between 1969 and 1974, employment declined in New York City while expanding by 35 to 44 percent in Arizona, Colorado, and Florida. Factors

contributing to this movement of jobs and business activity include technological developments (which have reduced the benefits of centralized facilities), energy cost differentials, and lower wages for industrial workers in other regions. Personal taste is also a major factor, since many people find the warmer, sunnier climates as well as lower living costs attractive.

Net migration from U.S. central cities totaled 7 million persons between 1970 and 1975, representing a fourfold annual increase over the 1960s. For a 5-year period of the 1970s, New York City's population decreased by 327,200 persons. In contrast, New York City suburbs, for the same period, showed a net population increase of 14,500 persons, only a small fraction of the City's population loss. Since those who migrate are younger, better educated, and more highly paid than those who remain behind, the City has been left with an increasing proportion of households which require public assistance.

To a large extent, the interregional movements of jobs and people reflect a set of nationwide social and economic adjustments. New York City is an aging, highly dense city which is losing population. It has twice as many municipal workers per capita as its surrounding suburbs and has traditionally paid them better. The resulting high payrolls, combined with increasing debt levels and the need for social services, has placed the City at a tax disadvantage relative to the suburbs since the City has to tax at higher rates to afford such expenses. High City taxes have contributed to the exodus of persons and business activity.

There is little direct evidence that intraregional or interregional shifts are largely attributable to fiscal or economic policies of any level of government. What does emerge from the available statistics, however, is that high taxes (particularly at the local level) have probably accelerated the rate of movement to the South and Southwest.

### State and Federal policy options

By what means could the State and Federal governments aid the City and how costly and effective would some of these policy options be? These questions must be viewed in a broader context than just aid to New York City, because other cities in financial trouble are likely to press for similar assistance. What, then, is to be the policy toward local governments which have or will have financial problems,

either because of local problems or because of the long-term decline of certain sections of the country?

The Federal Government is, of course, already heavily involved in State and local government finances, with general revenue sharing, matching grants, and other forms of programmatic aid and regulations. The questions of State and Federal policy options should be discussed in terms of goals, alternatives, and criteria by which policies are to be evaluated. The types of policy options are:

1. Improve the City's economic base.
2. Cut spending and increase revenues.
3. Improve management and control.
4. Redefine the region responsible for the function.
5. Federal or State takeover of certain functions.
6. State and Federal aid.

These options are appropriate to different degrees for the City, the State, or the Federal Government.

This report presents several examples of policy options, such as welfare reform, State takeover of the City university, and regionalization of the transportation system. These examples are presented not as recommendations, but as estimates of how such changes might or might not help solve the City's problems. In general, there is little chance of substantial relief from State aid, since the City is so large compared to the rest of the State. Certain types of welfare reform could reduce the City's financial burden, but they cannot solve its long-run problems. Moreover, in some illustrations City residents would have to pay higher State and Federal taxes.

The complex questions surrounding the option of massive Federal aid to cities--a so-called new "Marshall Plan"--are posed in this report. But our purpose is merely to provide an agenda for further analysis, not to answer questions that are fundamentally political as well as economic.

## MANAGEMENT AND BUDGETARY ASPECTS OF MAJOR NEW YORK CITY AGENCIES

The report also reviews the functions and some management problems of the seven major City agencies: the Human Resources Administration; the Board of Education; the Health and Hospitals Corporation; the Transit Authority; and the Police, Fire, and Sanitation Departments.

The Human Resources Administration and its subsidiary agencies control, coordinate, and dispense most of the family, social, and community welfare services. Federal and State aid is an important source of the agency's revenues, but it is accompanied by a host of State and Federal rules and regulations. The key issue is whether substantive improvements in the efficiency and economy of welfare programs can be achieved by the City without State and Federal action.

The task of providing public school education is shared by a citywide Board of Education and 32 community school boards. Since the City is attempting to reduce expenditures to meet its 3-Year Financial Plan, the issues appear to be (1) determining the appropriate balance between State and City support for public education and (2) deciding on the quality and total level of support to be provided. Similar issues are at the heart of the City university's problems.

The New York City Transit Authority operates subway and certain bus lines under the guidance of the Metropolitan Transportation Authority, a public benefit corporation. The primary issue is determining a fair allocation of costs among transit patrons, which includes City and regional taxpayers and other beneficiaries.

Efficiency and economy in operations can help solve financial problems facing all City agencies. Efficiency and productivity improvement play a dominant role in the operations of the uniformed services (police, fire, and sanitation). These departments are financed mainly from local taxes. The services provided are labor intensive and the quantity of services is proportional to staffing use. Defining and measuring productivity and determining the appropriate level of service are major tasks of management in these departments.

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#### ABBREVIATIONS

AFDC	Aid to Families with Dependent Children
CUNY	City University of New York
EFCB	Emergency Financial Control Board
HRA	Human Resources Administration
HHC	Health and Hospitals Corporation
MAC	Municipal Assistance Corporation
OMB	Office of Management and Budget

## CHAPTER 1

### INTRODUCTION

In each of the last 15 years, New York City borrowed to cover current operations. As a result, lenders became increasingly concerned about the City's credit worthiness. In April 1975 the City found itself excluded from the financial markets--precipitating a major financial crisis.

#### THE CITY'S CURRENT FINANCIAL SITUATION

This crisis prompted New York State to take several emergency measures. In June 1975 the Municipal Assistance Corporation (MAC) was established to serve as an interim borrowing agency for the City. Its primary purpose was to convert the City's short-term debt into long-term obligations. On September 9, 1975, the Emergency Financial Control Board (EFCB) was established to provide a new mechanism for expanded budget review and accountability and to oversee administration of the City's finances. The Control Board, made up of City, State, and other public officials, has budget approval authority and veto power over the City's actions. At the Control Board's request, the City drew up a 3-Year Financial Plan featuring substantial budget cut-backs which would balance the budget by fiscal year 1978.

The Federal Government, through the New York Seasonal Loan Act of 1975, authorized up to \$2.3 billion in loans (to be repaid within the fiscal year that it is received) to the City to cover its cash flow problems for the duration of the current EFCB plan.

The City's overextension in credit markets, however, is a symptom of more basic problems, which are economic and political as well as financial. These long-term problems take various forms: a changing and deteriorating economic base, heavy tax burdens, inadequate budgetary control, external mandates to provide services outside the control of the City government, and generous levels of some public services.

Comments, criticisms, and proposed solutions to the City's financial situation abound. The news media, academics, City officials, and others have their own explanations for the City's problems. The list of New York City's ills has included:

- Lack of budgetary accountability.
- Lack of adequate management in the City administration.
- Too much union power.
- Too many independent boards.
- An inefficient public work force.
- Inadequate support from the State government.
- Inadequate support from the Federal Government.
- An unmanageable, inefficient transportation system.
- Rent control.
- No accounting system.
- Too many people on welfare.
- An excessive tax burden.
- Too little attention given to attracting businesses into the City and keeping them as part of the tax base.

We do not believe that any one of the alleged ill~~s~~ is the basic cause of the City's financial problem, although some or all may have contributed to the problem. The situation is much more complex and generally relates to the City's economic base. The complexity of the problem makes the solution equally complex, and none of the following suggested solutions alone appears sufficient to "solve" the problem, although each would help reach a solution:

- Federal takeover of welfare.
- State takeover of the City's higher education.
- Garbage collection by private companies.
- New City accounting system.
- More budgetary control exercised within the City.
- A regional jurisdiction for the transportation authorities.

- More equitable sharing of hospital costs with the State.
- More management control in the City administration.
- More productive work by municipal employees.
- Reduced pensions for municipal employees.
- Eliminating rent control.
- Across-the-board cuts in spending.
- Increased tax rates.
- Declaration of municipal bankruptcy.

Not all these solutions are within the discretion of City government. Some would require only City actions; others, State and Federal action. Some are meant to effect cost savings immediately; others, over longer periods. We believe that the solution involves a complex combination of actions that, to be fully effective, need to be coordinated.

For the City, the major immediate question is how to balance the budget, through a combination of cost cutting, tax revenue increase, outside help, and possible divestiture of some functions. The State must decide how much more aid it should commit to the City and what sorts of controls it should maintain over City spending. The Federal Government already plays a large role in local finances, and it has provided aid directly to the City with the seasonal financing program. If this assistance is not sufficient, the Federal Government faces the options of (1) providing additional special aid, (2) helping within a more general framework of aid to State or local governments, or (3) letting the City (and other cities which may face similar problems) work out its own solution. Alternatively, the Federal problem can be stated: If more Federal assistance is needed for the City, are there specific policies (new or old) that the Federal Government can adopt within the general framework of fiscal Federalism which could help the City?

#### BUDGETARY OPTIONS AND LONG-TERM ECONOMIC VIABILITY

This report reviews the policies of the Federal, State, and City governments relating to the City's financial situation, in the context of the City's long-term problem. The

report focuses primarily on the economic and social problems underlying the City's current situation and on the outlook for the 1980s.

The current crisis has precipitated a series of actions by Federal, State, and local governments. Each governmental unit has taken steps it thinks will help solve the City's financial problems. However, the actions have focused on the short-run problem. The combination of Federal loans and the City's tax rate increases and expenditure cuts is designed to eliminate the need for short-term borrowing, restore investors' confidence, and facilitate the City's reentry into financial markets or capital projects.

Insofar as the long-run solution to the City's problems lies in improving its economic base, loans and short-term budget cuts are probably not, by themselves, such a solution. Short-run budget cuts accompanied by productivity gains to maintain services would help. However, the operating inefficiencies which can be corrected by the City administration are unlikely to produce enough savings to balance the City's budget.

Balancing the budget will mean tax increases or reductions in services. Either alternative may eventually weaken the economic base. Hence, the actions needed to deal with the immediate problem may aggravate the long-run problem. Thus, the City, the State, and the Federal Government must look beyond the current 3-Year Financial Plan, examine the long-term impact of current actions, and consider what policies may be necessary to solve the underlying problems.

## CHAPTER 2

### THE CITY BUDGET

This chapter reviews important changes in New York City's revenues and expenditures. The fiscal 1976 budget proposal developed by the mayor's office and the budgetary implications of the 3-Year Financial Plan (and modifications to the plan) are also discussed.

The chapter contains projections of the City's revenues and expenditures to fiscal year 1985 under various assumptions about the performance of the national economy, the State and Federal contributions to the City, and the City's ability to execute its Financial Plan and balance the budget in 1978. These alternative projections cover a range of possible outcomes and are intended to illustrate the types of fiscal problems the City might be confronted with after completion of the 3-Year Financial Plan. It appears that, under the best of circumstances, the City's financial pressures will continue into the 1980s.

#### HISTORICAL PERSPECTIVE

California and New York are the only States that have budgets approaching the size of the budget for New York City. If the funds in the State budget which simply flow to local governments are not counted, then the City's operating budget of \$13.1 billion is larger than the New York State budget. As an illustration, in 1973 New York State spending was \$14.4 billion, of which \$4.4 billion was for grants to cities, while New York City's total outlays were \$11.5 billion. The only government in the United States that spends more money than New York City is the Federal Government.

The operating expenditures, revenues, and deficit or surplus <sup>1/</sup> of New York City for 1960-74 are presented in Table 1. This data indicates that the City has not had a current operating surplus since 1960. In recent years, the operating deficits rose to more than \$500 million.

Over this period, the City raised expenditure levels to meet its perceived needs. City officials then attempted

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<sup>1/</sup> The operating or current account items include all expenditures and revenues received during the year, but do not include outlays for buildings and other items that appear in the New York City Capital Budget.

to balance revenues and expenditures through new taxes, tax rate increases, and short- and long-term borrowing. The use of borrowing to meet current operating expenditures had a cumulative and burdensome effect on the City's finances. From 1971 to 1975 alone, debt service has increased from 8.9 percent to 13.3 percent of total expenditures.

Table 1  
New York City Fiscal Data  
Fiscal Years 1960-75 (notes a and b)

<u>Date</u>	<u>Revenue</u>	Current expenditures Plus debt retirement (note c)	Current account <u>surplus</u>
		(billions)	(millions)
1960	\$ 2.770	\$ 2.717	\$ 53
1961	2.901	2.932	-31
1962	3.067	3.142	-75
1963	3.409	3.445	-36
1964	3.689	3.789	-100
1965	3.961	4.015	-54
1966	4.367	4.537	-170
1967	5.175	5.176	-1
1968	5.867	6.125	-258
1969	6.865	6.946	-81
1970	7.234	7.776	-542
1971	8.275	9.054	-779
1972	9.502	10.120	-618
1973	10.775	10.807	-32
1974	11.291	11.779	-488

a/Totals have been rounded.

b/Final data for fiscal 1975 is not yet available. After New York City was denied access to the municipal bond market in the spring of 1975, numerous special arrangements were made to keep the City from default. Preliminary statistical computations, which include these extraordinary transactions, indicate that the City had a surplus on current account of \$450 million. If certain large special receipt items, such as the \$800 million advance from New York State and the \$195 million advance from taxpayers, are excluded from the computation and the increase in current payables of \$1.4 billion included, the City would have a 1975 deficit of nearly \$2 billion.

c/Column excludes operating expenses from capital budget.

Source: U.S. Bureau of the Census, City Government Finances; 1960-1974. U.S. Bureau of the Census, Finances of Employee Retirement Systems of State and Local Governments; 1960-1963. U.S. Bureau of the Census, Census of Governments: Special Issues; 1962.

**Table 2**  
**New York City Expenditures and Revenues**  
**For Fiscal Years 1971-75**  
**(for Selected Budget Categories)**

<u>Function</u>	<u>Fiscal year 1971</u>	<u>Percent of total</u>	<u>Fiscal year 1975</u>	<u>Percent of total</u>
	(millions)		(millions)	
<b>Revenues (accrual basis):</b>				
Real estate tax	\$1,990.7	28.0	\$ 2,648.6	22.1
General fund taxes (note a)	2,091.4	29.3	3,410.6	28.5
Personal income	231.3	3.3	559.5	4.7
Sales	493.7	6.9	791.1	6.6
General corporation	194.0	2.7	299.3	2.5
Commercial rent tax	140.7	2.0	191.3	1.6
Stock transfer tax	258.6	3.6	184.8	1.5
Water charges	158.1	2.2	190.8	1.6
Utility tax	49.7	.7	90.5	.8
All other (note a)	565.3	7.9	1,103.3	9.2
Federal revenue sharing (b)	-	-	256.8	2.1
N.Y. State revenue sharing	323.9	4.6	404.6	3.4
Intergovernment grants	<u>2,709.9</u>	<u>38.1</u>	<u>5,269.2</u>	<u>43.9</u>
<b>Total</b>	<u>\$7,115.9</u>	<u>100.0</u>	<u>\$11,989.8</u>	<u>100.0</u>
<b>Expenditure (cash basis):</b>				
Education	\$2,061.5	29.0	\$ 2,970.1	24.9
Elementary and high school	1,603.9	22.6	2,270.4	19.0
Debt service	151.7	2.1	238.4	2.0
Colleges	305.9	4.3	461.3	3.9
Public safety	846.1	11.9	1,226.8	10.3
Police	546.4	7.7	813.4	6.8
Fire	242.6	3.4	350.1	3.0
Other	57.1	.8	63.3	.5
Sanitation and health	825.9	11.6	1,258.3	10.5
Social welfare and contributions	2,201.2	31.0	3,421.2	28.7
Debt service	632.0	8.9	1,588.6	13.3
Miscellaneous	<u>543.8</u>	<u>7.6</u>	<u>1,473.7</u>	<u>12.3</u>
<b>Total</b>	<u>\$7,110.5</u>	<u>100.0</u>	<u>\$11,938.7</u>	<u>100.0</u>

a/Includes other miscellaneous revenues.

b/Not available.

Source: Report of the Comptroller of New York City for fiscal years 1971 and 1975.

## RECENT NEW YORK CITY BUDGETS

The City's budget totals, as well as the budget composition, have changed during the last several years. The New York City Comptroller's Report for 1971 to 1975 provides some detail on the component parts of revenue and expenditures. This data, which is presented in Table 2, implies that the City had a surplus in each of those fiscal years. But the figures are misleading because the revenues were recorded on an accrual basis while expenditures were recorded on a cash basis. This results in the following type of situation. New York City spent \$11.939 billion in fiscal 1975, but there is no available figure for the cash actually received in that year. This accounting practice makes it difficult, if not impossible, to compare the City's receipts and disbursements in greater detail using the information in the Comptroller's Report.

The mayor's fiscal 1976 budget is an appropriate starting point for a discussion of the City's current financial situation. The original 1976 budget totaled \$12.1 billion. (See Table 3.) The mayor's expenditure budget, submitted before events in the municipal bond market forced substantial changes in New York City operating procedures, was superseded by the City's 3-Year Financial Plan and later modifications to that Plan.

In the mayor's 1976 budget proposal, expenditures on social services, education, and health services accounted for about 60 percent of the total. Since 1961, the education component of the City budget has increased from 23 to 25 percent of the total, and the health services component from 7 to 10 percent.

### New York City's 3-Year Financial Plan

The mandate of the Emergency Financial Control Board was for the City to achieve a balanced budget by fiscal 1978. On the revenue side, the City sought new sources of income, both through measures it could control and through State and Federal action. On the expenditure side, the City polled each operating agency for an estimate of its minimum operating costs. Table 4 shows summary revenues, expenditures, and balances for the 3-year period of the plan and later modifications of the plan.

The working total for the mayor's budget for 1976 was \$12.1 billion; the first working total under the Financial Plan was \$12.5 billion. The net \$400 million difference represents the judgment of the Office of Management and Budget and the Control Board that substantial changes were

necessary to carry out the City's functions, and part of the \$400 million reflects the Board's insistence on several accounting changes. The plan also incorporated the first year effects of both revenue increases and expenditure cuts, which were designed to result in a \$200 million swing in the deficit.

The calculations underlying the plan attempted to account for expected inflation in revenues and expenditures. The 1976 budget totals contained in the plan then formed the base for the revenue and expenditure targets for 1977 and 1978.

Since the plan's adoption, the City has suggested a number of modifications, not all of which have been formalized and submitted to the Control Board. These modifications take into account further efforts to change revenue and expenditure patterns to meet the 1978 goal. Two sets of accepted modifications, modification 3 (approved in March and April of 1976) and modification 4 (the current plan for fiscal 1976 and 1977), are shown in Table 5. The plan for fiscal 1978 was submitted to the Control Board in August 1976.

As the fiscal 1975 plans were modified, both expenditures and revenues tended to increase, although the estimate of the fiscal 1976 budget deficit stabilized at \$1.1 billion. Expenditures increased from \$12.5 billion in the original plan to \$13.1 billion in the current plan, and estimates of City revenues were revised upward from \$11.5 billion to \$12 billion. The Control Board allowed increases in some budget categories for which new revenues from other levels of government were available to fund the programs. Major modifications occurred in debt service, social services, higher education, and various smaller agencies which are included in the "other" category. Details of these changes are presented in Table 5.

For fiscal 1977, the original plan provided for total expenditures of \$12.5 billion, but modifications to the plan have resulted in increases of \$299 million. Although the original plan did not contain total expenditures by agency or function for fiscal 1977, the modifications have identified where the changes in expenditure categories are to occur. The major increases are \$122 million for social services and \$221 million for debt services; the major decrease is \$89 million for the Human Resources Administration. The New York City Council has authorized a budget of \$12.505 billion for fiscal 1977. This is strikingly similar to the plan's original expenditure total of \$12.508 billion for fiscal 1976.

Table 3

New York City's Budgeted Expenditures by Agency  
Fiscal Year 1976

	<u>Budgeted expenditures</u>	<u>Percent of total budget</u>
	(millions)	
Department of Social Services	\$ 2,937.5	24.3
Board of Education	2,468.0	20.4
Health Services Administration	1,165.3	9.6
Police Department	943.7	7.8
Board of Higher Education	597.9	4.9
Environmental protection	495.1	4.1
Payments to charitable institutions (note a)	586.3	4.9
Fire Department	410.5	3.4
Human Resources Program	164.9	1.4
Debt service	1,885.6	15.6
Other	<u>432.8</u>	<u>3.6</u>
Total expense budget (note b)	<u>\$12,087.6</u>	<u>100.0</u>

a/Primarily payments to voluntary hospitals

b/This total excludes \$1,145 million in funds from the capital budget and other special accounts which were to be used to cover expenses. These funds were not distributed by agency, nor were they included in the expense budget totals.

Source: New York City Expense Budget, fiscal year 1976.

Table 4

Financial Plan of New York  
Summary of Revenue and Expenditures

	<u>Revenues</u>	<u>Expenditures</u>	<u>Surplus or deficit (-)</u>
	(billions)		(millions)
<b>Fiscal year 1976:</b>			
Original plan (note a)	\$11,519	\$12,508	\$ -989
Revised plan (note b)	11,902	12,953	-1,051
Current plan (note c)	12,035	13,086	-1,051
<b>Fiscal year 1977:</b>			
Original plan (note a)	11,981	12,451	-470
Revised plan (note b)	12,106	12,698	-592
Current plan (note c)	12,064	12,750	-686
<b>Fiscal year 1978:</b>			
Original plan (note a)	12,313	12,282	31
Revised plan (note b)	12,338	12,304	34
Current plan (note c)	12,003	11,991	12

a/New York City Financial Plan, Office of the Mayor, City of New York. Approved by EFCB on October 20, 1975.

b/Modification Number 3 to the Financial Plan, Office of the Mayor, City of New York. Revenues approved by EFCB March 26, 1976; expenditures approved April 30, 1976.

c/Modification Number 4 to the Financial Plan, Office of the Mayor, City of New York. Approved by EFCB June 23, 1976.

Table 5

Financial Plan of New York Expenditures by Departments

	Fiscal 1976 (note a)			Fiscal 1977		City's authorized budget (note f)		
	Mayor's budget (notes b and c)	Original 3-year plan	Met changes in plan (note d)	Final planned expenditures	Original plan (note e)		Net changes in plan	Current plan
Total	\$12,088	\$12,508	\$ 578	\$13,086	\$12,451	\$299	\$12,750	\$12,505
Department of Social Services	2,938	2,817	102	2,919	-	122	2,831	2,831
Board of Education	2,468	1,871	54	1,925	-	3	1,868	1,849
Health Services Administration	1,165	1,012	19	1,031	-	14	786	937
Police	944	648	-	648	-	-6	642	572
Board of Higher Education	598	351	28	379	-	22	396	388
Environmental Protection Administration	495	296	-	296	-	1	306	306
Payments to charitable institutions	586	579	-	579	-	-	548	548
Fire	410	275	10	285	-	4	283	264
Human Resources Administration	165	133	-4	129	-	-89	56	56
Debt service (note c)	1,886	2,170	134	2,304	-	221	2,470	2,342
Pensions	-	b/1,091	-	1,091	-	-	1,152	1,355
Other and unallocated (note h)	433	1,255	235	1,500	-	7	1,412	1,616

a/Changes between the mayor's budget and other budgets include budgetary adjustments and changes in accounting methods as well as changes in expenditures. Expenditures exclude operating expenses from capital budget.

b/Under the mayor's budget for fiscal year 1976, departmental totals include allowances for pension costs; all other budgets treat pension costs as a separate item.

c/From Table 3.

d/Allocation of changes to the plan are estimated from program data, and general expenditures not allocated have been included in the residual item.

e/Breakdown by departments not available.

f/Budget authorized by the city council for fiscal 1977.

g/Where possible, includes MAC debt service which was transferred to expenditures from revenue offsets.

h/This category includes expenditures for various small agencies which are summarized in the table as "other." In addition, a number of expenditure adjustments, such as reduction in utility expenditures, make up the "unallocated" residual.

For fiscal 1978, the original Financial Plan of \$12.3 billion has been reduced through net cuts of \$273 million. These cuts result from decreases of \$263 million for higher education; cuts in the expenditures of various agencies, which make up the "other and unallocated" category of \$338 million; and major increases of \$113 million for social services and \$229 million for debt service. However, no baseline agency budget numbers are available against which these changes can be compared.

In fiscal 1976, actual expenditures totaled \$13 billion, an increase of \$900 million from the mayor's original budget and \$469 million from the first version of the 3-Year Plan. Major changes have also been made to the fiscal 1977 budget contained in the plan. It now appears that the City and the Control Board are attempting to constrain the fiscal 1977 budget expense totals to the fiscal 1976 levels. For both fiscal years, major increases have been granted to the Department of Social Services and for debt service. Both items are, to some extent, beyond the City's direct control.

The largest percentage cuts in the budgets are scheduled for the Human Resources Administration. Here, among other things, the City is reducing programs such as job training which have been financed largely by Federal grants.

In general, the changing totals in these budgets reflect outside forces which tend to raise expenditures and which are only partially offset by specific budget cuts. The most important force increasing expenditures is general price inflation taken together with high levels of unemployment in the economy. Price increases have put pressures on all segments of the City's budget. Depressed economic activity has tended to increase social service expenditures.

The main budgetary reductions have resulted from staff cutbacks (mainly through attrition). Since the beginning of the Financial Plan, the City has reduced its payroll through both attrition and terminations. According to the City, the number of employees has declined by 51,468 from June 1975 to November 1976. The plan calls for further reductions for fiscal year 1977. The change in authorized personnel ceilings displayed in Table 6 indicates the distribution of these reductions, detailed for major agencies. (Personnel ceilings may not reflect staffing levels.)

As shown above, there is no easy or direct progression from the budget deficits of fiscal 1976 to a balanced budget in fiscal 1978. In fact, despite the City's efforts to control the budget and expenditures, the fiscal 1976 totals are \$469 million higher than originally planned.

The attempt to balance the City's budget by 1978 will be affected by economic factors, such as persistent inflation and high rates of unemployment, and administrative factors, such as the City's ability to plan, initiate, and execute budgetary cuts. The City's efforts to date have been primarily directed to the latter.

Table 6

Authorized Levels and Planned Reductions  
in Personnel Positions  
Fiscal Years 1976 and 1977  
(By Major New York City Agencies)

	<u>1976</u>	<u>1977</u>	<u>Planned reductions</u>
Department of Social Services	30,000	23,900	-6,100
Board of Education	75,700	63,800	-11,900
Health Services Administration	7,400	5,300	-2,100
Police	34,700	32,500	-2,200
Board of Higher Education	22,000	19,200	-2,800
Environmental Protection Administration	20,000	18,900	-1,100
Fire	13,600	12,700	-900
Human Resources Administration	4,600	1,400	-3,200
Other	<u>67,800</u>	<u>49,000</u>	<u>-18,800</u>
Total	<u>275,800</u>	<u>226,700</u>	<u>-49,100</u>

Source: Executive Budget Fiscal Year 1977, City of New York, Abraham D. Beame, Mayor.

In attempting to cut expenditures, the City has had to face a reality common to all cities--most of the services it provides are highly labor intensive and (in economic terms) the potential for productivity gains is limited. In general, providing City services does not involve as large a capital component as other sectors of the economy (such as steel or automobiles) that can yield substantial productivity gains and technological improvements. Consequently, achieving substantial productivity gains is difficult.

Therefore, although current discussions in the City often refer to productivity gains, we doubt that substantial gains will be forthcoming. In many cases, output measures of public services are not available, and information and analysis about the possibility and implementation of such productivity measures do not exist. Just as tuition charges may radically alter the composition of the student body of the university system, a reduction in the number of teachers may seriously impair the quality of education.

The City's strategy has been to maintain selected programs, reduce program levels where possible, and generally keep the price of the continued services lower than they otherwise would be by limiting wage increases for City employees. These strategies are apparent from the Financial Plan and from statements of the Control Board. Although the strategy to keep wage increases to a minimum has been viable during the first year of the Plan, the dynamic nature of the collective bargaining process in the City cannot be ignored. The debate concerning the appropriateness of this strategy will continue and possibly intensify, and as a result, pent-up demands for wage increases may surface.

#### LONG-TERM FORECASTS OF CITY BUDGETS

The impact of budgetary reductions; tax increases; and demographic, economic, and social movements on the City's long-term economic health make it necessary to explore expected expenditures and revenues beyond 1978. To consider the City's long-term economic condition, scenarios have been developed with different sets of economic and budgetary assumptions. Projections of economic trends are presented and an analysis of them suggests that the City's financial problems are likely to persist into the foreseeable future.

After 1978, the City will have to live within its revenues unless it receives more State or Federal aid or it regains access to capital markets. Two revenue projections for fiscal years 1979-85 have been developed and are presented below. These estimates are based upon a number of economic, budgetary, and intergovernmental-assistance factors.

Forecasting future events, especially beyond 2 years, is always difficult and subject to error. Projecting New York City budgets for 1979 and beyond is particularly difficult. The difficulties arise from the large number of crucial assumptions that must be made. The forecasts presented should not be viewed as point estimates, but as indicators or general tendencies. Moreover, the longer the forecast is extended, the less certain the projections. As a general rule, forecasts up to 2 years are considered short-term and have been demonstrated to be reasonably accurate. Thus, any forecast to 1985 is subject to considerable error. These forecasts are meant to explore and illustrate potential City budgetary problems and not to predict what City revenues or expenditures will be in the 1980s.

The City budget is the accounting structure for recording the City's expenditures and receipts. The budget can be constructed for the past with actual data or for the future with projected or forecast data. Earlier in this chapter, past budgets have been discussed. Now we address the prospective budgets for 1978-85. These budgets can help policy decisionmakers. The projections presented are intended to illustrate the pattern of the City's revenues and expenditures after 1978.

### City revenues

New York City's revenues can be divided into four categories: (1) general fund revenues, (2) Federal and State intergovernmental aid, (3) real estate taxes, and (4) other miscellaneous tax revenues. Different factors affect each type of revenue. Future receipts of Federal and State aid depend on levels of benefits established for aid programs. Real estate taxes depend on how often reassessments are made. General fund and miscellaneous revenues depend on the overall strength of the national and city economies and their effect on sales, personal income, and corporate profits tax bases.

A forecast of revenues depends somewhat on a forecast of national economic conditions, including inflation. Large econometric models of the national economy are used to forecast national economic conditions. New York City's Office of Management and Budget has constructed a model to forecast some of the general fund tax revenues on the basis of forecasts of the national economy. We have developed an alternative model for the same purpose.

Detailed assumptions underlying these revenue projections are contained in appendix II. In general, these projections depend upon inflationary, employment, demographic, and other social and economic factors. The revenue projections are presented in Table 7 below and in Figures 1 and 2.

### City expenditures

A problem in predicting City expenditures after 1978 is that the actual level of expenditures for 1978 is not known with any degree of certainty at this time. According to the City's 3-Year Financial Plan, the 1978 budget expenditures will be about \$12 billion. We have based our projections on that figure. But, if the City is unable to cut its expenditures to that level by 1978, the projections would have to be adjusted upward.

The City's expense budget is made up a large number of programs, and the composition and size of that budget after 1978 depend upon a multitude of budget decisions as well as other factors. Thus, innumerable projections of expenditures could be made. We have limited our projection of expenditures for the period to two, which are based upon alternative economic conditions (specifically, the inflationary factor) that might prevail at that time. These projections are intended to be illustrative, not definitive, but they indicate the general levels of post-1978 City expenditures before administrative actions would be taken to adjust the totals.

These projections of City revenues and expenditures are depicted in Figures 1 and 2. Under the best circumstances and starting with a balanced budget in 1978, the City would have a surplus in fiscal 1979 and 1980. In 1981, it would face a deficit of \$175 million which would grow to almost \$1.5 billion by 1985. Pinpointing the exact magnitude of the gap is impossible, but these projections indicate that the City will likely be under continued financial stress for years to come. If the City cannot balance its budget by fiscal 1978, the post-1978 period would bring larger budget gaps.

The dependence of any City budget gap on the national economy is manifest. If the national economy were to experience cycles of unemployment accompanied by inflation, the City's budgetary situation would be much worse. These economic factors are far beyond the control of the City or

the State. The projections indicate that the City will undergo sustained financial pressures and that the long-run situation may be largely outside the City's own control. The next chapter discusses policy options open to the City.

Table 7

Projections of New York City Budget: 1979 - 1985

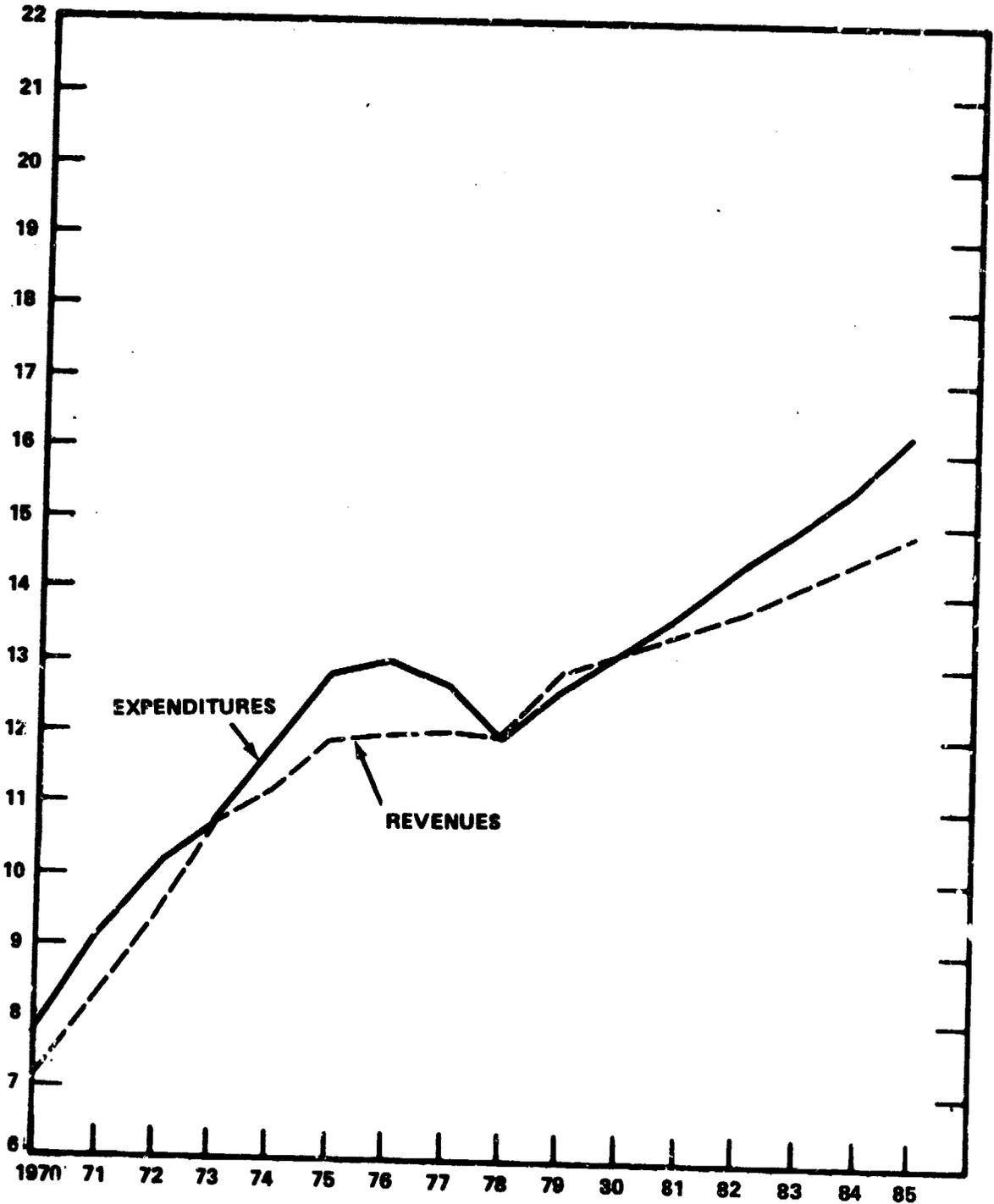
Sustained Growth Projections

<u>Year</u>	<u>Expenditures</u>	<u>Revenues</u>	<u>Budget gap</u>
	—————(billions)—————		
1979	\$12.531	\$12.825	\$0.294
1980	13.040	13.103	.063
1981	13.549	13.374	-.175
1982	14.076	13.660	-.416
1983	14.589	13.959	-.630
1984	15.098	14.249	-.849
1985	15.598	14.553	-1.045

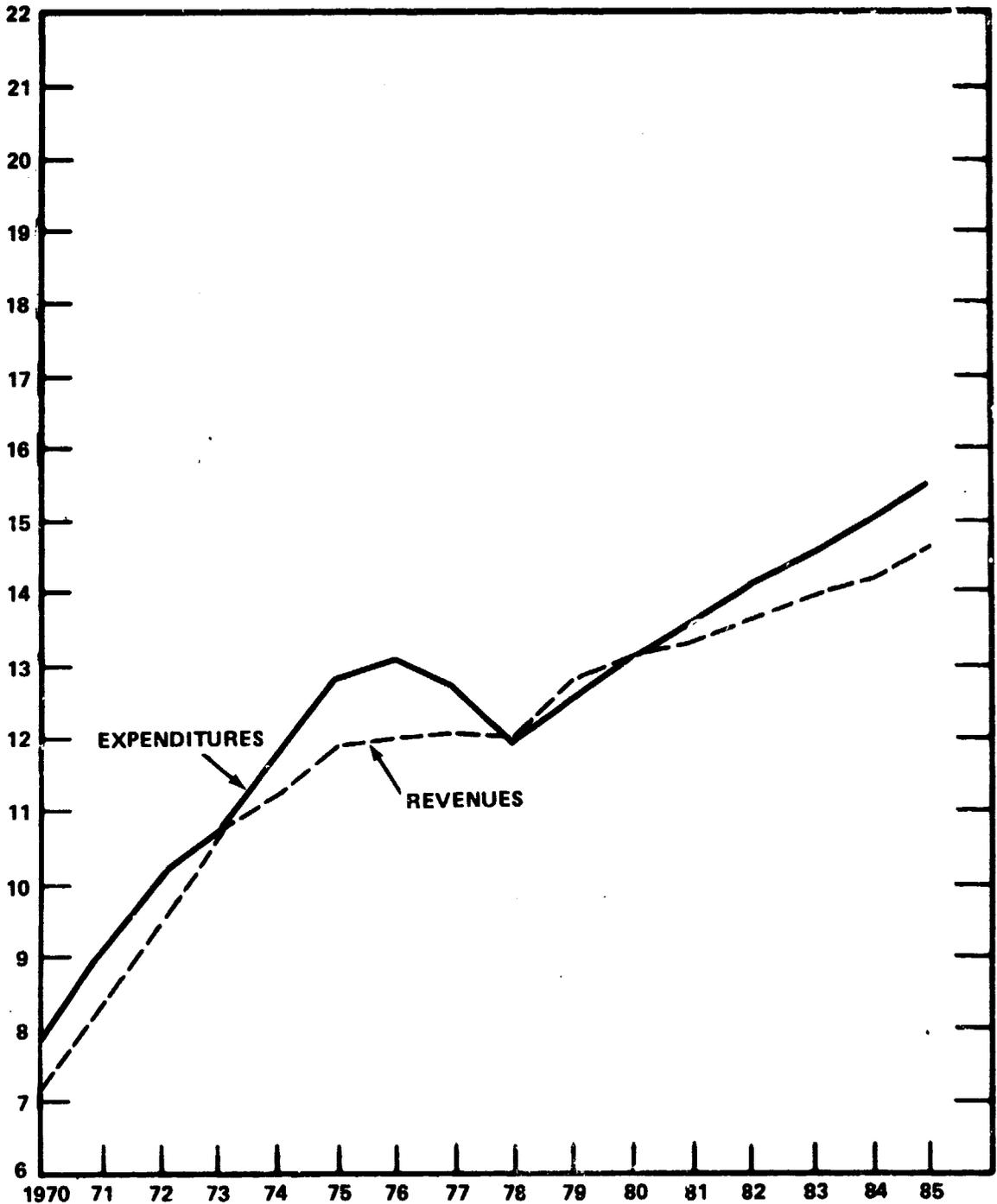
Cyclical Projections

<u>Year</u>	<u>Expenditures</u>	<u>Revenues</u>	<u>Budget gap</u>
	—————(billions)—————		
1979	\$12.652	\$12.846	\$0.194
1980	13.228	13.164	-.064
1981	13.761	13.489	-.272
1982	14.360	13.760	-.600
1983	14.995	14.113	-.882
1984	15.618	14.505	-1.113
1985	16.354	14.859	-1.495

**FIGURE 1**  
**CYCLICAL PATTERN: NYC REVENUE & EXPENDITURE FORECAST**  
**(BILLIONS OF CURRENT DOLLARS)**



**FIGURE 2**  
**SUSTAINED GROWTH PROJECTION: NYC REVENUE & EXPENDITURE FORECAST**  
**(BILLIONS OF CURRENT DOLLARS)**



## CHAPTER 3

### BUDGET CONTROLLABILITY

The projections of New York City expenditures (at current service levels) and revenues for 1980 and 1985 presented in chapter 2 indicate that the problems the City will face in those years are similar to, but perhaps more severe than, the problems it addressed in designing a 3-Year Financial Plan. The Federal and State Governments and the investment community are likely to exert pressure on the City for "fiscal responsibility" for some time to come. It is unlikely that the City, even when it regains access to the municipal bond market, will be able to borrow to cover operating deficits.

The clear implication of the projections in chapter 2 is that, when the 3-Year Financial Plan expires in 1978, the City, unless it receives additional Federal and State funds, will have to attack its fiscal problem by making further budget cuts or by raising more revenues. Achieving and maintaining a balanced budget involve difficult choices. Areas for additional cuts will become increasingly difficult to find, and the post-1978 period is more likely to bring forth substantial pressures for budget increases. City workers have agreed to a virtual wage freeze for 1976-78, but after 1978 they are likely to try to recoup their losses through collective bargaining.

In many cases, the City's options are limited. For example, the City has in some cases committed itself to projects that must be paid for in the future. In other cases, the City is required by other levels of government to provide certain services. Further, certain services are necessary to maintain public order and safety. These constraints mean that portions of the City's budget are beyond its total, direct, and immediate control. Nonetheless, the City and other levels of government can take legislative action to bring more and more of its budget under its direct and immediate control. And, as previous commitments are met, more funds are released and can be used for other purposes.

### THE CONCEPT OF BUDGET CONTROLLABILITY

The term "uncontrollability" has long been used in discussing Federal and State budgets. It is usually applied to costs or activities which are in some sense relatively fixed. The President, for example, cannot unilaterally alter Social Security benefit levels. On

the other hand, the Congress and the President acting together (through new legislation) could alter benefit levels, if they chose to do so. To have meaning, therefore, the term "controllable" must take account of differences in the degree of control that can be exercised by different participants in the process.

From another prospective, control is a function of time. Once a contract has been signed, the costs resulting from that contract may become uncontrollable for the duration of the contract. The costs were controllable, however, before the contract was signed and become controllable after the contract expires. Thus the concept of controllability must also recognize a time dimension. To the technical questions involving the power and timing of control must be added the political dimension of willingness to exercise control. Some functions of government (maintaining public order and safety) are generally accepted as so fundamental as to be effectively uncontrollable except within a fairly narrow margin. As time passes, the number of functions falling in this category tends to grow dramatically. Controllability is a major focus of the rest of this report.

#### CONTROLLABILITY IN THE NEW YORK CITY BUDGET

In part, the City's plight and its difficulties in adjusting to the economic realities of a balanced budget are underscored by the confusion surrounding the terms "controllability" and "uncontrollability" as they are applied to the City's budget. For example, one estimate of the magnitude of uncontrollable items suggests that \$8.7 billion of the \$12.1 billion in the mayor's fiscal year 1976 budget was not directly controllable by the mayor in the short run. That leaves only \$3.4 billion as directly controllable. Even if all budget balancing cuts could come from this part of the budget, a \$500 million reduction could easily involve substantial social costs and greatly disrupt the orderly conduct of City government. The point is underscored by the fact that about 40 percent of the so-called controllable items in this calculation went to police and fire protection.

There have been other estimates of the magnitude of uncontrollable expenditures. The 3-Year Financial Plan contains detailed information in proposed budget cuts by functional category. Implicit in those cuts are working definitions of controllability and uncontrollability derived from section 8 of the Emergency Financial Control Act. That provision states that the financial plan must "provide for the payment in full of the debt service

requirements on all bonds and notes of the city and the covered organizations \* \* \* [and] fund adequately programs \* \* \* mandated by state or federal law; \* \* \*."

One source, using this definition, concludes that \$4.198 billion of the fiscal 1976 budget was "totally" uncontrollable. In yet another document, \$4.8 billion of the City's fiscal 1977 expense budget was labeled "relatively" uncontrollable by New York City's Office of Managment and Budget.

In fact, there appear to be at least four different types of uncontrollability that the City must confront. These arise from four general sources:

1. Expenditures that reflect the City's long-term contractual obligations.
2. Programs legally mandated by other levels of government.
3. Independent boards within the City government structure itself, such as the Board of Higher Education.
4. General obligations to the public to maintain an orderly environment.

The first source of uncontrollable expenditures reflects the City's present and future obligations and includes such items as debt service and pensions. The City is legally obliged to meet these commitments. For example, the State constitution protects the pension rights of New York City civil servants. Over time, control of the level of expenditures in these areas is gained by retiring debt and negotiating new pension benefits for currently employed civil servants. However, major reductions in this type of expenditure would take years, perhaps decades, to accomplish.

The second category of uncontrollable expenditures includes programs mandated by other levels of government. <sup>1/</sup> Aid to Families with Dependent Children (AFDC) and Medicaid

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<sup>1/</sup>The court system, a co-equal branch of government, was created by the State constitution. It also must be provided funds by the City with the level of funding determined by law but not specified exactly in the law.

payments are examples. These are mandated at the State level, and the City cannot unilaterally act to reduce its share of the costs. At the same time, although the total welfare bill is mandated by State laws fixing eligibility requirements and benefit levels, these laws can be changed. The City, while it cannot act unilaterally, has some influence on the State's decisions. In summary, the State could change the legal basis for the City's public assistance payments and the Federal Government could increase or decrease its contribution, but the City must maintain these payments until such actions are taken.

The third source of uncontrollable expenditures has been the independent boards and related nonprofit corporations within the City. Historically, the status of these organizations severely limit the budget-cutting powers of the mayor. Although budgets voted by the Boards of Education and Higher Education had to be approved by the mayor's office, the State budget office, and others, they traditionally have not been subject to reduction without Board consent. The laws that established the Health and Hospitals Corporation left funding cutbacks to the discretion of the board of directors--not the mayor--and these laws commit the City to specific levels of support. Furthermore, the Board of Education, the Board of Higher Education, and the Health and Hospitals Corporation have had considerable discretion over the expenditure of funds allocated to them.

The usual reasons for granting such powers to boards and establishing independent corporations are twofold. First, the resulting services are judged to be so important as to demand formal insulation from political influence. Second, a judgment is made that the organizational structures of schools, the university, and hospitals differ enough from that of a government agency to make impossible, or extremely difficult, line-item budgeting which adheres closely to standard city or State management and accounting practices.

Boards and corporations are meant to serve as informed agents for resource allocation. On these grounds there is no reason to believe that the boards could not cut back in response to an overall City-wide deficit. Such boards, however, tend to become advocates for the primacy of the program areas they represent, to resist budgetary cutbacks with whatever legal powers they possess, and to make the task of assigning priorities in an expenditure reduction program more difficult.

In the short run, the combination of mandated eligibility rules and benefit levels for program participants and the existence of independent boards introduce considerable institutional rigidity into the budget-cutting process.

A fourth set of constraints on the budget process adds to the problems associated with budget reallocation or cutbacks. The City is responsible for providing and maintaining an orderly environment for its residents and visitors; this requires adequate police and fire protection. This social responsibility requires the City to maintain these services (in that sense, some of these expenditures are uncontrollable), but it does not require an absolute level of funding. The City has some flexibility in determining the levels of police and fire protection and how that protection is to be provided.

Expenditures have risen most rapidly in program areas in which the State and Federal governments encourage or mandate spending and those in which independent boards have some budgetary authority. Unfortunately, those program areas where the City could exercise direct budgetary control are areas traditionally viewed as encompassing essential services. This adds further rigidity to the budget process.

To illustrate this rigidity, Edward Gramlich <sup>1/</sup> listed welfare, higher education, transit, public hospitals, public housing, and pension contributions as areas in which the City's contributions toward expenditures are atypical of most major cities. Currently no other major U.S. city funds a university system and pays 25 percent of welfare costs. Of the six areas listed by Gramlich, four are not under the direct control of the New York City Office of Management and Budget. Either an independent board or a State-mandated limit would influence the level of expenditures and control the extent to which the City could make unilateral short-run adjustments to these expenditures.

This does not mean that the organizational structure of the City government is the sole obstacle to reducing expenditures. Rather, the organizational structure means that short-run adjustments are more difficult and longer run adjustments must involve more than one governmental unit.

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<sup>1/</sup>Edward Gramlich, "The New York City Fiscal Crisis: What Happened and What Is to Be Done," American Economic Review: Papers and Proceedings, May 1976, pp. 415-429.

The existence of the Control Board has temporarily changed the budgetary process for New York City. The previously independent boards and corporations now must receive Control Board approval of all major budgetary matters. EFCB may succeed in balancing the budget in fiscal 1978, and the Board may soon pass out of existence. When that happens, the problems of controllability regarding these independent boards and corporations are likely to reemerge.

To sum up, there are four principal sources of uncontrollability--legal mandates, independent boards, previous obligations, and other social or legal constraints. In Table 8, the major budget functions are classified according to the principal constraint that they are subject to in terms of controllability.

In the following chapter each major expenditure area in the City budget is reviewed and an assessment is made concerning the type of control that the City--acting alone--can exercise over the budget levels in the functional category. This assessment of budgetary controllability by function suggests the fiscal problem that the City will face if it tries to balance the budget without further State or Federal assistance.

Table 8

New York City Major Expenditure Categories  
and their Principal Controllability Constraints

	<u>Controllability constraints</u>			
	<u>Legal mandates of State and Federal benefit levels</u>	<u>Independent board</u>	<u>Previous obligations</u>	<u>Other social or legal</u>
Social services	X			
Health and hospitals	X	X		
Elementary and secondary education		X		
Higher education		X		
Debt			X	
Pensions	X		X	
Transportation				X
Fire, police, and sanitation				X
Public housing				X

## CHAPTER 4

### THE CITY CONFRONTING ITS OPTIONS

This chapter discusses the activities and budgetary problems within each major expenditure category. The myriad of budgetary details involved in the operations of each City agency are not presented, but that information is synthesized to suggest possible solutions. The discussion begins with two of the largest expenditure categories in the budget, human resources (social services) and health. Together, the agencies responsible for delivering services in these areas spent \$4.7 billion in fiscal 1976, or 36 percent of total City outlays on current account.

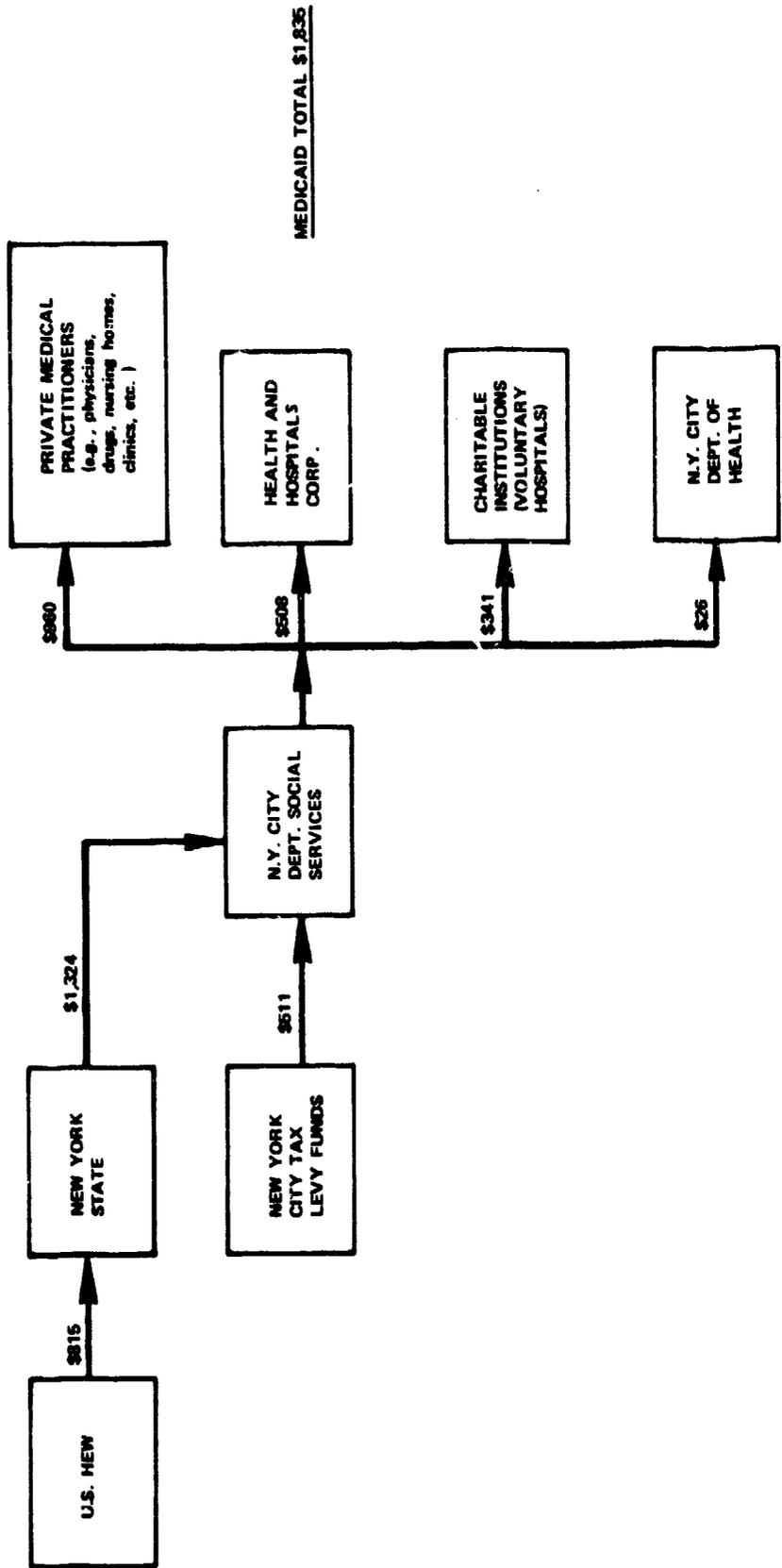
The agencies that deliver these services are structurally complex, and the funding arrangements that accompany the services involve all three layers of government (Federal, State, and local). Figures 3 and 4 diagram the flow of Medicaid and AFDC money through these agencies. Table 9 identifies the programs and compares agency activities. (For additional detail on management and budgetary processes, see app. I.)

#### LEGAL MANDATES

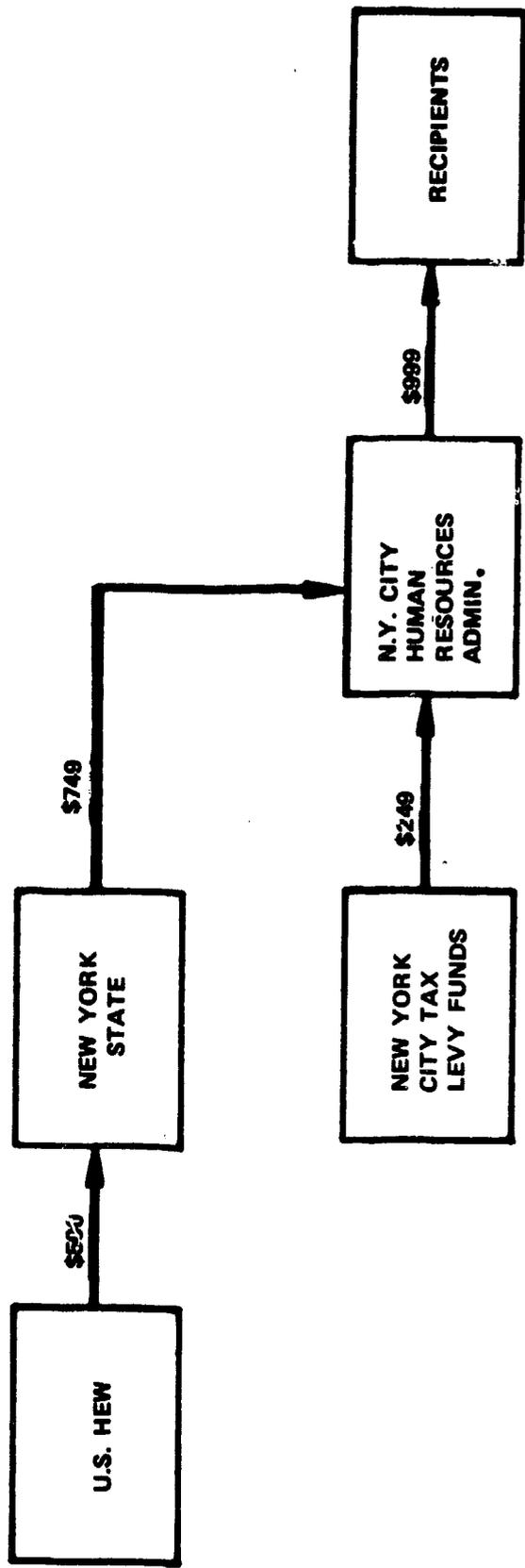
The Department of Social Services and the Health and Hospitals Corporation (HHC) are examples of how legally mandated eligibility criteria and benefit levels combine to drive up agency expenditures and severely limit the City's short-run ability to reduce its commitment.

Medical assistance expenditures are a common element in these two categories. The City's eligibility procedure for AFDC automatically establishes eligibility for Medicaid and food stamps. One result is that the Department of Social Services pays the medical bills of those on its welfare roles. Hospitals operated by the City's Health and Hospitals Corporation, a public benefit corporation, provide medical services and collect directly from the patient or his third-party agent. Therefore, a welfare patient in a public hospital would have his bills paid by Medicaid. The public hospital would treat the Medicaid payment as income, while that portion of the expenditure that the City must absorb represents a claim against City tax revenues. Because the City must pay for about 28 percent of all Medicaid expenditures, the activities of the Department of Social Services and HHC in providing medical care to the poor generate a considerable tax bill. The details of that bill projected for fiscal 1977 are in table 10.

**FIGURE 3**  
**ESTIMATED FISCAL 1977**  
**MEDICAID FLOW OF FUNDS**  
**(\$MILLIONS)**



**FIGURE 4**  
**BUDGETED FISCAL 1977**  
**AFDC FLOW OF FUNDS**  
**(\$MILLIONS)**



**AFDC TOTAL \$999**

Table 9

Major Policy Decisions in Statutes or Regulations

Program categories	AFDC	Medicaid	Home relief
Administering organizations: Federal--Department of Health Education and Welfare	<ul style="list-style-type: none"> <li>- Define target groups</li> <li>- Define cost-sharing relationships (50% of program cost in City)</li> <li>- Approve State plan</li> </ul>	<ul style="list-style-type: none"> <li>- Approve State plan</li> <li>- Define target group</li> <li>- Define minimal services required to be covered</li> <li>- Define optional services to and will be covered</li> <li>- Define cost-sharing relationships (50% of program cost in City)</li> <li>- Define ceiling on eligible income level</li> </ul>	
State--Department of Social Services	<ul style="list-style-type: none"> <li>- Established eligibility rules (income-resources)</li> <li>- Established payment benefit levels (food and shelter, etc.)</li> <li>- Define cost-sharing relationship with local government for non-Federal share (25% State, 25% City)</li> <li>- Establish and supervise quality control systems</li> </ul>	<ul style="list-style-type: none"> <li>- Establish eligibility rules (income-resources)</li> <li>- Define medical services that will be covered</li> <li>- Define cost-sharing relationship with City for non-Federal share (25% State, 25% City)</li> </ul>	<ul style="list-style-type: none"> <li>- Define target group (generally do not qualify for Federal aid)</li> <li>- Define eligibility rule (income and resources)</li> <li>- Establish payment benefit level</li> <li>- Define cost-sharing relationship (50% State, 50% City)</li> </ul>
State--Department of Public Health		<ul style="list-style-type: none"> <li>- Establish rates for reimbursement to providers of care</li> <li>- Develop standards</li> <li>- Review and audit quality of care supervise local systems of audits</li> <li>- Approve local medical plans</li> </ul>	
City--Human Resources Administration	<ul style="list-style-type: none"> <li>- Certify client eligibility</li> <li>- Authorize payments to clients</li> <li>- Perform eligibility audits</li> </ul>	<ul style="list-style-type: none"> <li>- Certify client eligibility</li> <li>- Authorize payments for providers or services</li> </ul>	<ul style="list-style-type: none"> <li>- Certify client eligibility</li> <li>- Authorize payments to clients</li> <li>- Perform eligibility audits</li> </ul>
City		<ul style="list-style-type: none"> <li>- Set standards</li> <li>- Perform reviews and audits</li> </ul>	

Table 10

Budgeted Major Medicaid Expenditures  
For New York City, Fiscal Year 1977 (note a)

	<u>City</u>	<u>State</u>	<u>Federal</u>	<u>Total</u>
	—————(dollars in millions)—————			
Department of Social Services (note b) non-hospital	\$255.8 (26.65)	\$252.9 (26.34)	\$451.3 (47.01)	\$960.0 (100.0)
Charitable institutions voluntary hospital inpatient care	98.9 (29.0)	98.9 (29.0)	143.2 (42.0)	341.0 (100.0)
Child care	6.4 (25.0)	6.4 (25.0)	12.8 (50.0)	25.6 (100.0)
Health and Hospitals Corporation	150.1 (29.55)	150.1 (29.55)	207.8 (40.90)	508.0 (100.0)
<b>Total</b>	<u>\$511.2</u> (27.86)	<u>\$508.3</u> (27.71)	<u>\$815.1</u> (44.43)	<u>\$1,834.6</u> (100.0)

a/Parentetical figures given below each level of government's contribution to Medicaid in the particular agency indicate the percentage of the total for each line item which that contribution represents.

b/Primarily for physicians' services.

Source: Richard Bing, New York City Bureau of the Budget.

Medicaid expenditures are budgeted at \$1.8 billion, of which the City's share for fiscal 1977 is \$511.2 million. Estimates are that over half, \$960 million, represent payments to physicians, dentists, nursing homes, outpatient clinics, homemakers, druggists, etc., for nonhospital services; the City's share of that is put at \$255.8 million. The City will pay \$98.9 million of the \$341 million voluntary hospital Medicaid bill and \$150.1 million of the \$508 million in Medicaid payments made to HHC. Recent data indicates that in 1974, 98.6 percent of all AFDC cases in the City received Medicaid benefits and that the average benefit

cost for all cases was \$1,606. Average welfare benefits per case for all cases were \$5,628; thus, about 28 percent of benefits received were Medicaid related.

HHC expected to receive \$508 million, about 52 percent of its total 1977 operating revenues, from Medicaid. Clearly, a major portion of the activities of both the Department of Social Services and HHC involve delivering health care to the poor. The City tax bills so generated are controllable only by restricting or cutting back on that care. To gain insight into this and the related income-maintenance issue, one must look at agency activities in greater detail.

Department of Social Services programs for the low-income population can be divided into three general categories: income maintenance and food stamps, medical assistance (Medicaid), day care and homemaker services. The largest and most important income maintenance program is AFDC. The rules regarding benefits and eligibility for both AFDC and Medicaid are determined at the Federal and State level and are administered by the City. The 1974 data on welfare recipients in the City indicates that the average level of support per case was \$3,393, consisting of \$1,885 in cash allowance and \$1,508 in shelter allowance. The average case received \$501 in food stamp benefits. Taken together, AFDC and Medicaid payments account for \$4,999 of the \$5,628 in aid received by the average case. <sup>1/</sup> Since New York City is unique among large cities in that it pays 25 percent of the total income maintenance expenditures and also about 28 percent of total Medicaid expenditures, it is easy to see why some would consider the City's share of total expenditures in the Department of Social Services to be uncontrollable. However, a part of this agency's total expenditures is allocated to staff, and one City option is to cut back this staff while maintaining benefit payments to those eligible. A second option is to devote more resources to screening potential recipients, thereby attempting to reduce the number of eligibles. The first option is apparently being exercised with announced decreases in authorized positions from 30,000 in fiscal 1976 to 23,000 in fiscal 1977.

Most recently the agency has made a number of management changes designed to reduce total expenditures. Specifically, the agency has instituted a process of certifying eligibility

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<sup>1/</sup>The most recent data indicates that average welfare benefits will increase to over \$6,700 per case in fiscal 1977.

three times a year rather than twice. The objective is to eliminate ineligibles more efficiently and minimize the welfare roles while adhering to State-mandated eligibility criteria. It has scaled down benefit levels in areas where the law has left it some discretion. The agency pays moving expenses and security deposits on apartments, but it is allowed to make a judgment with respect to the level of need. It has reduced its level of support for these items by \$19 million in hopes of saving the City \$6 million. It has changed its management procedures in administering Medicaid, eliminating some internal approval procedures. It is this combination of scaling down of benefit levels when permitted, tighter enforcement of eligibility rules, and increases in internal management efficiency that one expects to see occur.

At least one program, Children's Day Care, is City funded. Not unexpectedly, the City had stopped funding 49 centers, changed eligibility criteria, and reduced staff. It hopes to "save" \$15 million by these actions. All of these actions may lower total expenditures; nevertheless, externally established eligibility criteria and benefit levels seriously constrain the City. The level of expenditures for social services in New York City and the City's contribution to those expenditures reveal neither the City's explicit choice of expenditures nor an easy place for the City to cut back in order to balance expenditures and revenues.

The City clearly has incentives to negotiate with the State over its share of costs and to attempt to influence State decisions on benefit levels. However, there are large potential social costs associated with any drastic cutbacks in income maintenance. Moreover, cutbacks in Medicaid coverage would impose serious social costs on City residents without addressing the more fundamental problems associated with the delivery of health care to the elderly and the poor. These problems are reflected in the fiscal difficulties of HHC.

Of the budgeted \$1.834 billion in Medicaid expenditures for fiscal 1977, hospitals will be paid \$849 million, \$508 million of which will go to HHC. In fiscal 1977, the Corporation is scheduled to take in an additional \$196 million in other charges, mainly Medicare and self-pay. Medicaid is the most important source of revenue for HHC and, significantly, New York State has chosen to establish a high-option Medicaid plan from those available under Federal guidelines. To the extent that poor people's demands for medical services are influenced by the net prices they face,

the quantity of hospital services demanded in New York will be relatively higher than in States and cities with less generous plans. Greater quantities of services provided by HHC, in turn, generate relatively higher Medicaid tax bills for the City.

Experts have argued that increases in the coverage of third-party payment mechanisms, combined with the public's increased preference for highly specialized health care services, have greatly increased the demand for health care. The medical industries' supply response has been to try to satisfy this preference, and the result has been rapidly increasing health care costs.

The City finds itself involved on both sides of this market. The demand side link is Medicaid. The supply side involvement results from its separate commitment to provide general tax support to HHC. In fiscal years 1973 and 1974, that support totaled \$279 million and \$272 million, respectively. As HHC attempts to meet the demand for quality medical care, its costs increase; to the extent that these costs are not recovered from direct charges to patients and from other third-party payments, its claim on the City's general tax sources will increase.

Insofar as Medicaid is a critical component of pressure on the demand side, scaling down of the Medicaid plan might be considered a way to lower hospital costs. However, lowering the level of Medicaid benefits would not necessarily lower the cost of providing hospital services in public hospitals. The relationship between occupancy rates, fixed and variable costs in these hospitals, and the desire to substitute "free care" might instead generate pressures for a larger tax subsidy payment from the City to HHC.

On the supply side, the City could (1) move to reduce its general tax subsidy to HHC, (2) ask HHC to increase hospital rates, or (3) ask HHC to close facilities and reduce personnel levels. Reducing the level of tax subsidy will cause cutbacks in municipal hospital services unless efficiency and productivity can be increased. And, such cutbacks may lead the poor and medically indigent to view the municipal hospitals as being inferior to voluntary hospitals. Since they can choose between the two, they may then choose voluntary hospital facilities. If that happens, the total Medicaid bill might conceivably increase in a way that offsets the tax-subsidy savings, because the price of care is higher in such settings and Medicaid payments are tied to these prices.

Raising hospital rates may have beneficial budgetary effects. To the extent such charges are now set lower than comparable voluntary hospital charges for comparable services, raising them would increase the price of such services to those not eligible for Medicaid. If Medicaid payments are adjusted to reflect the higher hospital charges, the size of the non-Medicaid City tax subsidy may decrease. In effect, more Federal and State funds would be available to cover the same set of services now provided. However, if non-Medicaid patients opt for less care because of the higher price, lost revenues may partly offset the Medicaid gains. And the increased charges must still be at or below the allowable Medicaid reimbursement rates.

The third option, closing facilities and reducing personnel levels, has already been exercised. This may be the only real option left, because holding down hospital employee wage rates is clearly only a short-run measure, not a solution to the cost pressures HHC faces. To address those problems, new types of supply responses to the demand for medical care are needed and the City alone cannot provide them.

Clearly, in both the income maintenance and medical care areas, the proper way to reduce the City costs is by providing new work incentives to individuals now on welfare and new incentives to medical care providers. These solutions would require fundamental changes in the respective delivery systems, changes that require the cooperation of other levels of government and a long time to accomplish.

### INDEPENDENT BOARDS

The Board of Education (for elementary and secondary education) and the Board of Higher Education manage labor-intensive programs. Teachers are the single most important input in the provision of educational services. In ordinary times, the boards' independence gives them an extra ability to resist budget cuts; in these extraordinary times, proposals for large cuts must be weighed against the possible decline in the quality of education.

#### Board of Education

For fiscal 1977, the City has budgeted \$2.7 billion to elementary and secondary schools, but it considers the entire amount controllable, except that part going to debt service and pensions. In effect, OMB has taken the position that

educational methods can be flexible and that the level of resources necessary to produce existing levels of service can be reduced. Attempts by the City to substantially reduce the Board of Education's budget have produced a series of countermoves. Special legislation limiting the percentage cuts in education to no more than the average for other agencies passed by the State legislature (Stavisky-Goodman Bill) was recently declared invalid by the State supreme court.

The most obvious method of cutting expenditures in the instructional part of the budget is to allow the pupil-teacher ratio to increase. The financial plan calls for a reduction from the June 1976 strength of 47,307 regular full-time teachers to about 44,850 for the 1976-77 school year. Such actions reverse a policy of decreasing the pupil-teacher ratio. The New York City Teachers Union (United Federation of Teachers) has been committed to this policy for many years. In fact, over the period 1966-75, the pupil-teacher ratio fell from 20.4/1 to 17.6/1. Although there is no conclusive evidence that lower pupil-teacher ratios produce better school outcomes, this theory is firmly held by educators. Substantial increases in the ratio are likely to be opposed strenuously. The Board of Education has already claimed that the reduction in teachers has set equal employment opportunity efforts back 10 years because of the effects of seniority rules on layoffs of blacks and other minority members.

The City can be expected to cut back on auxiliary school personnel and to adopt school management cost-saving procedures. Since January 1975, the system has cut social service workers by 25 percent and guidance counselors by 14 percent. The overall full-time staff reduction is approximately 14 percent. The City may be approaching the limits of the amount of staff reductions that can be made without deterioration of education quality.

If EFCB is abandoned after the completion of the Financial Plan, the traditional power of the Board of Education and the powers of the community boards, which are unique for large cities, will intensify bargaining with the City's OMB over the proper level of funding.

Like many large cities, New York would like to turn to the State for larger grants through the school-in-aid formula. As in many other States, the school-aid formula used to disperse funds employs a measure of local wealth. As a result, a greater share of the total education bill must be borne by

local taxes in the larger industrial cities than in the smaller more rural areas. New York City receives about 29 percent of its funds from the State, while some other cities and towns receive as much as 40 percent. Increased State aid is an attractive alternative to further reductions in personnel, but the City, acting alone, cannot bring about such changes.

### Board of Higher Education

The debate over the necessary level of funding in higher education parallels that regarding elementary and secondary schooling. Once again the City's options are limited, but in this case they include the imposition of tuition charges in addition to cutbacks in personnel.

The City University of New York (CUNY) is composed of 10 senior colleges, 8 community colleges, and an affiliated medical school. In fiscal 1976, it had a student enrollment of about 222,000 (full-time equivalent) and a budget of \$539 million. Since 1970, CUNY has maintained a policy of open admissions, and until June of 1976 it charged no tuition for undergraduate City residents.

The decision to establish an average tuition price for City residents of \$850 1/ was made with great reluctance; it changed a social policy which began in 1847. Changes limiting open admissions were scheduled to take effect in the fall of 1976. No other U.S. city had ever attempted to provide tuition-free, open access to higher education for its residents.

In 1975, the financial crisis led the City to make major cuts in its support. To comply, the university made administrative and instruction personnel reductions, eliminated programs, deferred sabbaticals, and took other cost-saving measures. These actions were estimated to have saved \$57 million. Nonetheless, CUNY could not complete its ordinary academic year operations that ended last spring.

The CUNY budget authorized by the State legislature for fiscal 1977 is \$470 million, substantially below the \$539 million budget for the previous year. Only part of the \$69 million reduction will be net savings to the City. Since the State contributes a portion of the cost of the CUNY

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1/\$775 per student for each of the first 2 years and \$925 per student for each of the last 2 years.

system through a matching-fund formula, the net saving to the City is about \$35 million. Some of these cost reductions for higher education undoubtedly reflect the elimination of inefficiencies, but some represent a reduction in the availability and quality of higher educational services available to City residents. Thus, the real level of these services could be eroding because of the cuts in the CUNY budget.

Although CUNY might be able to make further cuts by eliminating duplicative programs, combining resources of various colleges for special programs, or eliminating unnecessary supportive services, these cost-saving devices may be limited.

Tuition charges could be further increased. However, this would quite likely change the composition of the CUNY student body. Because tuition charges have an impact on low-income students and make it more difficult for them to afford higher education, substantial increases in tuitions are likely to make higher education much less accessible to students from low-income groups. State and Federal scholarships and grants for these groups could alleviate this problem, but such support is not likely to completely offset the effects of higher tuition.

What would be the most efficient and equitable set of tuition charges in public universities has been debated for a number of years. There are good arguments for and against low tuition in public colleges and universities. The basic disagreement involves the trade-off between efficiency and equity criteria in the provision of the service. Without trying to resolve the issue, we can only reiterate that empirical findings suggest that low-income students would not be able to afford the high tuition and that no State subsidy mechanism has as yet been established which conclusively offsets this effect. Federal and State programs are aimed in the right direction but do not answer all objections of the low tuition advocates.

The City could seek more aid for higher education from the State and Federal Governments. Once again, these policy alternatives are beyond the control of the City. (See ch. 8.)

#### PREVIOUS OBLIGATIONS

New York City's fiscal 1975 debt service was \$1.798 billion. All debt service is uncontrollable unless the City defaults or refinances it. In addition to interest

payments, some proportion of the \$12.5 billion of outstanding principal is scheduled to be retired each year. The only way the City can reduce cash outlays in a given year is to attempt to lengthen maturity dates, thus postponing principal payments. This, however, can only be done with the concurrence of the bond holders. Even if this could be done, it would impose greater total costs on the City in the form of larger lifetime interest payments. Recently, attempts by MAC to induce holders of short-term debt to accept the substitution of higher yield long-term debt are encountering difficulties. However, insofar as this problem is attributable to uncertainty and continued lack of confidence of investors in the City, it may be temporary. To the extent that the City succeeds in curtailing the rate of increase in expenditures, investors may be more willing to switch long-term bonds for short-term notes. In the short run, there is little the City can do to reduce the large demands which interest payments and debt retirement impose on current tax revenues.

### Pensions

Pension outlays are a part of every agency's personnel costs of operation. In fiscal 1976, the City paid out \$1.48 billion in pension fund contributions. That total is expected to increase to \$1.68 billion in fiscal 1977, spread among the various operating agency budgets.

In addition to cutting back staff and holding down wages, the City can attempt to reduce or limit increases in personnel costs by cutting back on fringe benefit contributions. Of course, staff reductions also reduce fringe benefit contributions, but the City correctly views the two actions as independent decisions.

Historically, the City has viewed increases in wages or fringes as substitute ways of increasing workers' compensation. The City has been willing to grant rather substantial increases in the pension benefit package, perhaps because some of the budgetary impact of such actions are postponed and actual payments are made years after the promised benefit has been agreed upon.

When the cost of these past commitments comes due, it becomes apparent that the bill is substantial and that large parts of it are not subject to reduction. A provision of the State constitution bars diminishment of pension benefits of public employees, once such benefits have been granted.

The fiscal impact of these commitments has prompted a new piece of legislation. The State legislature recently passed legislation limiting and substantially changing the pension benefits of City workers joining the retirement system after June 30, 1976.

Also, a careful review and evaluation of the "Increased Take-Home Pay provision" revealed that it was granted by the State temporarily and not subject to constitutional restriction. According to the provision, the City agreed to assume the employee's pension contribution in lieu of a pay increase. As a result, all parties could benefit at the expense of Federal tax revenues.

An example illustrates the point. If a worker earns \$250 per week, pays Federal taxes of \$40 per week, and contributes \$15 a week toward retirement, his take-home pay before State and local taxes is \$195 a week. In any tax bracket the worker would gain more from a \$10 reduction in his retirement contribution than from a \$10 a week increase in gross pay. If the worker bargains for a \$10-a-week increase in net take-home pay, the City would be induced to offer to pick up \$10 of his \$15 dollar retirement contribution rather than agree to a \$11.90 per week increment in wages. In this example, the worker would gain \$1.60 in tax savings, the City \$1.90 in gross wage payments, but Federal taxes would decrease.

This is what occurred in New York City during the 1960s. Workers, through their unions, agreed to increased City contributions to retirement rather than gross wage increments--and both parties were satisfied. However, given the present fiscal constraints, the City would now prefer to combine wage restraint, through elimination or severe restriction of gross wage increases, with increased contributions from workers toward their retirement funds. If successful, the policy most probably leads to decreased take-home pay.

The move to eliminate the Increased Take-Home Pay provision cannot be carried out by the City alone, and it can only be successful in a budgetary sense if combined with wage restraint. The predicted savings to the City from a change in this provision is \$187 million per year beginning in fiscal year 1979. The Temporary Commission on City Finances has cited this savings and others that jointly sum to \$204 million as a convenient offset to a \$208 million yearly increase in the rate of City contributions to retirement

funds necessary to place the funds in a more actuarially sound position. However, the expected savings may prove illusory because they depend so heavily on the City's ability to hold down the wage bill over a number of years.

The City can make changes to provisions in the calculation of pension benefits that could hold down pension costs somewhat. For example, the City could eliminate the crediting of overtime pay when computing benefits. In addition, State law provided statutory presumption that a heart condition resulting in the disability or death of a policeman or firefighter was work related. In practice, virtually all heart conditions (whether incurred on or off the job) of police and firefighters that result in early retirement have been considered work related.

### SOCIAL CONSTRAINTS

Earlier discussion has emphasized that the funding levels of some activities of the City, although under the control of the City government, may still be difficult to reduce. The section discusses three of them--transit, uniformed services, and public housing--as examples. But even the organizational structures in transit and public housing are such that some would question the City's ability to control expenditures.

### Transit Authority

The New York City Transit Authority operates under the policies and direction of the Metropolitan Transportation Authority, whose board serves as a governing body for the several transportation authorities operating in the metropolitan area. The City Transit Authority operates transit facilities leased from the City and has a budget, including its subsidiary, of about \$1.3 billion and total employment of over 44,000 people.

Analysis of the Transit Authority's finances is complicated by the fact that definitions of revenues, deficits, and subsidies can vary depending on whose viewpoint--the City's or the Transit Authority's--is used in examining the financial statements. Data from the March 25, 1976, revised financial plan (of the City) indicates that the Transit Authority's \$11.8 million expected deficit of fiscal 1976 could, in the worst case, increase to \$118.1 million in fiscal 1977. The City budget personnel, however, expect the deficit to be about \$50 million. Most of the projected

increase will be caused by decreases in State and Federal subsidies. These deficits, however, represent the viewpoint of the Transit Authority, for which "deficit" refers to the gap between expenses and all projected revenues, including City, State, and Federal subsidies. An alternative view would identify the earned revenues of the Transit Authority and treat the other revenues as subsidy payments from the City, State, and Federal governments.

The Transit Authority's deficit from the City's viewpoint could then be considered much higher than \$11.8 million. At one extreme the deficit could be estimated at \$618 million, based on the cost of operations less earned revenue. Perhaps the most useful way of examining the City's contribution to the Transit Authority or to transit-related costs is to divide the payments into two categories--those for current operations and those for past capital expenditures. The amount of the City's annual subsidy for current operations is about \$212 million. In addition, a payment of \$35 million in notes and bonds and approximately \$164 million in annual debt service are paid directly by the City to the bondholders. Total transit-related expenses to the City for fiscal 1976 are in the \$411 million range.

Other services of the City also involve capital investments and debt service. We have not systematically analyzed these costs by functional area and mention debt service here only because of the manner in which the Authority allocates some expenditures between the two accounts. Details of the City's payments either to the Transit Authority or for transit-related costs are shown in Table 11.

The Transit Authority is under no legal mandate to provide a particular level of service to the City. However, services to particular groups, such as transportation to school children, must be provided. Presumably, the cost of the operations which would provide essential mass transportation services to the City constitute the uncontrollable portion of the Transit Authority budget. The Authority is likely to respond to tight fiscal constraints by setting priorities for the services that it provides and attempting to reduce expenditures on lower priority services. The Authority has identified a series of service cutbacks, including elimination of air-conditioning, elimination of bus routes that duplicate subway lines, elimination of weekend bus service, and reduction in the frequency of bus runs. Total savings are estimated at \$87 million.

Obviously, such reductions impose costs on City residents. Because public and private transportation are somewhat substitutable, those costs can take the form of increased highway traffic. As additional cutbacks are introduced, the costs in terms of long lines, congestion, and possibly reduced access to employment begin to reach substantial levels.

Table 11

City Subsidies to the Transit Authority  
for Current Operations, Fiscal 1976

<u>City appropriation</u>	<u>Amount</u>
	(millions)
School and senior citizens reimbursement (note a)	\$ 98.2
Transit police reimbursement	93.0
Operating assistance (note b)	70.0
Adjustment for State reimbursement for school transport costs (note a)	<u>-49.1</u>
<b>Total</b>	<u><u>c/\$212.1</u></u>

a/The Consolidated Statement of Operation for the Transit Authority Systems lists \$98.2 million for City contributions to school and senior citizens, but part of this is reimbursed with a time lag by the State. Data for fiscal 1977 implies that the average reimbursement rate is 50 percent.

b/Operating assistance is provided for in Capital Budget Project T-120.

c/This calculation is exclusive of debt service, which is considered separately.

If the Authority can reduce the work force and maintain levels of service, it is in its interest to do so, but work rules may limit such action. The wage bill can also be reduced by holding down the real wages of transportation workers. Perhaps an indication of what will come in efforts to hold down the wage bill was given by EFCB at a May 1976 meeting. At that time the Control Board mandated that collective bargaining agreements provide no increase in wages, salaries, or fringe benefits and that any cost-of-living increases be offset by productivity increases or other savings approved by EFCB.

There is also the possibility of raising fares. The success of that strategy depends upon the response of the public. Studies suggest that demand is not highly sensitive to price increases, so that a 10-percent increase in fares would result in about a 2.5-percent decrease in riders, producing an increase in total revenue. If such estimates are reliable and if fare increases could be combined with restraint in wage negotiations and the continuation of present City subsidies, deficits might be overcome.

From the City's point of view, hope for the future may lie in some rearrangement of tax subsidies to the system which would reduce the payments it now makes to the Transit Authority and to bondholders. Such a rearrangement would most likely involve regionalization of the system with new tax user charge financing. However, such attempts at regionalization depend critically on participation by other governmental units. (See ch. 5.)

#### Police, fire, and sanitation

The City's Police and Fire Departments and Environmental Protection Administration are under the direct budgetary control of the mayor's office. In fiscal 1976 these three operations had combined expenditures of \$1.806 billion.

For the City, controlling expenditures in these functions depends on its ability to minimize the size of the force needed to provide a given level of protection or service. It is difficult to determine what levels of police protection or sanitation service are absolutely essential--and even more difficult to ascertain what size force is minimally required to provide that service. Attempts to estimate the ideal levels of police, fire, and sanitation services have not been successful. Information on the relationship between the size of the police force and the incidence of crime is mainly anecdotal and largely inconclusive. Logically, there is some minimum level of police force necessary in the City to prevent anarchy; there is some minimal firefighting force necessary to prevent a citywide conflagration; and there is some size sanitation crew necessary to assure pickup of trash and garbage at a rate that prevents the outbreak of disease. Above these minimum levels, the City's preferences for clean streets and public safety, along with an informed judgment on the number of employed people necessary to satisfy those preferences, will determine the minimal size of the uniformed service.

There is reason to believe that over the past several years the City agreed to work rules and other operating procedures that left the uniformed services with larger work forces than those necessary to deliver the services demanded by City residents. Given a budgetary crisis, the City could seek to reduce the size of the work force and to lower real wages per employee. Between December 31, 1974, and February 29, 1976, the City reduced the number of full-time police by 479, firefighters by 1,926, and sanitation workers by 2,612. It will, of course, seek to minimize wage increases and perhaps not even adjust wages for cost-of-living increases. Data presented elsewhere <sup>1/</sup> suggests that salaries for those workers are not out of line with those of comparable workers in other cities.

As the City reduces the size of the uniformed services work forces and seeks to minimize wage increases, it will presumably gather information on the relationship between size of force and levels of service delivered. Obviously, the combined effects of the previous cuts in employment and the ability of the uniformed services workers through their unions to impose substantial social costs by striking limits the possibility of substantial further cuts in employment levels.

The City's most likely response is to attempt to keep wage increases down. This strategy could eventually lead to higher turnover and a lower quality work force.

### Public housing

Through City, State, and Federal programs, the City has become a major supplier of housing to its citizens. About 300,000 housing units, more than one-fifth of the new housing units completed in the City since 1927, have been public or publicly aided. Public housing units built entirely with Federal funds do not contribute to the City's financial problems since their operating deficits are covered by special Federal subsidies. However, two other housing programs in the City do have budgetary implications. First, a State law, the Limited Profit Housing Company Law, commonly called Mitchell-Lama, allows local governments to issue tax-free bonds to finance mortgages for limited-profit housing

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<sup>1/</sup>Congressional Budget Office, "New York City's Fiscal Problem: Its Origins, Potential, Repercussions, and Some Alternative Policy Responses," Background Paper No. 1, October 10, 1975.

companies. The City has used the law extensively, selling tax-free bonds to finance mortgages at below-market interest rates, often for 100 percent of development costs. Despite the substantial subsidies involved in Mitchell-Lama construction, rental revenues have not generally been sufficient to allow borrowers to meet mortgage payments.

The City administration has announced that it will ask for three legislative changes to help increase revenue from these projects: (1) repeal of the City's law which requires hearings in advance of any Mitchell-Lama rent increase but limits rent increases to every 2 years; (2) repeal of the local law restricting housing agency access to income-verification data, and (3) authorization for the City to impose automatic rent increases for extraordinary increases in maintenance and operations costs.

Such actions may not be sufficient to offset the need for further subsidy on existing Mitchell-Lama housing. Because the City does not, at present, have access to capital markets, lending for new construction under this law has ceased, and efforts to encourage private investment have been made through exemption and abatement of City property taxes on construction and rehabilitation. Maintaining and upgrading existing structures has become the City's primary housing goal.

Public housing built, owned, and operated by the City and financed by City and State funds is the second major source of financial problems for the City. Again, rental revenues have not been sufficient to cover operating expenses, and operating cost subsidies for fiscal 1977 will be about \$42 million. Reducing these operating cost subsidies means increasing rental revenues, reducing services (such as maintenance), or obtaining State or Federal money to cover the subsidy.

Obtaining State money to cover operating subsidies seems remote, and recently the Federal Government rejected a City plan to use about \$85 million over the next 2 years (1977 and 1978) of section 8 1/ Rental Subsidy Program Money. Briefly, the section 8 1 program is intended to use Federal money to cover the difference between a "fair market rent" and a rental rate of between 15 and 25 percent of a lower income family's income. The tenant may live where he chooses, under certain constraints. The Federal Department

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1/Section 8 of Housing and Community Development Act of 1974.

of Housing and Urban Development rejected using the money to cover City- and State-financed public housing operating deficits (which would be the effect of the City's proposal) because the proposal did not meet the full intentions of the program.

### COLLECTIVE BARGAINING

A recurring theme in the discussion of the City confronting its financial situation is that the City may be able to reduce expenditures by reducing the number of people on its payroll. Cutbacks in personnel are always a City or agency alternative, and much of the media coverage has focused on the City's efforts to reduce the number of City workers.

This policy of employment cutbacks together with the wage freeze announced by EFCB marks a new phase in City labor-management relations. Both of these cost-cutting strategies run counter to union and worker interests. In the absence of other factors, attempts to drastically reduce the work force and to eliminate wage increases would almost certainly be met by fierce union resistance and possibly by illegal strikes.

However, except for problems with hospital workers and some earlier protest meetings, the situation is notable for the lack of such reactions. Several other factors are, of course, influencing the situation. Perhaps the most important is a public perception that the City's work force is too large--a perception that would weaken public support in the event of a strike. Secondly, the unions have voted to allow the pension funds board to buy several billion dollars of City municipal bonds. This complicates the usual bargaining relationship between the union and the City. The union must consider the impact of its collective bargaining actions on the safety of the pension board investments, which in turn affect the interests of current and future pensioners.

However, this situation also gives the unions a new bargaining tool, in that their refusal to buy more bonds could intensify the financial pressure on the City. In addition, the pension board's creditor status could give it a pivotal position in any bankruptcy situation. In the event of bankruptcy, the union representatives to the boards would have to agree to any court plan of reorganization. Thus, having the unions authorizing the pension board's purchases of City municipal bonds should be viewed as a mixed blessing by the City's management. It may help

to temper union demands in the short run but leave the unions with powerful leverage in the long run if management demands run strongly counter to worker interests.

The immediate areas of concern to union and management are the employment cutbacks and the wage freeze. The reductions in the work force that have occurred are hard to document; the planned cutbacks are said to be substantial but equally hard to document. Apparently, layoffs have taken place primarily among non-full-time and lower level employees. This tends to keep wage expenses from falling as rapidly as might otherwise be expected. Wage costs do not appear to have declined proportionally with the reported decline in employment. However, limitations in data are such that many agencies do not have exact knowledge of their payrolls, and higher levels of City government cannot be expected to provide processed information of greater accuracy than they themselves receive. Therefore, City employment and wage expense statistics cannot always be accepted at face value.

The State comptroller has compiled data indicating that the average annual salary of laid-off provisional workers and civil servants was \$11,500 and \$14,300, respectively. These figures are substantially lower than the \$15,800 average annual salary for personnel on the payroll. At the Board of Education, the average salary of those teachers who were separated was \$3,600 less than those who remained, and payroll decreased by only 6.9 percent during a period when full-time employment declined by 10.6 percent.

We cannot say with confidence how many layoffs have already occurred. A problem in making the calculations is the choice of the numerical base from which comparisons are made. To use the number of approved positions as the base is not meaningful, because approved positions often remain unfilled, even in normal times. Furthermore, simple counts of changes in the total number of city employees are misleading because of the use of part-time personnel.

A concept of full-time equivalent personnel is used by the City to convert part-time employees into a reasonable approximation of how many full-time employees would be needed to replace them. It is based on a weighting factor relating part-time earnings to average departmental salaries. The City comptroller's office issues monthly payroll reports which provide a personnel count, but this count is based on an averaging calculation and is not an exact count of the number of personnel. There are limitations in the reporting

systems: personnel may be employed for several months before their names appear on the payroll and personnel may be appointed and paid from agency funds before approval of the Vacancy Control Board. Despite these problems, the City has tried hard to reduce its staff. The unions will become increasingly concerned as additional proposed layoffs begin to affect workers with higher salaries, more seniority, and greater pension rights.

The wage freeze, coupled as it is with a call for productivity improvements, presents both union and management with serious problems to be negotiated through collective bargaining. Here the union acts as a counterbalance to management demands which, in their extreme form, would ask fewer workers to accomplish more work for an uncertain change in wage and fringe benefits. Although an attractive alternative for management, it is traditionally opposed by workers who want assurances that they will benefit from the productivity gains. Even then, the difficulty of achieving or measuring such productivity gains raises serious questions about the feasibility and equity of tying City salaries to productivity.

Given the seriousness of the City's financial situation, the unions can be expected to cooperate on holding the line on wages in the immediate future. But they cannot be expected to do so for many years. In fact, if the unions hold the line until fiscal 1978, there will be considerable pent-up demands for wage increases. These demands will have to be negotiated, and the longer run pressures on wages and salaries may be considerable.

The pursuit of improved productivity is commendable, and the City's employees have cooperated in the effort. However, the process is far from being simple or automatic. It will require continued effort by both sides. The "summer hours" work rule has been adjusted, and the 8-1/2-hour police tour of duty was reduced to 8-1/4 hours, thus providing the time for eight additional tours of duty per man per year, although not without strenuous objections. These changes resulted from a common concern of both the unions and the City, and they were achieved through negotiations. Further changes will have to be negotiated, but they will not be easy to accomplish.

#### SUMMARY

There is no practical way to add up the various alternatives open to the City and arrive, in balance sheet fashion, at a "bottom line." The terms controllable and

uncontrollable mean different things in different contexts, and no programs are either totally controllable or totally uncontrollable. Efforts by the City to reduce spending in a given program are subject to a combination of legal, organizational, contractual, political, and social constraints which are unique to that program. In a different program area, the constraints will be different.

In some cases, State and Federal law and regulations represent constraints on the City's freedom to act. For the most part, these laws and regulations could be altered to ease the City's problems. But as will be discussed in later chapters, the State and Federal Governments face constraints which are just as real as those faced by the City.

For the City's fiscal problems to be overcome, these constraints will have to be relaxed. The extraordinary powers granted to the Control Board represent a significant effort to do this. But as was shown in chapter 2, the problems will continue well beyond the 3-year life of EFCB. It is not yet clear that the short-term objectives can be met with the Control Board and its powers. It is then doubtful that the City could deal with its long-term problems without something like the Board.

## CHAPTER 5

### THE MUNICIPAL BANKRUPTCY OPTION

This report has dealt systematically with a series of options available to the City. For the sake of completeness, another option that has been debated at some length--debt adjustment under the Bankruptcy Act--is discussed in this chapter.

Recent amendments to chapter IX of the Bankruptcy Act, as amended, (11 U.S.C. 401 et seq. (1970)), providing for the adjustment of local government debt, eliminated or reduced requirements which would have been unmanageable in the case of New York City.

As enacted in 1937, chapter IX was a response to the many Depression-related local government insolvencies and defaults on debt. It provided a means for a city, or other local taxing agency, that was insolvent or unable to meet its debts as they matured to secure a court-approved debt restructuring under a plan worked out between the municipality and its creditors. Under chapter IX, a court-approved debt rearrangement could bind nonconsenting creditors, while State municipal debt composition plans could bind creditors only with their consent.

While workable in smaller city and special taxing district debt rearrangement proceedings, chapter IX probably would not have been usable in a complex major city reorganization because of the impossibility of complying with its requirements for acceptance by specified majorities of the debt to be composed. When proposed by the city, a debt composition plan was required to have the approval of holders of 51 percent of the debt which would be affected and, on confirmation, the approval of holders of two-thirds of all admitted or allowed claims which would be affected, other than claims which were to be paid in full or otherwise protected.

The 1976 amendments (Public Law 94-260, approved Apr. 8, 1976), permit any State's political subdivision, or public agency or instrumentality, to file a petition for debt adjustment after obtaining preliminary acceptance by holders of a majority of its debt in each class affected by the plan. However, in recognition of the practical problems which would confront New York and other large cities, they also permit filing without preliminary majority approval if a good faith

effort to gain approval was unsuccessful, if negotiation with creditors would be impractical, or if a reasonable fear exists that a creditor would attempt to gain a preference. Court approval of a plan is authorized if among other requirements it is found to be fair, equitable, feasible, and not unfairly discriminatory, upon acceptance by holders of two-thirds in amount of allowed claims of each court-designated class of debt and by holders of a numerical majority of allowed claims in each class.

In addition, the 1976 amendments included provisions (1) requiring that a municipality have authority under State law to begin a chapter IX proceeding, (2) automatically staying judicial or other claim enforcement actions against the city, (3) authorizing rejection of executory contracts and unexpired leases, and (4) authorizing the borrowing of funds by issuance of certificates of indebtedness.

There is considerable disagreement about whether use of Bankruptcy Act debt adjustment procedures would solve New York City's financial and economic crisis. Some argue that institution of proceedings under chapter IX would drastically disrupt the City's functions; would have severe spillover effects at the local, national, and perhaps international level; and would merely postpone the effects of the crisis. Others suggest that the potential local, national, and international effects have been overstated and that municipal bankruptcy would enable the City to lengthen the maturity of its debt and would contribute to the revitalization of the City's economic base.

A declaration of municipal bankruptcy and the actions that follow would have two major effects on the City's indebtedness:

1. A restructuring of the composition of the petitioner's debts with a lengthening of their maturities.
2. Postponement of debt service payments during the time that an automatic stay of all actions against the petitioner is in effect. This stay provides an opportunity for the City to negotiate and develop a plan of adjustment acceptable to the creditors and the court. It remains in effect until the case is closed or dismissed, unless terminated earlier by the court.

As a procedure for recomposing debt within the bankruptcy powers of the United States, the chapter IX municipal

bankruptcy differs from a personal bankruptcy. The City, which must continue in operation and provide necessary governmental services, neither surrenders its property to the court nor has its debts discharged, except as provided in its voluntary plan upon acceptance by the required majorities and approval by the court.

Thus, a chapter IX municipal bankruptcy would merely give the City time in which to determine the best means by which to achieve repayment, given the revenues available to it. If the City sought an adjustment of its debts under chapter IX, the court (with powers similar to those granted in the reorganization of railroads and corporations), would have to supervise the drawing up of a "plan of composition" designed to correct the City's financial problems. The mechanism for arriving at a plan is complex but is aimed at achieving acceptance by creditors holding at least two-thirds of the claims within each class of debt instrument.

Postponement of debt service payments and restructuring of the maturity of the debt might ease current cash flow problems, but is municipal bankruptcy the best means of achieving that end?

#### THE MERITS OF MUNICIPAL BANKRUPTCY

According to the July 20, 1976, Staff Memorandum on New York City's Progress Under the New York City Seasonal Financing Act of 1975, prepared for the Subcommittee on Economic Stabilization, House Committee on Banking, Currency, and Housing, some proponents of formal petition for municipal bankruptcy argue that the debt service savings achievable under chapter IX would go far toward enabling the City to "halt the erosion of city services, resume capital construction, and invest in economically vital projects." We believe that this can occur only if:

1. The period during which interest payments are postponed is long enough to enable the City to revitalize the economic base.
2. The savings achieved during the period would be large enough to revitalize the economic base, and would be used strictly for that purpose.
3. The revitalized base would enable the City to balance the budget, pay postponed and current interest on the principal amount of the recomposed debt following approval of the plan, and retire that debt.

4. Municipal bankruptcy would provide a focal point for dealing with the City's complex financial problems and would overcome the legal and institutional constraints that confront the City.

However, these four objectives may not be achieved under municipal bankruptcy.

First, the amount of time that would be required to draw up and receive approval of a plan of composition is a matter of conjecture. Such a plan would probably take more than a year to be approved, and could take as long as 10 years. Unless interest is postponed for a long time, the temporary financial benefit to the City would be limited.

Second, there is disagreement over the cost savings that would be achieved as a result of postponing debt service payments during the period in which a plan of debt composition is being worked out. Some proponents argue that a chapter IX proceeding would free the City of \$2.3 billion in debt service payments annually. However, others argue that, because existing laws tie \$1.5 billion of property tax revenue flows to debt service payments and because MAC takes out about \$600 million in sales and stock transfer tax revenues for debt service, savings may actually be about \$200 million.

Under law, some property tax revenues are tied to debt service and suspension of payments would require reduction of the property tax rate from about \$9 to about \$5 per \$100 of assessed valuation. Therefore, unless the law were changed, tax revenues would decrease along with debt service payments. A decrease in tax rates might be viewed as having favorable short-run effects on business decisions to relocate or landlords' decisions to abandon housing. However, because those are essentially long-run decisions and the tax decrease would be temporary, any substantial response by businesses and landlords should not be expected. If the law were changed, a tax windfall would accrue to the City--but such gains would be temporary and might not be large enough to reverse the City's fortunes, even if these funds were allocated to the most hard-pressed categories of the budget. In addition, it is not known how much of whatever savings actually accrue would be offset by expenses associated with protracted and expensive litigation associated with the proceedings.

Other proponents of municipal bankruptcy see it as the only way of curbing City spending. That view was argued forcefully in the June 14, 1976, "Review and Outlook" section of the Wall Street Journal. Although a court-imposed

solution might bring about budget balance, would such a solution be aimed primarily at assuring that the City's creditors are satisfied that the solution is equitable? In fact, the plan of composition requires that such satisfaction be achieved.

Some opponents of municipal bankruptcy point out that under the act, the presiding judge has broad discretionary powers and, according to the "Staff Memorandum," they question whether a presiding judge in a chapter IX proceeding would be "sufficiently competent in municipal administration to make such decisions for a city as complex as New York City." The competence of the Federal judge, the court-appointed referee, and the pool of talent that would no doubt be required to reach a solution to the City's problems is uncertain. Because of the uncertainty regarding the court's expertise in municipal administration and its obligation to assure equitable satisfaction of creditors, it is possible that a balanced budget could be achieved through the imposition of controls so stringent that the long-run attractiveness of the City would be reduced. Under State law, broad powers over City finances have been delegated to the Control Board. EFCB is charged to balance the budget so that, among other things, the City can reenter the bond market. The question is whether a municipal bankruptcy court would make better social decisions than EFCB and the City.

In addition, some have pointed out that, because a number of States prohibit fiduciaries from investing in the securities of defaulted municipal corporations for a certain number of years, seeking a solution under chapter IX might postpone the time at which the City could reenter the capital markets beyond the time at which the recomposition of the City's debt is approved.

It is difficult to imagine a situation in which the City could reenter the capital markets after a chapter IX proceeding any faster than if an alternative approach to lengthening the City's debt structure is attempted. A compelling argument for more rapid reentry would be a belief that the social costs imposed on City residents would be less under a plan of composition than under present arrangements.

There is also disagreement over the magnitude of spillover effects at the State, national, and international level that would result from a chapter IX municipal bankruptcy. Proponents of municipal bankruptcy feel that the severity of the psychological reaction of investors to a City default has been overstated. Clearly, such an action would

have some harmful effects beyond those that have already occurred. The disagreement is over the extent to which the market has already discounted those effects.

Under present banking regulations, a New York City default (of the nature involved in a petition for bankruptcy) could cause the banking community considerable difficulty. These regulations would require an immediate evaluation of bank holdings of City debt at their postdefault market value. Large New York City banks have about \$9 billion in capital and hold about \$1.2 of the City's \$6 billion notes outstanding. To quote E. J. Kane in the Bulletin of Business Research, July 1975:

"This write down would simultaneously eliminate a substantial portion of these banks' reported net worth and reduce the amount of credit they could raise by offering their questionable securities as collateral for subsidized loans from the Fed. The first consequence increases the probability of a resulting run in these banks by uninsured large depositors, while the second consequence would make it harder for the banks to cope with sizeable deposit outflows."

Authorities have shown great interest in amending existing regulations to permit a 6-month grace period during which banks would be allowed to value a city's securities at predefault levels. In addition, past experience indicates that both the Federal Reserve System and the Federal Deposit Insurance Corporation would lend funds to banks endangered by a municipal default.

### THE ALTERNATIVES

There appear to be two basic alternatives to municipal bankruptcy for alleviating the City's financial crisis. The first, and most obvious, is reliance on normal municipal bond market processes to lengthen the City's debt structure. The bond markets are closed to the City, but they are not closed to the Municipal Assistance Corporation. At present, MAC, with less than complete success, is trying to lengthen the maturity of the City's moratorium debt. In addition, interim cash flow requirements arising from shortfalls in variable revenue flows are being satisfied by seasonal financing provided by the Federal Government. This latter arrangement is due to expire in 1978.

Both of these policies are designed to accomplish the same result as municipal bankruptcy--to defer the crush of current liabilities. Neither policy is designed to solve the underlying economic problems of the City. However, in both cases, conditions are imposed on the City and a system of monitoring has been designed to eliminate some of the causes of the revenue-expenditure imbalance. Nevertheless, neither policy is going to do much to permanently alleviate the financial crisis until progress is made in solving the City' more fundamental economic problems.

A second alternative to be considered if the present arrangements fail would be a program of long-term Federal loans or loan guarantees designed to swap currently maturing securities for long-term securities. This alternative might differ little in its effects on the City's debt structure from an adjustment of its debt under chapter IX. In addition, austerity measures imposed on the City might not differ much from those imposed by a Federal court in a municipal bankruptcy proceeding. But the effects on investor perceptions of such an action would probably not be as severe as those that potentially could result from a City petition for an adjustment of its debt under chapter IX.

## CONCLUSION

Our assessment indicates that chapter IX of the Bankruptcy Act, as applied to the New York City situation, would not be the best way to solve the City's financial and economic difficulties for two main reasons. First, it is not a long-run solution to the City's economic problems and may, in fact, have harmful effects on the City's long-run economic health if judicial solutions limit policy options aimed at revitalizing the economic base. Second, as a means of lengthening the maturity of the City's debt, a chapter IX adjustment of debt should be viewed only as a last resort after fiscal attempts to rebuild investor confidence and other types of intervention have failed. For, although municipal bankruptcy accomplishes the same objectives as the alternatives, it:

1. May postpone the time at which the City can reenter the capital markets both because of legal constraints and because of its potential for limiting rather than creating policy options aimed at solving the City's economic problems.
2. Is likely to reduce the ability of other State and local governments to finance essential operations.

## CHAPTER 6

### PROSPECTS FOR THE CITY'S LONG-TERM ECONOMIC BASE

A common belief is that a strong city is a growing city, increasing in population, income, and wealth. Over the last decade, New York City has failed to grow, has lost population, has had lower levels of business activity, and has had a declining employment roll. Therefore, any revival of the City will have to start from a smaller economic base. To plan for the future, the City must create an environment in which businesses are not prone to move out or to curtail their economic activities and in which new businesses are induced to move in.

This chapter describes the interactions between the City's economic base and its budget. Although both revenues and expenditures affect the economic base, this chapter focuses on the relationship between the City's revenue-generating activities and its economic base. Both the short- and long-run implications of City revenue actions are considered. The potential conflict between the City's short-run actions to balance its budget and its long-term economic health is also presented.

### THE BUDGET AND THE ECONOMY

Changes in the City's revenues and expenditures affect its economic base and vice versa. The tax revenues depend upon the City's choice of tax base and tax rate, which are applied to the income or wealth of individuals and businesses. Increases in economic activity generate increases in income and wealth, which in turn generate increased revenues from several sources: personal income tax, corporate income tax, sales tax, and, with a lag, property tax. Increases in economic activity also tend to generate decreases in unemployment compensation and other categories of public assistance.

This interrelatedness between the budget and the economy is critical to any policy decision. Budgetary decisions have both direct and indirect effects on the economy. A City action to raise taxes to balance its budget in a given year may or may not accomplish its stated goal for that year; but it may also affect the tax base in later years. This indirect effect may actually lead to smaller future revenues--a result counter to the purpose of the short-run action.

The reasons for business and residential movement are complex; tax differentials are only one of several factors that influence these decisions. Faster population growth outside the central city, the aging of buildings, the rise in urban congestion, land prices, changes in industrial technology, and even rising affluence are important forces. Taxpayers' perceptions are also crucial. The City's financial crisis and the perceived actual and potential deterioration of City services may, when combined with tax increases, discourage many who might otherwise prefer city life. For all these reasons, the starting point for the discussion is the City's current economic condition.

### THE ECONOMIC BASE

During the 1960s, private sector employment in the City grew by only 2 percent, compared to almost 27 percent in the entire United States. While employment in manufacturing nationwide grew by about 15 percent, it declined in New York City by 19 percent with a loss of 180,000 jobs. There were also sizable job losses in the City's construction and transportation sectors, but during the decade all these losses were offset by large gains in employment in the service sector, the banking sector, and the government sector. Since 1970 the City has experienced a drastic decline in employment--a loss of 468,000 jobs. With the possible exception of government employment, all sectors have experienced job declines. Manufacturing employment has fallen at an average rate of 48,000 jobs per year since 1969 to its present level of 527,800.

Part of the decline in employment reflects the relative decline of the entire Northeast, as population and industry move toward the South, Southwest, and West. The reasons for that movement are many and complex, including important changes in price for land and labor, possible changes in the tax burdens for both firms and individuals, and the simple desire of many people for the outdoor lifestyle possible in warmer climates. These and other factors have led to widely differing rates of change in population, real personal income, and manufacturing employment across the various regions of the country. For the period 1960-75, the Middle-Eastern region (New York, Pennsylvania, New Jersey, Maryland, and Delaware) saw its population grow by 10.9 percent, its real income grow by 57.8 percent, and its manufacturing employment decline by 13.7 percent. The New England region experienced a population increase of 16.1 percent, an income increase of 65.5 percent, and a manufacturing employment decline of 9 percent. In contrast, the West South Central region (Texas,

Oklahoma, New Mexico, and Arizona) had a population increase of 29.4 percent, a personal income increase of 105.8 percent, and a manufacturing employment increase of 67.3 percent. The increase in manufacturing employment in the West South Central region stands in stark contrast to a decline of 44.3 percent for New York City over the same period.

Changes in employment patterns in the New York metropolitan area also hurt the City and reflect a worsening of the City's economic position relative to the rest of the metropolitan area. Table 12 contains information on total employment by place of work and personal income by place of residence for the five City boroughs and for the rest of the metropolitan area. From 1969 to 1973 the City lost about 260,000 jobs, a 6.6-percent decline, while the rest of the metropolitan area gained about 220,000. The proportion of metropolitan area employment located in the City fell 3 percent. The loss of jobs (see Table 13) would have been greater but for the growth in State and local government employment in the City. Employment in that sector increased by about 43,000, or 10 percent, during the period, while the private sector lost 311,000, or 9.1 percent.

Another indicator of the economic base is personal income. The proportion of total metropolitan personal income accruing to individuals living in the City has changed little over the period 1970-74, remaining close to 42 percent. (See Table 12.) Over the 5 years, labor and proprietor's income decreased from 69.8 percent of personal income to 66.1 percent, while transfer payments increased from 11.6 to 15.2 percent of City personal income. Although some individuals continue to live in the City and commute to work in the suburbs, a growing portion of the City's population is on income maintenance programs. Earned income by suburban residents appears to have increased appreciably compared to that of City residents.

Table 12

Selected Economic Indicators For New York City  
and Surrounding Metropolitan Area (1969-1974)

<u>Year</u>	<u>Employment</u> by location of job (note a)		<u>Personal income</u> by location of residence		<u>Percent in City</u>	<u>Percent in City</u>
	<u>New York City</u>	<u>Rest of metro. area (note b)</u>	<u>New York City</u>	<u>Rest of metro. area (note b)</u>		
1969	4,160	3,730	(c)	(c)	52.7	(c)
1970	4,100	3,780	\$38.354	\$51.327	52.0	42.6
1971	3,980	3,750	\$40.097	\$54.658	51.5	42.1
1972	3,920	3,840	\$42.007	\$58.393	50.5	41.6
1973	3,900	3,950	\$44.280	\$62.522	49.7	41.2
1974	(c)	(c)	\$47.683	\$67.840	(c)	41.0

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a/Full- and part-time wage and salary employment plus number of proprietors.

b/New York City and the metropolitan area comprise the New York Consolidated Statistical Area. As organized by Office of Management and Budget revised circular 1975, New York City column data includes the New York counties of Kings, Queens, Bronx, Richmond, and New York. Rest of metro. area contains the New York counties or cities of Rockland, Putnam, Westchester, Nassau, Suffolk; the New Jersey counties of Essex, Morris, Somerset, Union, Hudson, Middlesex, Passaic, and Monmouth; and the Connecticut county of Fairfield.

c/Not available.

Source: Regional Economics Information System, Bureau of Economic Analysis, Department of Commerce.

Table 13

Composition of New York City Employment Changes  
1969-73 by Industry and Sector

	<u>Employment</u> <u>change</u>	<u>Percent</u> <u>change</u>
Private sector wage and salary employment	-310,589	-9.1
Manufacturing	-169,590	-20.5
Trade	-60,548	-7.9
Finance, insurance, and real estate	-35,438	-7.3
Transportation, communication, etc.	-30,869	-9.3
Services	-13,177	-1.4
Others	-967	-.9
Proprietors	19,265	9.1
Government	26,544	4.9
Federal	-16,735	-14.7
State and local	43,279	10.1

Source: Regional Economics Information System, Bureau of  
Economic Analysis, Department of Commerce.

Table 14

New York City Population By Age Group

	<u>1960</u>	<u>Percent of total (note a)</u>	<u>1970</u>	<u>Percent of total (note a)</u>	<u>Percent- age change</u>
Total all ages					
(note a)	7,781,984	100.0	7,894,862	100.0	1.5
Under 19 years	2,251,896	28.9	2,354,955	29.8	4.6
20 to 34 years	1,538,920	19.7	1,725,226	21.9	12.1
35 to 49 years	1,624,657	20.9	1,395,497	17.7	-14.1
50 to 64 years	1,462,844	18.8	1,352,212	17.1	-7.6
65 and over	813,827	10.5	947,878	12.0	16.5

3

a/Total population adjusted for undercount estimates exceeds population in age groups by 1.1 percent and 1.5 percent in 1960 and 1970, respectively.

Source: U.S. Census of Population, 1960 and 1970.

This data indicates that, for the City, the trend of the 1960s has accelerated in the 1970s. The 1960-70 census data for the City shows a relatively stable population (increasing at 1.5 percent) accompanied by much larger changes in work-related age composition. (See Table 14 for details.) Working individuals, and their jobs, appear to be moving from the City. This trend is strengthened by data on New York City net migration from 1960 to 1970. As Table 15 indicates, the City suffered out-migration of 492,600 during the sixties although population increased by only 113,000. The difference was due to a net increase of births over deaths of 605,600.

Between 1970 and 1975, the City's population decreased 327,200. This decrease resulted from a net out-migration of 490,500 over the 5-year period, not countered by the increase in births over deaths of 162,700. For the suburbs, the net out-migration of 8,700 people was countered by a difference in births over deaths of 23,200, generating a population increase of 14,500.

Thus, the rate of out-migration during the sixties has doubled for the first half of the seventies, accelerating the trend from the sixties. For the suburbs, the trend has been reversed from a net in-migration of 63,700 for the sixties to a net out-migration of 8,700 in the first half of the seventies.

Against this backdrop the City is making decisions that will have both short-and long-run direct and indirect effects. The rest of this chapter discusses the direct and indirect effects of City tax decisions upon its economic base.

Table 15

Population and Comparisons of Net Migration (note a)  
for New York City and Suburbs: 1960-70, 1970-75 (note b)

	<u>Population</u>			<u>Net migration</u>	
	<u>1960</u>	<u>1970</u>	<u>1975</u>	<u>1960-70</u>	<u>1970-75</u>
	(millions)			(thousands)	
New York SMSA (note c)		9,974	8,763.3	-328,900	-499,200
New York City	7,782	7,895	7,567.8	-492,600	-490,500
Suburbs (note d)		2,079	1,195.5	63,700	-8,700

a/Net migration is positive if in-migration is greater than out-migration and negative if in-migration is less than out-migration.

b/1975 figures are preliminary.

c/Standard Metropolitan Statistical Area.

d/Suburbs are the non-central-city portion of the New York Standard Metropolitan Area.

Source: U.S. Bureau of the Census

REVENUES

New York is often cited as a city that taxes everything. Furthermore, the City has recently raised the rates and extended the bases of many of its taxes. It may be several years before the long-run effects of these actions are felt on the City's economic base, but such actions are then likely to interfere with the long-run goal of balancing the budget. Although precise estimates of the long-run effects of such decisions cannot be made, it appears that taxpayers will continue to move out of the City if tax rates are raised enough to balance the budget.

The likely effects of further tax rate increases are noted for each major revenue source:

Sales tax: In New York City there is presently a State sales tax of 8 percent, part of which is used as a revenue stream for MAC bonds. After MAC debt service is paid, a portion of the tax is passed back to the City. A higher sales

Table 16

Tax Rate Differentials  
(For New York City and Surrounding Areas)

	<u>New Jersey</u>	<u>Connecticut</u>	<u>Westchester County</u>	<u>New York City</u>
Personal income tax	2 percent up to \$20,000 (note a), 2.5 percent in excess of \$20,000 taxable income	None	2 percent up to \$1,000 (note b) Graduated to 2.5 percent \$25,000 and up (note b)	0.9 percent up to \$1,000 Graduated to 4.3 percent \$25,000 and up (plus State taxes)
Property tax (per capita in 1974)	\$228.09	\$514.85	\$233.72	\$338.32

Sales tax                    c/5 percent                    7 percent                    d/5 percent                    e/8 percent

a/This tax was imposed for the first time last year.

b/Westchester County does not have a personal income tax; the figures are the State personal income tax levied on the county residents.

c/No local sales tax.

d/Includes State sales tax of 4 percent, Westchester County sales tax of 1 percent; White Plains has an additional sales tax of 3 percent.

e/Includes City sales tax of 4 percent and State tax of 4 percent.

Source: Advisory Commission on Intergovernmental Relations

tax would encourage people to purchase taxable goods in neighboring political jurisdictions. If New York City residents buy more goods outside the City, the business and personal income generated in--and taxed by--the City would decline. (See Table 16 for the tax differences between the City and surrounding areas.) Thus, the business and personal income tax bases are also affected by the sales tax rates, and any short-run increase in sales tax revenues must be weighed against the potential long-term decrease in income tax base and revenues.

Income tax: Although a higher income and earnings tax is not likely to induce people to work less, great differences in individual and business income tax rates between New York City and surrounding areas may influence business and individual locational choices. This could have long-term effects on the income and earnings tax base and tax revenues of the City. In addition, such locational decisions have indirect, long-term effects on the sales and property tax bases.

The City's income tax is progressive, ranging from 0.9 to 4.3 percent of taxable income for City residents. Nonresidents are taxed at a proportional rate (0.45 percent on wage and salary income and 0.65 percent on self-employed income).

The corporate income tax is based on varying rates and formulas for allocating corporate revenues in the City. Commercial banks currently pay 13.823 percent of net income and savings banks and savings and loan associations pay 10.134 percent of net income.

Property tax: The property tax rate for fiscal year 1976-77 was 8.75 percent of assessed value. To the extent that individuals and businesses living in the City bear the burden of greatly different property and business taxes, such tax increases may cause them to alter their investment and locational choices. This will not only decrease property values and tax revenues but will decrease the business and personal income generated in and taxable by the City. Any increase in property tax and business tax revenues must be weighed against the potential long-term decrease in the income and sales tax bases.

## The tax burden

Recent data indicates that New York taxpayers on the whole bear a heavier burden of State and local taxes than do the residents of other large cities. The combined burden of residential property, personal income, and sales taxes for a family of four with \$7,500 income was 12.4 percent for New York City and 9.6 percent for all other cities. For those with an income of \$50,000, State and local taxes were 14.5 percent for the City and only 7.1 percent for all other cities. <sup>1/</sup>

Although tax revenues can be increased by either expanding the tax base or increasing tax rates, it is unlikely that much more revenue can be raised by expanding the tax base, since the City already has a comprehensive tax base consisting of a personal income and nonresident earnings tax, corporate and unincorporated business taxes, a sales tax, a property tax, a utilities tax, a stock transfer tax, and others. In fact, according to the City's Financial Plan, expansion of the tax base will account for only about \$15 million of the \$200 million increases in tax revenues anticipated in fiscal 1978. This \$15 million increase is attributable to small changes in the tax base, such as including more personal services in the sales tax base, and eliminating some personal income and business tax exclusions and deductions.

According to the Financial Plan for fiscal 1978, the other \$185 million is generated by raising tax rates, including: (1) increases in personal income tax rates (\$75 million) and large increases in real estate tax rates, and (2) rate increases and surcharges on financial corporations, State estate tax, cigarettes, and general corporations.

To illustrate the policy problem the City faces in generating new revenues to balance its budget, a hypothetical gap of \$929 million (see Cyclical Pattern Scenario in app. II.) in fiscal 1980 is assumed. If the gap is to be closed by tax actions, the rates on the sales tax, the personal income tax, and the property tax will have to be increased. Assuming each revenue source increases in the same proportion as total revenues, the property tax rate must rise from

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<sup>1/</sup>Source: Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, Washington, D.C., February, 1974.

\$9.07 to \$10.57 per \$100 of assessed valuation, the top bracket personal income tax rate from 4.3 percent to 5 percent, and the sales tax rate from 4 percent to 4.7 percent. Details of these calculations are presented in Table 17. Deficits of this size appear to require large rate increases to balance the budget. Naturally, a larger budget gap would require even larger tax rate increases to balance the budget.

Even the large tax rate increases presented in Table 17 are underestimates of the increases that would be necessary to close a \$929 million deficit, because it is unlikely that a 1-percent tax increase will yield a 1-percent revenue increase. This is particularly true for the sales tax. Citizens can easily substitute purchases outside the City for purchases inside the City, thus reducing the tax base and requiring a correspondingly higher rate increase to raise the additional \$185 million in sales tax revenues. The 1-percent revenue response to a 1-percent rate increase is likely to be more accurate in the short run for the personal income and property taxes, since it takes time for individuals and businesses to relocate themselves and taxable property. However, over the long run, rate increases such as those presented in Table 17 would probably greatly affect all three tax bases.

Table 17

Tax Rate Increases Necessary  
to Close a \$929 Million Gap  
Personal Income, Sales, And Property Taxes

	<u>Fiscal year 1980</u> <u>forecasts</u>		<u>Budget</u> <u>balancing changes</u>	
	<u>Revenues</u>	<u>Rate</u>	<u>Revenues</u>	<u>Rate</u>
	(millions)		(milions)	
Personal income and earning tax	\$ 975	a/4.3%	\$161	5.01%
Sales tax	1,116	4.0%	185	4.66%
Property tax	<u>3,523</u>	b/\$9.07 /\$100	<u>583</u>	\$10.57 /\$100
 Total	 <u>\$5,614</u>		 <u>\$929</u>	

a/This is the highest rate to which a resident's taxable income is subjected. The lowest rate is 0.9 percent, which would rise to 1.05 percent.

b/City estimate for fiscal 1978.

## Intergovernmental revenues

As New York City attempts to balance its budget by cutting expenditures, the institutional relationship between expenditures that the City itself finances and intergovernmental revenues (from the State and Federal levels) tends to further erode the City's revenues. This occurs in two ways. First, many of the State and Federal dollars flowing to the City are matching funds. When the City reduces expenditures in certain areas, it loses State or Federal funds because of the matching requirements. For example, a loss results in some water pollution control projects, where every dollar the City saves costs it \$7.50 in Federal funds and \$1 of State funds.

The second way in which intergovernmental funds are lost is through "maintenance of effort" requirements, in which the Federal Government requires that a locality maintain funding at a certain level in order to receive a certain amount of Federal funds. In such a case, a small expenditure cut could result in the loss of millions of dollars of Federal funds. For example, to receive Federal Urban Mass Transit Assistance operating funds, the City must maintain its expenditures at a level determined by an average of the previous 2 years.

## Alteration of regulatory policies-- rent control

Various City regulatory policies affect revenues. The regulated activity with the greatest revenue potential is rent control in the housing market. In New York, 642,000 apartments are subject to rent control. It is estimated <sup>1/</sup> that the actual rent on these units was no more than \$1 billion but that the market rent (without rent control) would have been at least \$2 billion. The loss of tax revenues due to rent control has been estimated by the Federal Reserve Board of New York to be more than \$220 million in 1975. These estimates were made with respect to existing housing.

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<sup>1/</sup>The two principal studies of rent control (I. Lowry, J. Desalvo, and B. Woodfil, Rental Housing in New York City, New York City Rand Institute, 1971, and E. Olsen, "An Econometric Analysis of Rent Control," Journal of Political Economy (Nov./Dec. 1972)) were both based on 1969 data. The updated figures used above are based on the work of J. Regan of the Federal Reserve Bank of New York.

Some contend that rent control leads to deterioration and abandonment of housing, and there is ample evidence that this has occurred. Rent control reduces rental income, and by allowing housing to deteriorate, landlords manage to "disinvest." In some cases, rent controls drive rental income so low that landlords cannot cover operating costs, so the units are abandoned. According to this view, without rent control, there would have been less deterioration and abandonment of New York City housing, market rents would have been even higher than the \$2 billion figure given above, and the potential tax revenues would be correspondingly larger.

In recent years, rent controls have been relaxed in several ways, most notably by allowing rent increases of 7.5 percent per year if the controlled rent is less than some administratively determined "maximum base rent." These changes have, however, increased the administrative costs of rent controls to about \$9.5 million a year. If controls are eliminated, a continued gradual phaseout would be preferable to sudden total removal of controls. Even so, the process could be made administratively simpler than existing methods. One way would be to allow all controlled rents to increase by the same percentage as the previous year's rents for uncontrolled apartments plus some additional percentage; for example, 10 percent. Knowing several years in advance about what their rents would be would greatly reduce the readjustment costs to tenants in rent-controlled apartments. Such a gradual phaseout would, of course, limit the City's tax revenue increases in the earlier years to a small percentage of the \$200 million cited above.

From the standpoint of equity, the beneficiaries of controls are those who happen to live in rent-controlled apartments. Proponents of controls view the mechanism as a subsidy to poor people, holding their rents down at the expense of landlord revenues. If this view were correct, rent controls and direct subsidies to the low income family for rental payments could be alternative ways of aiding the low-income population. There is, however, considerable disagreement about the income distribution of those living in rent-controlled housing. A recent study by George Sternlieb and James W. Hughes has shed new light on this controversy. 1/

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1/George Sternlieb and James W. Hughes, Housing and Economic Reality: New York City, 1976.

As indicated in Table 18, the median income of those living in rent-controlled housing has not kept pace with the U.S. median income or with inflation. New York City's renter households are clearly not maintaining the level of comparative affluence that they enjoyed in 1965. In Table 19, we note that a large share of the City's poverty households live in rent-controlled housing. For example, renter households under the \$4,000 level represent 21.6 percent of the total, while the equivalent within the controlled segment is 27.8 percent. As Sternlieb and Hughes note, 6 of every 10 controlled units are occupied by households with incomes of less than \$8,000. Conversely, 16 percent of households within the controlled stock have income levels of \$15,000 or more.

To the extent that low-income people are hurt by de-control, an alternative policy would be to supplement controls with direct transfer payments to this group. However, if the City decontrols rents, it may end up paying more in the form of AFDC payments than it would gain in taxes.

#### SUMMARY

The City has recognized that its economic base is an important element of its future financial viability. The City's newly founded Department of Economic Development has recently completed a detailed study aimed at securing a fundamental change in the City's policies as they affect its economic base. The proposed 5-year economic recovery plan includes capping the real estate tax, reducing the commercial occupancy tax, eliminating the sales tax on machinery and equipment through a tax credit process, and generally reducing business taxes when possible. Many other steps designed to improve the local business climate are also set forth. The program has been launched by the City administration. Various implementing steps will require the approval of the Emergency Financial Control Board and State or local legislation. We believe that these and future City efforts to firm up its economic base are steps in the right direction. However, it is not known whether these actions, by themselves, are sufficient to counteract the dramatic declines the City has experienced in its economic base.

Table 18

Comparison of Median Income of Families  
and Individuals Living in New York City  
Rent-Controlled Housing with the  
U.S. Median Family Income, Selected Years  
(in current dollars)

	<u>1965</u>	<u>1968</u>	<u>1970</u>	<u>1975</u>
New York City rent-controlled housing	5,500	6,000	7,200	8,395
United States	5,862	7,094	8,284	11,101

Source: George Sternlieb and James W. Hughes, Housing and Economic Reality: New York City, 1976, p. 102.

Table 19

Renter Households, Control Status by Income  
of Families and Individuals in 1975

<u>Revenue of families and households</u>	<u>Total renter occupied</u>	<u>Controlled</u>	<u>Uncontrolled</u>
3,999 or less	21.6%	27.8%	16.3%
4,000 - 7,999	26.4	28.7	23.7
8,000 - 12,499	23.5	21.4	24.7
12,500 - 14,999	6.7	6.1	7.3
15,000 - 24,999	16.0	12.6	19.9
25,000 or more	5.9	3.4	8.2

Source: Sternlieb and Hughes, p.108.

## CHAPTER 7

### CITY INTERACTIONS WITH OTHER

#### LEVELS OF GOVERNMENT

In considering the impact of the State and Federal governments on the City's policies and budget, one must confront the complexities of the American Federal system. This chapter discusses some of the constitutional, statutory, and administrative implications of the City's present situation and of potential policies for its amelioration.

#### CITY-STATE RELATIONS

New York State directly determines many City policies and programs, thereby having a major impact on the City's budget and financial situation. In some areas, such as legal levels of taxation and borrowing, State policies affect only New York City. In other areas, State policies ranging from the kinds of academic courses to be taught in schools to welfare and Medicaid eligibility and benefit levels affect every community in the State, including New York City. In the latter areas, the City's ability to influence policy decisions is diminished by the interests and the political persuasiveness of other constituencies in the State. These other groups may lobby successfully for their own best interests, which may contradict those of New York City.

The State also influences the City's financial situation insofar as transfer payments from the State constitute an important component of the City's budget. State funds partially underwrite costs in many program areas, the most important of which are welfare (particularly AFDC), Medicaid, and education. Total State transfers to the City in fiscal 1975 were \$3.5 billion, or 26 percent of that year's revenues. At the same time, State policies and formulas regarding such transfer payments have created a substantial burden on the City budget since the payment levels established do not cover the total costs of the mandated programs.

In terms of constitutional and statutory authority and powers, the State clearly could impose conditions on the City that would ameliorate its present budgetary problems. The State-mandated interposition of the Emergency Financial Control Board in the budgetary process of formerly uncontrollable entities, such as the formerly independent City agencies, demonstrates that the State has the legal power to change

the way the City operates. Similarly, the State could either mandate lower rates of benefit levels and expenditures or provide greater subsidies for City expenditures. Either action would provide partial or total relief to the City's budget problem. The constringing factors are not constitutional, but political or financial.

### CITY-FEDERAL RELATIONS

The relationship between the City and the Federal Government is not as direct as the City-State relationship. In many areas the City is mandated by the State to participate in Federal programs, such as welfare and Medicaid. In other areas City participation in Federal programs is voluntary. In these discretionary activities, the Federal Government provides strong incentives, in the form of subsidies, for the City and other communities to participate in programs. This often makes it difficult for a community to reject a Federal program, particularly in the case of New York City, which has historically provided high levels of social services.

The implications of these Federal incentives for the City's budgetary situation could be serious. The matching requirements and the administrative rules and regulations associated with the Federal programs add to the level of the City expenditures that must be covered by locally generated revenues. Furthermore, in some cases the Federal incentives might be the major impetus for undertaking a particular service that the City might not have otherwise provided.

Thus, the Federal matching grant system can add to the budgetary dilemmas of communities in general and New York City in particular. But the extent of this impact should not be exaggerated. In fiscal 1975 the Federal Government contributed \$2.4 billion--20 percent of the City's budget. Of that amount, \$1.76 billion subsidized State-mandated welfare and Medicaid programs and \$257 million was in the form of revenue sharing grants for which no matching is required. Therefore, a maximum of \$383 million of Federal funds involved incentive-type programs. In some cases these grants to the City might be viewed as actual savings to the City since the City might have provided similar services without Federal assistance. In such cases the Federal contribution diminished the amount of locally generated funds expended.

Probably of much greater significance than Federal matching programs is the impact on the City of Federal policies not directly related to "urban issues." Federal laws

and fiscal policies affecting unemployment, rates of economic growth, and inflation have a major effect on State and City expenditures for welfare, health care, and other social services as well as on State and City revenue generation. Similarly, Federal tax, transportation, and housing policies play a major role in determining the demographic and economic environment in which the City must operate. These impacts are difficult to measure, but they should be considered in the discussions of policy options for easing the budgetary problems of the City and other urban centers.

It is in the area of federally funded, State-mandated programs that the Federal Government could do the most to alleviate the City's budgetary problems. The Federal Government could impose certain conditions on the States; for example, the requirement that, to be eligible for Federal funds for welfare, a State must provide all matching funds at the State level.

### Constraints on the City

The constitutional and statutory powers of the State and Federal governments are such that the City is unable, on its own, to make the political decisions necessary to ameliorate its financial problems. As long as the City must assume all or part of the costs of State-mandated programs, it lacks sufficient control over its own budget to make the kinds of expenditure modifications that will ultimately lead to a balanced budget. Similarly, as long as the City must obtain legislative authorization from the State to modify or increase its revenue-generating capabilities, the City is further limited in its ability to resolve its financial problems.

### INTERGOVERNMENTAL POLITICAL RELATIONSHIPS

The relationships between the City and the State and Federal governments involve more than the constitutional, statutory, and financial aspects discussed thus far. There is also an intergovernmental political relationship, particularly between the City and the State. The City itself, generally through the mayor's office, frequently takes an active role in attempting to influence State and Federal legislation. Historically, City officials have worked hard to increase the kinds and extent of the same social services that presently constitute a major burden on the City's financial situation. Furthermore, the City has traditionally turned to the State during the final stages of the budget cycle to obtain greater taxing and borrowing authority. This

has frequently been achieved at the cost of the City having to in turn support legislative measures that benefit rural and suburban constituencies but perhaps hurt the interests of the City and its residents.

In addition to the political activities of City officials on the State and Federal levels, there are also the activities of State and Federal legislators from the City. Such persons, particularly those on the State level, often hold great power and can play a major role in developing programs and establishing requirements, including financial requirements, with which the City must comply. A recent example of this is the State's attempt to establish a budgetary minimum for City expenditures for education, thereby limiting the ability of the City officials to make budgetary decisions. Other influential individuals and groups from the City, most conspicuously municipal employees, frequently have a significant impact on the formulation of State policy relating to the City.

The great majority of the representatives of New York City, whether official or self-appointed, have historically tended to support higher levels of social services and easier eligibility requirements, even if this meant greater expenditures from City-generated revenues and higher levels of subsidization from the State and Federal governments. Any future attempt to shift some of the City's financial burdens to the State will involve either higher State expenditures, greater Federal subsidies, lower service levels (through stiffer eligibility standards, lower benefits, or both), or a combination of the three. It is in this context that political factors constrain the authority of the Federal and State governments to take those steps that will most effectively solve the City's present financial problem.

#### ADMINISTRATIVE CONSIDERATIONS

At the administrative level, Federal and State officials develop policies and regulations that play a major role in the day-to-day organization and activities of the City government. Informal ties frequently develop between Federal, State, and City administrators in certain functional or programmatic areas. These ties, together with multiple levels of rule- and decision-making, limit the ability of the City, particularly the City's elected officials to formulate policies appropriate to the community as a whole.

A primary feature of the American Federal system is that, among the three levels of government, most activities-- legal, political, and administrative--complement and even overlap each other. The result is a situation in which responsibility, authority, and accountability are frequently divided among many individuals on all levels of government. This situation is both beneficial and harmful. Federal laws and regulations limit the ability of States and cities to determine their own fates by taxing and providing services solely as they see fit, but at the same time they assure a certain base level of government services across the country. Similarly, State laws and regulations setting service standards on a statewide basis limit local flexibility.

If administrative responsibility for local programs is shifted to the State, it is not clear that in New York City the level and quality of services provided would improve or that their cost would decline. For certain types of services and particularly for small communities, an argument can be made that benefits, such as economies of scale, can be achieved by shifting the administration to a higher level of government. In the case of New York City, however, there is no evidence that there will be greater economy or efficiency generated by a shift in administration to the State level. Such a shift would move government even further from the people whom it is designed to serve and might make programs less responsive to local needs.

Although we are not attempting to assess the recent Arthur Andersen and Touche Ross reports recommending changes in the City's management and accounting practices, the City clearly must implement appropriate changes to increase the efficiency of its operations. These changes are essential not only to cut costs, but also to create an operating environment that emphasizes efficiency and that instills confidence among constituents and at the other levels of government that the City is doing all it can to improve its financial situation.

Such administrative changes, while essential, can play only a limited role in the solution of the City's financial problems. A complete solution is possible only if changes in the policies and levels of social services are made through the political process. And, as emphasized earlier, such modifications cannot be made just on the local level; decisions on the Federal and State levels will be required to implement changes that will enable the City to achieve long-run financial viability.

## CHAPTER 8

### STATE AND FEDERAL POLICY OPTIONS

New York State and the Federal Government have long been inextricably entwined in New York City financial affairs and have recently acted in direct response to the City's financial crisis. The State established the Emergency Financial Control Board and the Federal Government authorized \$2.3 billion as seasonal loans. The question, therefore, is by what means could the State and Federal governments aid the City and how costly and effective would some of these options be?

More Federal and State involvement would not, in general, be inconsistent with current policy. State and Federal funds are presently spent in the City, paid to City authorities, and taxed away from City residents. State and Federal authorities influence City spending in many ways, such as by near mandates for the City to spend certain amounts on certain functions. In welfare, for example, the City is required to partially support a level of services determined by the State pursuant to Federal law. Participation in Federal programs may require strict (and costly) adherence to Federal standards. In addition, the Federal Government has expressed concern about the quality of urban life and has spent billions to upgrade the cities. Depressed regions, such as Appalachia, have likewise been singled out for special attention, and the Federal Government has pursued policies to aid them.

One thing is clear: The magnitude of New York City's financial problems is such that a State or Federal "solution" would require huge expenditures. If other problem cities are treated the same, the costs would be multiplied.

We are not, in this chapter, trying to answer the basic question of whether there should be more Federal and State involvement. Rather, we attempt to analyze the alternative, identify specific policy options, and show generally how the policies would affect the City budget and the State and Federal budgets.

The approach to policy options differs depending on whether one takes the point of view of the City, the State, or the Federal Government. As stated earlier, the major question for the City is how to balance the budget, with some combination of cost cutting, tax revenue increase, help from other sources, and possible divestiture of some functions. The

State's problem is how much more aid it can provide and what control it should exercise. In addition to these considerations, the Federal Government faces the central question of whether it should treat New York City any differently than other cities. Can it give aid to New York City which it will not offer later to other cities in financial trouble? (To some extent, the Federal Government has already made an exception for the City with the seasonal financing loans.) The Federal alternatives are to do only what has been done, to go on treating New York City as a special case, or to try to develop a new set of policies to help any city in serious financial difficulty.

Although each city and its problems are in some sense unique and other cities have not yet received the attention given New York, New York is not the only city facing serious financial difficulty. For reasons that are not fully understood, this condition is increasingly typical of older industrial cities. Accordingly, we believe changing circumstances necessitate a careful reexamination of Federal policies affecting State and local government fiscal status. For example:

- What is to be the policy toward local governments which have or will have financial problems as a result of the relative decline of certain sections of the country? In this connection, should the movement of people and economic activity toward the South and Southwest be accepted as a natural economic and social phenomenon? Should efforts be made to alter that flow? Should something be done to ease the costs of adjustment (both to the receiving city and the one left behind)?
- Has the means of directing Federal aid to local governments (general revenue sharing by means of formulas that include tax effort and matching grants) tended to encourage unnaturally high levels of local spending? Do these formulas impede local government efforts to control their budgets? Should programs be altered to make it easier for cities to adjust their budgets to changing circumstances?

### Policy on Federal and State aid

Federal policy toward New York should be approached in the context of its relations with all State and local governments. Whatever immediate policies are adopted, singling out New York for special treatment should be based on evidence

that the City's problems are unique (as some have claimed because of its large welfare population and the number of illegal immigrants who reside in it) or that the City is demonstrably more important than other cities facing severe fiscal problems.

Analysis of policy can be segmented into three parts-- goals, policies to reach the goals, and criteria by which to judge the policies. The following is a list of these items.

Presumed goals:

1. Achieve a permanently balanced City budget.
2. Ease the burden of all local governments that must adjust to long-run declines in economic activity.
3. Improve State and local government efficiency in providing public services.
4. Improve the equity of the current system of aid to State and local governments.

To some degree, these goals are mutually exclusive; but elements of them would be mutually supportive in any act of policy alternatives for the City.

Policy alternatives:

1. Financial assistance to particular cities (city-specific grants, loans, loan guarantees, etc.).
2. Financial assistance for providing specific services in all jurisdictions (categorical grants, etc.).
3. General budget support for all jurisdictions (revenue sharing, etc.).
4. Management assistance (development of accounting, budget control, and personnel systems, etc.).
5. No change in present policies and programs.

Criteria by which policies should be evaluated:

1. Probability of accomplishing goals.
2. Short- and long-term cost.

3. Impact on the economy.
4. Social disruption.
5. Administrative feasibility.
6. Flexibility of policy to changing conditions.

How well are these goals being achieved by current programs? Present Federal aid policy should be studied to determine how well its goals are being fulfilled and whether the goals are still appropriate.

In analyzing the role of the State and Federal governments, it is worthwhile to start from widely accepted principles of taxation. Our approach is to suggest that, in achieving a more efficient and equitable tax system, some of the City's financial problems could be eased, though not necessarily solved. Our findings are meant to suggest approaches to problems, each of which requires substantial additional study.

The "benefit" principle of taxation suggests that those who benefit from a public service should pay for it, either through taxes or user charges. When benefits cannot be measured exactly, this principle is difficult to apply. For example, consider a public transportation system which, among other things, reduces automobile traffic and, consequently, congestion and air pollution. Even if these two benefits could be measured, it would be administratively impossible to levy taxes accurately according to each person's benefits. The benefit principle is obviously inapplicable to the finance of welfare programs, for which redistribution of income is a primary objective.

The "ability to pay" principle calls for extracting larger taxes from the rich than from the poor and for equally taxing people in equal circumstances. It is most applicable when benefits are hard to substantiate, as in the transportation example, and when income redistribution is the goal.

#### TYPES OF POLICY ALTERNATIVES

Policy alternatives may be classified in several ways-- by budget functional category, by the level of government that would carry out the policy, and by the type of problem that the policy addresses. This chapter is organized around the last classification, pointing out six basic types of

alternatives. Table 20 illustrates the relationship between the type of alternative and the level of government authority that would be responsible for carrying it out. In some cases, more than one level of government is involved. In all cases, several budget functions are involved.

In a broad sense, the City's economic base may be affected by all six alternatives. Alternative 1 refers to specific policies to improve the economic base by attracting new business. Such actions might include improved public facilities, special incentives to firms to locate in New York, or the Federal Government's placing more of its installations in the City.

Alternatives 2 and 3 are the current focus of City efforts. They were discussed in earlier chapters. This chapter deals with the other three approaches, whose implementation would require State or Federal action. Each case is illustrated with examples of possible implementation.

#### REDEFINITION OF THE REGION RESPONSIBLE FOR PROVIDING PUBLIC SERVICES

Both principles of taxation presented above imply that, when provision of a public service is limited to a certain geographical region, taxes to support the service should be paid by people in the region. A fundamental problem of State and local finance is that this rule is frequently violated. Too often, people who benefit from a service escape taxation because they live outside the taxing jurisdiction. The burden placed on those within the jurisdiction is thus disproportionate to the services they receive. This tends to drive people away from the overtaxed region, making the problem worse.

A reason that this problem is so widespread is that taxing jurisdictions are often a result of historical accident, but changing their boundaries involves substantial political trauma. At the same time, it is usually difficult to define a region of benefit with sufficient precision to overcome the inertia attached to the historical boundaries. In many cases, the benefits from a public service diminish gradually the further one lives from the center of a city. No matter what region of taxation is defined, the people within it differ greatly in the benefits they receive.

The problem applies to many City services. At one extreme, it can be argued that any visitor to the City

Table 20

Alternatives for Solving the City's  
Financial Problems Appropriate to  
Different Levels of Government (note a)

<u>Alternatives</u>	<u>Actions appropriate to</u>		
	<u>City</u>	<u>State and region</u>	<u>Federal Government</u>
1. Improve the City's economic base	X	X	X
2. Cut spending, increase revenues	X	(X)	(X)
3. Improve management and control	X	(X)	(X)
4. Redefine the region responsible for the function	(X)	X	
5. Federal or State takeover of certain functions		X	X
6. State and Federal aid		X	X

a/X denotes an alternative appropriate to a certain government; (X) denotes possible influence but no direct action.

receives many benefits paid for by City taxpayers--the use of streets, parks, museums, police protection, and so on. Achieving total equity through the tax system would be administratively impossible. At best, one can hope to eliminate the worst violations of the benefit principle.

It could be argued that welfare is a national problem that should be financed at the Federal level. Similarly, higher education may be considered a benefit to all in the State (or Nation) and therefore defined as a State (or national) responsibility. These two budget areas are discussed in the section of this chapter devoted to possible State and Federal takeovers. Transportation is discussed as an example because the region of benefit is clearly not national or statewide, but does extend beyond the City boundaries.

Example: rationalization  
and regionalization of  
the transportation system

The benefits of the transportation system extend over the entire metropolitan area. By straightforward standards of benefit taxation, support for the system should come from the same area. There are, however, difficulties in identifying exactly who benefits and to what extent. The riders are direct beneficiaries, but virtually all economic activity in the area is facilitated by the system. As noted before, benefits from reduced congestion and pollution are not easily measured or taxed. It is therefore reasonable that a mass transit system be financed in part from general revenues.

There are several ways to collect revenues to support public transportation.

Mass transit fares: Fare increases have been mentioned under the category of options open to the City, but they can also be viewed as an attempt to shift the burden of mass transit from City taxpayers to riders who do not pay city taxes.

Regionalized taxes: Taxes that would shift more of the burden to non-City residents have been proposed. The Citizens Budget Commission examined several proposals, the most prominent of which would be a 12-county (the Metropolitan Transit Authority region) payroll tax of 1 percent. The State Department of Transportation has estimated that this tax would yield about \$572 million annually, of which \$286 million would come from New York City.

The only regional taxes at present are the City income tax and the non-residents earnings tax. They have the merit of being levied upon those likely to benefit from the transportation system, since they apply to those who commute to jobs in the City as well as those who live in the City. But, this is precisely the type of tax which can drive people away from jobs in the City and reduce the tax base.

Tolls and parking taxes: These taxes (or user fees) fall directly on the actual users of the public services. Raising them would increase the demand for public transportation. In applying principles of taxation, however, it is important not to set user fees greatly in excess of the costs of providing the service--this can result in the misallocation of resources. Practically speaking, these two sources of revenues can not be counted upon for much additional money, and there is considerable political opposition to raising them.

In summary, more taxes could be levied to support the transit system, and they could be somewhat more broadly based than at present. None of the proposals would, however, significantly reduce the burden on City taxpayers and users of mass transit; they would merely distribute the burden of paying for the apparently inevitable cost increases. No solution to the City's financial problem is to be expected from modifying transit fares and taxes.

#### FEDERAL OR STATE TAKEOVER OF CERTAIN FUNCTIONS

If the State or the Federal Government were to take over enough of the responsibility for programs now financed by the City, New York's immediate financial problems would disappear. These other governmental levels have not, however, shown an inclination to take over City programs on a scale sufficient to close the budget gap. In this section, we consider some of the suggested takeover options and suggest how the various options might affect the City budget, the State and Federal budgets, and the tax burden on City residents (who pay State and Federal, as well as local taxes).

Saving the City money is not a good enough reason for the State or the Federal Government to take responsibility for financing a particular activity. Rather, efficiency and equity should be major considerations. If a problem is national in scope, it may be beyond the City's power to correct, or it may be inequitable to expect the City to remedy it.

For example, transferring welfare expenditures to the Federal budget might be justified if the alleviation of poverty were defined as a national responsibility. Then, localities that might have shown greater concern for the poor or had historically attracted more than their share of the poor would not have to pay disproportionately large costs of welfare.

The rest of this chapter discusses some of the more commonly suggested options for State or Federal assumption of responsibilities.

### State takeovers

In the case of New York, the potential for State aid is limited by the size of the City relative to the State. The City's population is about 42 percent of the State's population. Income per capita is about the same in the State as in the City. In addition, the State's "tax effort" is already among the highest.

The State cannot reasonably be expected to pick up part of the City's budget without doing the same for other cities. This adds to the cost of any takeover.

Although State aid would ease the pressure on the City budget, it would ease the tax burden on City taxpayers less, for they would have to pay higher State taxes. If all of the State's taxes were raised proportionately, every dollar of new State aid would be financed by about 40 cents more in taxes on City taxpayers. Relying on one particular State tax to finance the additional aid might mean more or less of a burden on City residents.

From the City's standpoint, an important advantage of State takeover of functions is that it would allow reductions in taxes collected by the City. This would reduce the disparity between the taxes paid by City and non-City residents, thereby reducing the incentive to move from the City to escape high taxes.

### Federal takeovers

New York City's population is only 3.6 percent of the total U.S. population. In addition, the Federal Government can operate with a budget deficit for a while, if necessary, which greatly augments its ability to command economic resources. Thus, its ability to aid the City greatly exceeds that of New York State.

Other considerations, however, tend to limit the feasibility of Federal aid. If the Federal Government takes over a function in New York, it would be inequitable not to do so elsewhere. Moreover, because levels of services and benefits are relatively high in New York, taking over a New York function and financing equivalent levels of service and benefits nationwide would increase the total Federal costs even more. For every dollar spent on taking over a New York function, many more dollars would be spent aiding other cities.

In discussing Federal takeovers, a distinction must be made between a full Federal assumption of responsibility and a simple reimbursement to the City for its own spending on a program. For example, the City might be reimbursed for a larger fraction of the costs of its welfare program. This would do nothing to solve alleged problems of inefficiency, excessive numbers of employees, and over-large payments. In fact, with the local budget discipline reduced, there would be greater incentives to press for more generous benefit levels, and total welfare spending might well increase. The problem is one of control.

But even with the other extreme of suggestions on welfare takeovers--a totally nationalized welfare system--problems of control would persist. With a national welfare system, the benefit levels could not be as high as those now provided in New York without substantial increases in the Federal budget. Therefore, pressures would mount for the City or State to supplement national benefit levels from City or State funds.

There are several possibilities for takeovers by the State or the Federal Government. The proposals concerning the City university, the City's welfare system, and the medical services sector illustrate of the major issues.

#### Example: the City university

Higher education has argued for some governmental support on the grounds of "spillover effects." The question of which branch of government should provide the support (by application of the benefit principle) is far from clear. Governmental aid to higher education is a complicated array of direct aid, aid for research, tax benefits, aid to students, and government operation of institutions. Only an elaborate analysis could shed light on what should be the role of each unit of government. We will instead provide a rough list of what could be done to relieve the City of part of the burden.

The proposed executive budget for fiscal 1977 estimates the City's contribution to CUNY to be about \$161.9 million (\$140.3 from tax levy and \$21.6 million from capital funds)--roughly 37 percent of CUNY's \$445.4 million operating budget (without debt service).

There are three basic levels at which the State could assume greater financial responsibility for CUNY. First, it could simply assume responsibility for the amount that otherwise would appear in the City's budget--the \$161.9 million mentioned above. Second, it could also assume the costs which the City bears but which do not fall under the City's higher education budget. The City owns the land and buildings but does not fully charge for these costs. Other services, such as police protection, are provided but not budgeted to the university. These additional costs were estimated at about \$72 million in fiscal 1975.

The third approach would be for the State to spend as much per CUNY student as it does for each student at the State University of New York. In 1975-76, the State contributed to each CUNY student about 33 percent of what it spent on each State university student in a senior college. (The Governor's office, however, maintains that such comparisons are misleading, because of differences in programs and operating procedures.) It has been estimated that full parity would increase State aid to CUNY by as much as \$2,800 per student, a total of about \$400 million above its present contribution of \$195 million. Other estimates of the cost of achieving full parity are lower (as low as \$40 million), based on different ideas of what "parity" entails.

There have been proposals that the City end support for the senior colleges of CUNY in 1977-78, forcing the State to assume this responsibility. There is movement for increased State aid, but tied to the City's continued support. It seems likely, from the direction of recent statements and events, that what will emerge in the next few years is a de facto merger of CUNY into the State system, but with some degree of institutional autonomy. The City will probably contribute to the community colleges and some special programs which it wishes to maintain (for example, the Urban Institute, a joint program with the City government and CUNY), and thus retain some voice in CUNY affairs.

Example: welfare

Transferring welfare responsibility to the State or Federal level would reduce the City's budgetary burden. However, it would reduce the burden on the City's taxpayers only to the extent that welfare funds put into the City were not supported by increases in taxes paid by the City's taxpayers to the State or Federal governments. The effects on the City's budget and taxpayers of six different proposals for transferring some or all the welfare responsibility away from the City have been estimated. (See Table 21.) In all cases, the benefit levels are assumed to be equivalent except that in the case of the two negative income taxes, some individuals may gain and some lose. All the alternatives would reduce the City's budget deficit, but by different amounts. The change in taxpayer burden column shows the difference for the City's taxpayers between the taxpayers reducing the budget deficit by the amount of that alternative (1) by taxing themselves and (2) paying their unchanged proportion of increased taxes to a different level of government to finance the alternative. That is, where the change in taxpayer burden is a negative number, the taxpayer is paying that much less in taxes if the alternative is implemented than he would pay in city taxes to reduce the deficit by the same amount as the alternative does. All data (dollars and the underlying welfare caseload) is in fiscal 1973 terms because that was the data used in the most recent comprehensive study of the negative income tax.

State assumption of the welfare cost would render the City's budget more consistent with those of most major cities. New York State's requirement that localities pay about half the non-Federal share of these costs differs from common practice. The local share in New York is the highest of all local share requirements. In our cost estimates for the last alternative, we have assumed that the State takes over all costs for AFDC and Medicaid, the most costly welfare programs.

Table 21

Impact of Welfare Alternatives  
(Constant Services) (notes a and b)

<u>Alternative</u>	<u>City budget burden</u>	<u>State budget burden</u>	<u>Federal expenditure</u>	<u>City taxpayer burden (note c)</u>
----- (millions) -----				
\$3,000 negative income tax	-65	-90	<u>d</u> /3,000 to 4,000	125 to 200
\$3,300 negative income tax	-125	-180		30 to 100
Increased Federal shares:				
83% flat Fed- eral share	-235	-1,410	1,195	-395
65% flat Fed- eral share	-105	-640	1,495	-245
65% floor on Federal share	-105	-640	1,950	-210
Transfer to State	-470	1,070	0	-53

a/In fiscal year 1973 dollars.

b/In all alternatives, the intent is that benefit recipients as a whole neither gain or lose. The negative income tax alternatives reach the benefit levels of the other four alternatives by supplements made by the State and City.

c/This column reports the difference between taxes City residents would have paid to the City to finance the City burden to the same extent and estimated increase in Federal and State taxes to finance the alternative. Estimates of the cost of the negative income tax vary, but the \$3,300 benefit would obviously incur greater Federal expenditures.

d/The \$3,300 negative income tax would incur greater Federal expenditures than would the \$3,000 tax, but we could not obtain firm figures on the difference.

Two approaches to "federalizing" welfare costs could be taken. First, by simply increasing the Federal share of costs while leaving administration and other responsibilities to the local governments. Second, by fundamentally changing the way income is redistributed, such as adopting a negative income tax. 1/ Any Federal decision that would affect City spending on welfare presumably would entail some national change, since Federal intervention only in New York, leaving all other local welfare programs intact, seems unlikely.

Changing the formula by which the Federal share of local welfare expenditures is calculated (the third, fourth, and fifth alternatives in Table 21) could result in an increased Federal share in the high income States such as New York. The Federal share in these States is now 50 percent; poorer States receive shares ranging up to 83 percent in Mississippi. 2/ If the formula were revised to make the Federal share more uniform, New York State and the City would obtain financial relief. For the examples in Table 21, we have postulated three different revisions in the Federal share of AFDC and Medicaid costs. Two would simply have all States receiving the same Federal share, one at the present top level of 83 percent and another at a mid-range of 65 percent. The other would raise the Federal share in all States receiving less than 65 percent to that level and leave States receiving more than 65 percent at their present level. The only real effect of this approach is that it transfers more of the funding responsibility to that level of government with the greatest taxing power. It does not resolve any of the many inequities and shortcomings of the present system. In addition, the greater the Federal share, the less incentive to control costs when administration is left at the local level.

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1/"Negative income tax" refers to a Federal program which would provide a guaranteed income to all families. There have been a number of specific proposals, the main distinction among them being the specific benefit formula. In general, the higher the family's income, the lower its benefits; at some income level, there would be no Federal payment, and at higher incomes, the family would pay an income tax. States or localities might choose to supplement the Federal benefit payment.

2/It should be noted that the Federal share of AFDC and Medicaid payments for the Nation has been rising steadily and now exceeds 60 percent of the total.

A study recently performed for the Department of Health, Education, and Welfare illustrates the effect on the City's budget of a negative income tax. The specific conclusions of the study are subject to important reservations, principally because of limitations of the data and assumptions as to the existence of programs not yet fully implemented in fiscal 1973. The study is useful, however, in showing the extent of potential relief to the City's budget. The study measures the financial impact on AFDC recipients and the amount of fiscal relief provided to the States.

Assuming that the State supplemented the Federal AFDC benefit so that the combined Federal/State guarantee equaled the largest amount paid at zero income to each family size plus the food stamp bonus value, the study estimated fiscal relief in New York State at 15.7 percent if the Federal guarantee were \$3,000 and 30.9 percent if it were \$3,300. These financial relief estimates do not include the effect of State or City supplements to the Federal supplemental security income program, general assistance costs, or administrative costs. Also, if the City were to decide to "hold harmless" present benefit recipients, savings would be reduced by payments to recipients who otherwise would be made worse off. But if the City did not cut the level of welfare benefits, the incentive to migrate to its higher-benefit jurisdiction would still exist. Such growth in the welfare population would exert pressure on other parts of the City's budget, such as education and health.

Another proposal is countercyclical Federal financing of welfare programs. This would protect cities from welfare costs associated with recession and inflation on the grounds that the state of the economy is a Federal responsibility and the cities should not have to absorb resulting increased welfare burdens. There could be Federal takeover of increased welfare costs attributable to inflation or increased Federal shares of welfare costs when unemployment rates reach certain levels. To successfully allocate to the Federal Government the costs resulting from economic fluctuations, however, some differentiation would have to be made between increased welfare burden attributable to shifts in geographic distribution of economic activity and increased welfare burden attributable to shortfalls in the national economy. For example, some of the recent increases in New York City welfare costs have clearly resulted from the national recession and inflation, but City private jobs have also been declining at least since 1970 independent of the business cycle.

### Example: health and hospitals

The issues involved in possible Federal takeovers of medical services closely parallel those in welfare. The City currently (fiscal 1977) pays out \$511 million as its share of Medicaid and contributes \$297 million to the operations of the City hospital system. There have been several different national health insurance proposals, some of which involve universal medical insurance coverage financed largely out of payroll taxes. In some plans, Medicaid and Medicare would be supplanted, thereby federalizing the responsibility for a large item in the City budget. As with a national welfare system, the increased Federal spending would provide relief to the City budget but would increase Federal taxes paid by New York taxpayers.

As a side effect, national health insurance might well increase the demand for hospital services, which would raise the total cost of operating the City hospitals. Whether it would increase the operating deficit would depend on the relationship between reimbursement rates and the incremental cost of serving the additional patients. In any event, any increase would be small in relation to the possible savings on Medicaid payments.

As with national welfare reform, the prospects for enactment of national health insurance are uncertain, and its characteristics are difficult to predict. Therefore, neither approach seems likely to help New York City much in the short run.

### DIRECT AID

Direct aid denotes financial assistance without transfer of control. Whether allocated by formula or by appropriation, direct aid may have strings attached, but it does not shift administrative responsibility.

In this section, we again distinguish aid to New York City from a more general aid policy to urban areas. In earlier sections, it was clear that the latter approach would be much more costly. This is even more apparent with direct aid, which is essentially open ended. That is, there is no objective limit to the amount of direct aid that could be offered.

## Direct aid to New York City

The principal form of direct aid to the City so far has been the \$2.3 billion seasonal financing program. Additional loans and government-guaranteed loans have been proposed. These would provide a subsidy, equal to the reduction in interest payments by the City compared to payments it would have to make on nonguaranteed or private loans. In addition, the ease of obtaining loans under a government guarantee might induce the City to borrow more than it otherwise would.

Another form of direct aid would be for either the State or the Federal Government to increase its share of some existing aid formula. Primary and secondary education is an example of this type of direct aid.

### Example: primary and secondary education

In primary and secondary education, increasing direct aid could, in principle, greatly ease the City's financial burden. The fiscal year 1977 budget allots \$2.7 billion to education, of which the State will contribute about 30 percent and the Federal Government 9 percent.

The State's contribution is determined by a formula based upon local districts' student attendance, full valuation of local property, and to a lesser extent, such variables as tax effort and growth trends. Because of the City's relatively high ratio of "full value of taxable property per pupil," its State aid per pupil (30 percent) is considerably below the average for the entire State (40 percent). If State aid were distributed equally (the same amount per pupil), the City would receive about \$270 million more. Although the State's large cities are seeking such a revision of the aid formula, achieving full equality with the rest of the State would entail a very large increase in State expenditures.

The estimate of aid from the Federal Government represents a 12-percent decrease from the previous year. Education is another case in which increased Federal aid to the City would entail much larger increases in aid to the rest of the country, unless New York City receives special treatment.

## AID TO CITIES IN GENERAL

New York City already receives about 50 percent of its revenues from Federal revenue sharing, State revenue sharing, and intergovernmental grants. Still, there is considerable

leeway for an increased Federal emphasis on aid to urban areas through a number of different approaches if this were determined to be desirable.

### Revenue sharing

Revenue sharing formulas could be revised to provide more direct aid to problem cities. First, it would have to be determined what measurable variables are correlated with the problems in question. Some of these might be population density, some measure of decline in the economic base, or other measures of need that are not included in current formulas.

### Categorical grants

Matching-type grants (that is, those which are meant for specific purposes and which depend upon local spending) are a different matter. A matching formula encourages and rewards higher spending in a certain budget area. This, however, is not desirable for cities in financial trouble, since it makes cutting spending more difficult. A formula that works the opposite way could be designed. However, if the Federal Government tried to encourage lower spending by, for example, offering to fill the gap between local spending and some fixed level, it would soon find itself called on to finance all of the costs. If the objective is to concentrate aid on troubled cities, doing so through the categorical grant system would require complex mechanisms.

### Aid to certain areas

Another type of Federal aid is assistance to depressed areas and small communities. Outlays for development assistance programs are budgeted for \$333 million in fiscal 1977, and funds for Appalachian development are budgeted for \$332 million. In addition, the tax-exempt status of interest on industrial revenue bonds can help communities attract industry through lower borrowing costs. The estimated fiscal year 1977 cost of this tax expenditure is \$300 million. In addition, loan programs of the Farmers Home Administration are directed to communities of less than 50,000. New loan commitments are expected to exceed \$1 billion in fiscal year 1977.

Whether urban areas should be receiving this type of assistance is a complex question. There is no objective way to determine a region's "fair share," since the above programs

follow from the presumption that there is something unique about depressed rural areas and small communities that requires special treatment. Nevertheless, the growing awareness of urban financial problems may require a reassessment of the criteria by which such funds are allocated.

### A "Marshall Plan" for the cities?

The term "Marshall Plan for the cities" has recently been used to denote a policy of massive Federal grants for economic development in the cities. The term comes from a parallel drawn to the Marshall Plan of aid to Europe after World War II.

The parallel is not exact. The original Marshall Plan brings to mind large outlays for a program that worked very well. Actually, the Marshall Plan cost \$12 billion, which would be comparable to about \$28 billion in current dollars. Would expenditures of this size go very far in solving our broad array of urban problems? And are the preconditions for economic growth in today's troubled cities as favorable as those in postwar Europe?

Marshall Plan aid was not simply presented to European governments; it was accompanied by detailed planning in which the United States played a major role. The recent trend in Federal aid to local governments has been in the opposite direction--unrestricted block grants. The degree of Federal control over the local governments' spending is another issue to be considered in designing a massive program of urban assistance.

### CONCLUSIONS

This chapter has discussed the principal means by which the Federal Government and New York State could increase their involvement with the City. In discussing specific options, we are not advocating or opposing any particular action; we have simply presented the alternatives to give a rough idea of the main effects, particularly the effects on the City's budget. Each alternative has many other aspects that would have to be evaluated before it could be seriously proposed.

There are several approaches the Federal Government might take, entailing progressively greater levels of involvement. (Of course, the option of doing nothing whatever should be included in the range of policies to be considered.) The distinction was made between singling out New York City for

special attention and offering similar aid to other cities somehow defined to have financial problems. Aiding only New York would entail a far lower cost to the Federal Government, but other cities in financial trouble would probably soon argue that they too deserve special aid.

A second level of effort by the Federal Government would entail reexamining its policies for welfare, housing, and the like, to determine whether a greater Federal role is justifiable on grounds of equity or efficiency. As we have shown, changes of this type might bring some financial relief to the City, but higher Federal taxes on City firms and residents might also ensue. The welfare example also showed that with a Federal takeover, unless the benefit levels were set fairly high, New York City would either have to permit a decline from current levels or still be faced with the burden of making up the difference between the national support level and the level the City wished to maintain. In such cases, the net benefits to the City budget are less than might be supposed.

The policies discussed in this context were aimed primarily at people as recipients of Federal aid, as distinct from policies aimed at city governments. The former type of policy does not require giving New York special treatment, but because of New York's relatively high level of public services, these policies would not generally send much more money to the City.

A third possible level of Federal effort would be to devise a program of aid to cities with financial problems, analogous to existing programs of aid to depressed areas. Aid to cities might entail a far larger commitment than has gone to aiding such depressed areas as Appalachia. Aid to rural depressed areas has focused primarily on building the infrastructure (for example, highways) to attract industry. Aid to a region to help attract new industry is at best a partial cure for unemployment. Attracting enough new industry to provide tax revenues to close New York's revenue gap is a far larger and less promising undertaking. It would mean reversing the strong downward trend in the industrial base (see ch. 6) and in the final analysis would be costly to other regions in which the industry might have located.

## CHAPTER 9

### CONCLUSIONS AND POSSIBLE NEXT STEPS

This report has dealt with a set of problems related to New York City's financial crisis and the City's budgetary actions to alleviate that crisis. The City's recent budgetary and economic history indicates that these problems are likely to continue, generally complex, and not amenable to simple or direct solutions. Our review indicates that remedial, short-term actions by the City, acting alone, will at best provide only temporary relief to the budgetary situation and may actually harm the City's longer term economic health. Thus, the City is likely to remain under the continuous and extraordinary financial and budgetary pressures for some years, definitely beyond the 3-Year Financial Plan which ends in 1978.

Several policy options available to New York State and the Federal Government could improve the City's financial situation, but those options are not without their attendant costs. Furthermore, the effectiveness of these options in alleviating the City's financial stress needs further analysis.

### CONCLUSIONS

A number of conclusions can be drawn from the analysis of the previous chapters.

1. The fiscal and economic base of New York City continues to deteriorate, and this deterioration is at the root of the City's problems. The City's economic base has been deteriorating because people, jobs, and businesses have been moving out of the City and into the South, Southwest, and West for a number of years. The reasons for that movement are complex; they include important changes in costs of living and doing business, the availability of land and labor, possible changes in tax burdens for firms and individuals, and the desire of many people for the outdoor lifestyle available in warmer climates.

Nevertheless, the impact on the City's economy has been notable and severe. During the 1960s, private sector employment in the City grew by only 2 percent, compared to almost 27 percent in the entire country. During that decade, U.S. employment in manufacturing grew about 7 percent, but it declined in New York City by 19 percent (representing a loss of 180,000 jobs). Since 1970 the City has experienced a drastic decline in employment with a loss of 468,000 jobs;

since 1969 manufacturing employment has fallen at an average annual rate of 48,000 jobs. The prospects for halting this trend are not bright. City policies that directly or indirectly influence its economic base are limited in number and scope. Governmental policies (at any level) have generally not been effective in revitalizing the fiscal base of a city or a region. Deterioration of large cities is a new experience in this country, and remedies have not been developed to refurbish a city like New York.

2. New York City will continue to find it difficult to cut expenditures. Accordingly, if the City is to achieve a balanced budget in fiscal year 1978, it will probably require major administrative actions and policy shifts at the Federal and State levels. The City, under its 3-Year Financial Plan, has made many cuts in its programs. Nevertheless, its budget has continued to grow. Further cuts are planned, but they will probably be difficult to identify and execute. Nonetheless, many more expenditure reductions will be necessary to balance the budget by 1978. Expense-cutting is made especially difficult for the City because it does not control large segments of its budget, such as welfare and Medicaid. (See chs. 3 and 4.) Expenditures in these program areas represent a large fraction of the City's budget, yet the City has little budget control over them. Thus, new arrangements between the City and higher levels of Government may be necessary to alter the magnitude of uncontrollable expenses in the City's budget. The City's deteriorating economic base is not likely to allow the City to raise enough revenues to cover its expenditures by 1978.

In the City of New York's Financial Plan published January 6, 1977, entitled "Program to Eliminate the Budget Gap: Fiscal Year 1978," the City presented a program to restore a balanced budget by the summer of 1978. Much of that program involves action requiring State support and a great deal of Federal assistance that would provide budget relief.

3. Barring major policy shifts at the State and Federal levels, 1977-85 will be an extremely difficult period for the City. The City's budget is sensitive to economic factors. Our assessment of the influence of these factors on the budget indicates that, under the best of circumstances, the City will face extraordinary financial pressures in the late 1970s and the 1980s. Expenditure levels for the City are difficult to cut, and revenues growth is limited by the

City's deteriorating economic base and the insensitivity of certain sources of revenue to inflation.

4. Declaring municipal bankruptcy will not solve the City's problems. Although the municipal bankruptcy option is available to the City, none of the City's basic problems would be dealt with expeditiously under this option. Municipal bankruptcy would not solve the budgetary and financial problems or bolster the deteriorating economic base.

5. Better budgetary and fiscal information on cities is needed, and the Federal Government should explore ways to generate such information for better decisionmaking at all levels of government. In recent years, cities have made considerable progress in improving their accounting systems and budgetary information. Better fiscal, budgetary, and accounting information is needed by decisionmakers at all levels of government. Our studies in New York City and elsewhere have indicated that sufficient management and budgetary information does not exist for most cities. More and better data would allow cities to address their present and potential financial problems more comprehensively.

#### ALTERNATIVE FEDERAL POLICIES TOWARD URBAN AREAS

Our analysis indicates that New York City's long-term problems reflect a private sector decline in economic activity exacerbated by cyclical swings in national economic activity. During periods of recession, New York City, like many other older urban centers, experiences higher unemployment rates than the Nation as a whole. During periods of inflation, the City must finance rapid increases in the cost of public services with a revenue base that is relatively less sensitive to price changes. Thus, recession and inflation have added to the City's financial problems. In the absence of effective countermeasures, a recurrence of recession and inflation similar to the 1974-75 situation would make the City's budget problems even more severe.

The impact of recession and inflation on city finances is not unique to New York City; it is common to many, perhaps most, State and local governments. The effects on cities of fluctuations in the national economy is one of many reasons for the Federal Government to pursue effective economic stabilization policies. Reducing the national rate of inflation and unemployment would greatly benefit the Nation's cities.

One policy would be to introduce standby measures to offset the effects of economic downturns and periods of rapid inflation. One such approach might be antirecessionary aid to State and local governments which could be targeted to their needs. The difficulties of this approach include developing valid indicators of need, distinguishing problems resulting from national economic fluctuations from those resulting from private sector declines in particular regions or localities, and assuring that such aid does not undermine fiscal discipline at the State and local levels.

In addition to the problems created by recession and inflation, New York City is burdened by long-term decline. The City's economic base has eroded severely in the last decade, at least partly reflecting the relative decline of the Northeast region. Long-run fiscal prospects for the City are critically related to the direction of future changes in the local and regional economy. The Federal Government could move in several directions in trying to deal with urban and regional economic decline.

If the Federal Government chose to soften the blow of the economic movement from the Northeast, revenue sharing formulas could be altered to give additional weight to factors that are indicators of the declining economic base of cities. The Federal Government could also provide assistance aimed at alleviating the social costs imposed upon new and rapidly growing centers of economic activity. For this course of action, it would be difficult to draw a line between easing the adjustment process and becoming committed to supporting a permanent level of services that cities would otherwise be unable to finance from local revenues. This approach thus risks undermining fiscal discipline at the State and local levels.

The Federal Government might choose to try to retard the adjustment process by encouraging new or expanded economic development in the regions suffering from economic decline.

Efforts could also be made to design a set of incentives to encourage investment in declining localities and regions. Areas might also be revitalized through multistate or regional organizational arrangements to coordinate plans and agree on development priorities. It should be noted, however, that the record of regional development efforts is spotty, both here and abroad. There have been few real successes and many instances where accomplishments have been limited. If this approach were to be chosen, emphasis should be placed on those economic activities for which the region is specially suited

rather than on a broad effort to rebuild the region's traditional economic base.

We again emphasize that this discussion is intended to illustrate the available options and the difficulties involved in any approach. Much more analysis will be required to provide a basis for choosing among those options or for devising an appropriate combination of them.

### REMAINING ISSUES

This report has raised a number of issues that would require further analysis before policy alternatives could be fully considered. An assessment of these policy alternatives (at each level of government) is beyond the scope of this report, but there are several such issues which are worthy of analysis. Analysis of the following issues would appear to have the highest priority.

1. Are there effective policies that the Federal Government could pursue to bolster the economic base of deteriorating cities? Would assistance for physical reconstruction contribute much to this objective?
2. What are the most effective means by which the Federal Government can stabilize the national economy and major sectors of the economy (such as urban centers) during periods of recession or high inflation?
3. Should the Federal Government consider means to ease the problems associated with the demographic movement to the South and Southwest?
4. Are analyses of the economic base and long-term prospects of other cities necessary before new Federal policies toward decaying urban centers are devised?

### COMMENTS OF CONCERNED OFFICIALS

We received comments on this report from officials of the City and the Emergency Financial Control Board. The Office of the State of New York Special Deputy Comptroller for New York City was requested to provide comments, which it provided at the staff level. We requested, but did not receive, written comments from the Federal Office of Management and Budget and the Department of the Treasury.

The written comments which were received are summarized below. The full comments are included as appendix III.

### City comments

City officials said our report was a comprehensive and thoughtful examination of the broader aspects of the City's current and long-term fiscal difficulties. The City reaffirmed its intent to balance its budget for fiscal year 1978, but indicated that its economic recovery will be possible only if the coalition of interests in the unions, the financial community, the State and Federal governments, and the public continues to work together.

In its comments, the City indicated that several approaches that the Federal Government could adopt within the general framework of fiscal federalism would aid the City. The City agreed with the major thrust of our conclusions.

### Emergency Financial Control Board comments

The Board's executive director observed that, if the City cannot meet all of its credit needs privately by fiscal year 1979, it has no choice but to turn to the Federal Government for assistance. He was pleased that this issue was being raised in a new forum.

As pointed out in chapter 8, Federal assistance to the City could take various forms. There is a long history of Federal assistance to stimulate and support State and local programs, but direct Federal aid to a city, which the Federal Government has provided in the form of seasonal loans, presents a different policy question. Direct Federal aid to a local government with the explicit objective of enabling that government to meet its overall fiscal needs may require certain safeguards to insure that the government has adequate incentives to efficiently manage its own financial affairs.

MANAGEMENT AND BUDGETARY ASPECTS OF  
MAJOR NEW YORK CITY AGENCIES

During the course of our review of New York City's financial situation, we became aware of a real and pressing need for better accounting and budgetary information for the various City functions. The City has already begun to remedy these deficiencies, but several years may be required to fully implement the new systems that are being developed.

The review also indicated that the City's budget process is complex, and the emerging role of the Control Board has added even another dimension to that process. A wide variety of institutional arrangements exist in the operating agencies of the City, and each agency has its unique structure, budget process, and management problems. Institutional, structural, and financial details are presented in this appendix in an attempt to help elaborate and clarify the issues related to the City's provision of public services. The major agencies covered are: the Human Resources Administration (and Department of Social Services), the Board of Education, the Board of Higher Education, the Health and Hospitals Corporation, the uniformed services agencies, and the Transit Authority.

ELEMENTARY AND SECONDARY EDUCATION

Background

The New York City Public Schools were to provide approved instruction to about 1.1 million children in regular grades from prekindergarten through high school in 1976. Under the decentralized community school district system, established by the State legislature in 1969, the operation and control of the public schools are shared by a citywide Board of Education and 32 community school boards. The Board of Education has jurisdiction over high schools, special schools and classes, and certain other citywide operations. The community boards control the elementary and junior high-intermediate schools in their respective districts, subject to collective bargaining agreements and citywide policies established by the Board of Education in consultation with the community boards.

Each community school board has nine members elected by voters in each of the 32 school districts. The Board of Education is composed of seven members, one member appointed by each of the five borough presidents and two by the mayor.

### Student population

In the 1976-77 school year, there were to be an estimated 1,084,575 pupils in the City public schools. This represents about 50,000 fewer pupils in the school system than in 1970-71. Minority pupils now represent 65 percent of all pupils, compared to 37 percent 15 years ago. The attendance rate in City public schools is an important issue. As with other large cities, the attendance rate is lower in the central city than in the non-central-city area. As a result of legislation which favors attendance over enrollment, the City receives less aid than it would if aid were to be distributed on the basis of enrollment.

### Teachers

In September 1975 there were 52,918 full-time teachers who were supported by general funds (nonreimbursable moneys), city tax levy, city capital funds, State education aid, and funds from general State revenue sharing. By June 1976 the number had been reduced to 47,307 regular full-time teachers on the payroll. The financial plan called for a further reduction to about 44,850 teachers for the 1976-77 school year.

According to the Board of Education, the current reductions are "setting the equal employment opportunity efforts of the public school system back a decade." It notes that half of all black teachers have been laid off. In addition, former paraprofessionals (predominantly women from minority groups) who had recently elevated themselves to full status as regular teachers were among the first to be laid off.

### Funding

The fiscal year 1977 executive budget provided for \$2.7 billion--over 20 percent of the City's total budget--to be spent on education. Although the amount of the total budget allocated to social services exceeds that for education, the largest amount of the City's own funds is used for education.

The City public schools receive about 30 percent of their funds from the State (\$813 million) and 9 percent from Federal sources (\$258 million).

In New York State, the basic formula which distributes State aid to local districts is based on pupil population (attendance), local wealth (full valuation of local property), and, to a lesser degree, such variables as tax effort and

growth patterns. The State has set a goal to share 40 percent of the elementary and secondary education cost, and the State Board of Regents would like to increase that share to 46 percent. Statewide aid is very close to 40 percent. However, since one of the key variables is wealth of the local district, only about 29 percent of New York City elementary and secondary education costs are paid from State sources. If the State were sharing 40 percent of the City's education budget, about \$270 million in additional State aid would release an equal amount in local tax funds. The large cities in New York State are seeking a change in the definition of wealth used in the aid formula.

The largest amount of Federal funding for education in New York City is from the Elementary and Secondary Education Act of 1965, Title I, for educationally disadvantaged children aged 5-17 in public and nonpublic schools. Other sources of Federal funds include the Comprehensive Employment Training Act of 1973 (funds are transferred by memorandum from the City Human Resources Administration), Vocational Education Act, Bilingual Education Act, and Emergency School Aid Act.

The 1977 City executive budget estimates that Federal school aid will decrease by 12 percent, from \$294 million in fiscal year 1976 to \$258 million in fiscal year 1977. The largest decreases are \$20 million in the Elementary and Secondary Education Act and \$10 million in the Comprehensive Employment and Training Act (the 1977 budget does not include funds under the latter act for education).

The \$2.7 billion budget of the City public schools is huge; it exceeds the combined total direct expenditures of State and local governments on all functions in 28 States. Only in California, Illinois, Pennsylvania, and New York are State and local expenditures on elementary and secondary school larger than the City's \$2.7 billion.

Mayor Abraham Beame's fiscal year 1977 budget submission in April 1976 stated:

"Since January 1, 1975, the Board of Education has reported a total full-time staff drop of approximately 14%. The teaching staff has been reduced by 10%. Fourteen percent of the guidance counselors were dropped as were 25% of the social service workers and 10% of the school secretaries. Many schools have reported an increase in class size. In addition, many school security guards were dismissed.

"Most after-school and adult education programs have been severely reduced or eliminated, including many athletic programs."

The following table summarizes the City Public Schools funding levels.

Budget Totals for City Public Schools

<u>Fiscal Year Budget</u>	<u>Total</u>	<u>Other agencies</u>	<u>Board of Education</u>
	(millions)		
1974-75 (note a)	\$2,866	\$265	\$2,601
1975-76 (note a)	2,792	299	2,493
1976-77 (Board of Education 12/30/75)	2,972	283	2,688
1976-77 (Expense budget 3/76)	2,760	383	2,377
1976-77 (Budget as adopted 6/76)	2,767	383	2,383

a/As modified during the year.

Budget process

Since no taxes are raised specifically for education, the public schools depend on the City tax levy for support. In July of each year, the Board of Education sends out forms to the 32 districts and to all offices and bureaus, including the high schools and special schools. Based on information provided, the chancellor submits the organizations' budgets to the Board and the Board submits its budget request to the mayor. State, Federal, other miscellaneous revenues are estimated by the School Board in its budget. The City, because of its fiscal crisis, now tells the Board how much the City intends to provide, and the Board must limit its expenditures to stay within the total estimated revenues. The Board of Education also submits revenue estimates and estimates of receivables by month.

Stavisky-Goodman legislation

The Stavisky-Goodman bill was enacted by the State legislature over the Governor's opposition in June 1976. The law had been strongly endorsed by the Board of Education and strongly opposed by the Mayor. It was directed solely at the City and was intended to prevent the City from reducing the

funding level for the school system by a greater proportion than the total proportional reductions in other City departments. Although the law was later ruled invalid, its scope and passage demonstrated the extent to which the City may be limited in the management of its affairs by the State legislature.

### Selected issues relating to City public schools

Based on interviews of City education officials, the following issues were identified as being of greatest concern to the City:

1. Is additional Federal funding of education possible? The City's 1977 executive budget actually reflects a decrease in Federal aid of 12.2 percent--from \$294 million to \$258 million.
2. Will continued layoffs of teachers prompted by the fiscal crisis lead to disproportionate effects on minority employment?
3. What is the appropriate role of the State in elementary and secondary education? The State Board of Regents is to develop plans for safeguarding the City school system over the next 3 years of anticipated financial crisis. They also provided for technical assistance to City schools through the Office of Urban School Services. State aid is fairly stable, but additional State action has yet to surface.
4. Will further cutbacks result in a deterioration in the educational program that will further drive out members of the middle class, who the City leaders are attempting to keep in the City?.

### BOARD OF HIGHER EDUCATION

#### Background

The City University of New York is the municipal university system of the City. It consists of nine senior colleges; eight community colleges; a graduate school; and an affiliated, but not financially supported, medical school. In 1975-76, the number of full-time equivalent students was approximately 222,000.

The university traces its beginnings to a municipal public referendum in 1874, wherein City residents indicated their willingness to fund a tuition-free college. The Free Academy, later the City College of New York, was the result. In 1926, the State legislature established the City Board of Higher Education, whose purpose was to create a municipal college system. Colleges were slowly added to the system from the 1930s through the 1950s. In the 1960s a period of rapid growth resulted in the establishment of 10 colleges and the graduate school. From 1960 to 1970 total enrollment increased from 91,450 to 197,664, while the budget rose from \$45 million to \$322 million. (Student fees are included in the latter figure, but not the former.)

### Governing structure

The Board of Higher Education is the overall governing body of CUNY. Originally established with 21 members, it has since become an 11-member body including the president of the Board of Education; seven members, including the chairman, appointed by the mayor; and three members appointed by the Governor. Effective July 1, 1976, a new Board and Board structure was mandated by the State legislature. The new Board has seven members appointed by the mayor, seven appointed by the Governor, and one elected by the Board members. The Board decides major policy issues, such as the establishment of programs, admissions policy, and tuition.

The individual colleges of CUNY have some control over their educational and business affairs. Each college has its own budget and budget officer and can make some changes to its budget without higher level approval. The chancellor is the operating arm of the Board with responsibility for executing Board policies. He is assisted by a central office staff that is independent of the colleges. The central office is solely responsible for a number of functions, including collective bargaining, admissions services, legal and financial management, internal auditing, and is jointly responsible with the colleges for academic program development and the budget process.

### Funding

The two main sources of funds have been the City and the State. The actual amounts provided have depended on legislation and the City's financial condition. However, the senior colleges receive State funds under a different formula than that used for funding community colleges. For the 1973-74 academic year, the City contributed 48 percent of the CUNY

budget, the State provided 42 percent, and tuition and fees provided most of the rest. Because of the City's financial problems and the financial constraints of the State, the Board has recently voted to establish tuition comparable to the tuition charged by the State University of New York. This marks the first time that tuition will be levied on matriculated undergraduates who are City residents. In addition, both the Board and the City are urging the State to increase its support of CUNY by establishing parity between CUNY and the State University.

### The budget process

The 1970 inauguration of open admissions, a policy that guaranteed each City high school graduate admission to some college of CUNY, contributed to the growth in enrollment from 122,000 full-time equivalent students in 1969-70 to 209,000 in 1973-74. This policy required a major effort to assist the educationally disadvantaged; that is, remedial programs to improve basic skills. These efforts were made during a period of great growth in the size of the student body and under gradually tightening budget constraints that limited available resources. As the problems created by open admissions were being brought under control, the university encountered the unexpected stringency of the City's financial crisis. Thus, the budget process has, for the last few years, existed in a dynamic environment, which has had a major impact on the process itself.

### Before the Emergency Financial Control Board

In the basic budget process, the Board develops overall policies and plans; the colleges respond with preliminary budget requests that take into account such factors as mandatory pay increases, enrollment projections, and program needs. The colleges' budget submissions are reviewed and consolidated by the central office. They are then prepared as a preliminary chancellor's budget request, which is reviewed by the Board, revised, presented to public hearings, adjusted in response to the hearings, and submitted to the full Board for final approval. When the budget is adopted by the Board, the chancellor submits it to the mayor. The City's Office of Management and Budget reviews the budget on the mayor's behalf. Other groups with review and approval authority are the City Council Finance Committee, the Board of Estimate, the City comptroller, the State Division of the Budget, the Finance Committee of the State Senate, and the Ways and Means Committee of the State Assembly. The City government and the State legislature must each authorize their share of the CUNY budget.

A number of important changes have been made to the budget process since 1970. The budget plans now receive strong central direction--a practice not as evident in earlier years. OMB has begun to take a larger role in reviewing the budget, calculating the City contribution, and developing an estimate of expected State support. In the last 18 months, the changes have been even more substantial. In December 1974 the mayor approved the 1975-76 budget, which was then approved by the Governor and adopted by the State legislature. By mid-1975 the City, aware of its need to economize, made major cuts in its CUNY support. Many of these reductions were doubly felt, because in some areas State support involved matching funds. A gap of \$87 million between university needs and funding developed. The university responded with administrative and instructional personnel reductions, program elimination, deferral of sabbaticals, and other cost-saving measures estimated to save \$57 million. It increased tuition and fees to raise another \$30 million, but it was still unable to complete the year and closed down operations several weeks before the end of the academic year.

#### After the Control Board

An OMB program examiner task force now assists in budget preparation from the time preliminary requests are submitted by the colleges, although these requests have lost much of their significance. OMB represents not only the mayor, but is a de facto representative of EFCB, the final approval authority of the City's budget. The planned City and State contributions are known in advance. The task of budget development thus is now one of revising and reducing needs to stay within the available funding. The chancellor is also exerting more control in the assignment of students to colleges, and the number of students is a major factor in determining the budget cuts assigned to each college.

CUNY funding has become increasingly constrained. In the 1960s, funds were made available in response to needs established by the university. In the early 1970s, an apparent compromise between needs and resources was established. The current situation requires substantial changes in the scope and structure of the university to comply with the limited financial resources available. The budget process has changed to reflect the changing situation. The budget function has become more centralized and less initiative and flexibility can be exercised at the college level. We have not tried to determine whether these events by themselves represent either an improvement or a worsening in the budget process. They appear to be the necessary changes to enable the system to respond to a difficult situation.

Management control

The 1975-76 final operating budget was \$550 million; this was further decreased during the year to \$539 million. The \$550 million was 6 percent less than the \$585 million budget of the previous year. In a period of substantial inflation and 1.5-percent growth in enrollment, clearly there were substantially fewer resources available per student. The State legislature has authorized a budget of \$470 million for fiscal 1977. The operating economies generally have already been made.

The chancellor's 1976-77 budget request indicated that the following had been done to achieve the \$57 million in economies required in 1975-76: sabbaticals had been deferred, faculty-teaching contact hours had been increased 15 percent, instructional support and administrative personnel had been reduced, 40 percent of Master's programs had been eliminated, and considerable across-the-board reductions had been made in each college unit. These actions have resulted in an increase in the student-faculty ratio; 3,700 equivalent full-time faculty and staff positions remaining unfilled; and a major curtailment of services in library, counseling, tutoring, and facilities support.

Recognizing the effects of inflation and the prior year's economies, we believe that the standard practices of eliminating waste, increasing productivity, and generally sacrificing cannot realistically be expected to absorb an additional \$69 million budget cut. A fundamental restructuring and reduction of CUNY's programs, policies, and priorities would appear to be the approach that the Board and the colleges must now consider.

These decisions should be made by those with knowledge of the university system as a whole and by those who are familiar with the college-level detail. This has apparently been achieved by a two-tiered budget-cutting process. The Board and the chancellor set budget totals for each college and program, but implementing reductions in a college's specific areas is largely under the college president's control. However, the Board and the chancellor retain some authority to redirect and reallocate the colleges' budgets.

Certain aspects of the management process should be reviewed in terms of their effectiveness and impact. One such aspect is the budget modification process. Some changes can be made at the college level without higher level authorization, but others require approval by both the Board and OMB.

Higher level approval appears to depend more on whether the change requires the transfer of funds between line items in the Board budget than on the amount of funds involved. Additional economies are possible by closing individual colleges or implementing a more restrictive admissions policy. The power to close colleges rests with the State legislature, and this issue appears to involve social and political as well as managerial factors. Steps are being taken to insure that students receive remedial training, when appropriate, before they are admitted to CUNY and that students remain enrolled only if they progress at a reasonable rate. Such decisions fundamentally affect the university structure, and given the public nature of CUNY, they cannot be made purely on the basis of cost savings.

#### Intergovernmental relations and responsibilities

State law addresses separately the responsibilities of the City and State to the senior colleges and the community colleges. The senior colleges and the graduate school operate under a law that requires the State to match the City contribution. For fiscal year 1976-77, the State appropriated funds in excess of the funds provided by the City. The City appears to accept the general pattern of support for community colleges prevailing throughout the State. Based on State legislation specifying that the State is required to pay up to 40 percent of the total operating costs of community colleges, the university expected 40-percent State funding with the City providing the other 60 percent with student fees deducted from the City's obligation. In practice, however, the State uses a funding formula that has been providing only about 35 percent of the operating costs.

In the past, Federal funds have provided a small part of CUNY budget support. The imposition of tuition, however, will result in increased demands for financial aid for low-income families. The State expects additional demands on its student assistance programs; Federal programs that provide tuition assistance may also be affected.

The new Board structure, described earlier, is perhaps recognition of the increased responsibilities that the State is being asked to assume in CUNY affairs. The City and State, as the primary providers of funds, have powers of review and control and responsibilities to the institution and to the citizens. The mayor has indicated that the City intends to withdraw its financial support from the senior colleges. The State legislature has required that the City contribute

\$160 million for 1976-77. Legally, the City could withdraw its funding for later periods. In response to such an action, the State could again require a City contribution or threaten to withdraw its support of CUNY, which is based on a matching fund rule. The former approach is arbitrary; the latter would likely lead to the closings of the senior colleges. Higher education in New York City has in recent years been viewed as a joint City-State responsibility, with trends and legislation tending to give more responsibility to the State. It is not clear that this responsibility has been rationally divided in the past or that an adequate and clear rationale exists for a future division.

The State has established the Temporary Commission on Higher Education, which is addressing many of these questions and expects to issue its report by March 31, 1977.

## HUMAN RESOURCES ADMINISTRATION

### Background

The Human Resources Administration (HRA) is the operating agency controlling and coordinating the variety of programs providing, in cash or cash equivalents, the essential financial, medical, employment, social, and community development services to eligible individuals and families in the City. HRA provides overall planning direction of, budgeting for, and coordination of City policy related to the Department of Social Services. The Department, with a fiscal year 1977 estimated budget of \$3 billion, is the largest component of HRA. Other agencies under HRA include the Community Development Agency (with an estimated fiscal 1977 budget of \$3 million) and the Department of Employment (with an estimated budget of \$2 million). Although HRA has responsibility for a budget exceeding \$3 billion, its own budget is less than \$100 million for fiscal 1977.

Agency components under HRA provide seven service delivery programs supported by 20 staff operations with about 25,000 employees.

### Multiple funding sources

Funding for these programs comes from all three levels of government in amounts varying from program to program. At the State level, the Department of Social Services is primarily responsible for controlling public assistance policies and administration in the City. The Department is also the single State agency responsible for dealing with the public

assistance programs of the Federal Department of Health, Education, and Welfare. Other Federal agencies involved in various public assistance program funding include the Department of Agriculture for the Food Stamp program and the Department of Labor for the manpower development programs. A recent survey of the funding for the various programs by source is shown below.

<u>Program source</u>	<u>Income maintenance</u>	<u>Medical assistance</u>	<u>Social services</u>	<u>Management and overhead</u>	<u>Total</u>
----- (percent) -----					
Federal	15.3	21.2	13.3	1.0	50.8
State	9.2	12.6	2.2	.6	24.6
City	<u>9.2</u>	<u>12.6</u>	<u>2.2</u>	<u>.6</u>	<u>24.6</u>
Total	<u>33.7</u>	<u>46.4</u>	<u>17.7</u>	<u>2.2</u>	<u>100.0</u>

The percentages shown in this table are approximations of the actual funding received. The table illustrates that the Department of Social Services programs are reimbursed with Federal and State funds at varying rates. 1/

#### The budgetary process

Because of the large number and complexities of the programs, budget preparation is a lengthy, difficult process. Based on historical data, personal judgment, and experience, the HRA budget and fiscal affairs section prepares a budget for submission early in the calendar year to the City's Office of Management and Budget. This budget estimate considers such factors as:

1/This table reflects the relative percentages of funding as they relate to the overall total. Prepared from August 1975 claims submitted to the Department of Social Services. The reimbursement is based on claims to the State, prepared monthly, reporting actual expenditures by program, direct eligibility, category, and type. The data for these monthly claims is obtained from the City's payroll systems, the City's accounts payable/voucher payment systems, the Department's medical assistance claims payment systems, the Department's income maintenance client grant (welfare check) payment systems, and other sources.

- Client population trend--number of family units and total recipients.
- State-mandated rates, fees, and grant amounts.
- Possible increases in allowable rents and Medicaid rate changes.
- Rates of service use.
- State and Federal program (allowable services, etc.) changes and potential changes.
- Social services expenditure ceilings.
- Mandated expenditure and staff reductions.

Most of these expenditures are determined by Federal and State legislation, often in the form of mandated reimbursement formulas. Thus, there is little flexibility in the scope of services offered and in the management of HRA, other than to work within the constraints to see that the City receives maximum State and Federal reimbursement.

#### Management issues

The complete array of eligibility and budget criteria inhibit simple verification, objective evaluation, and routine determination of benefits. The multilayered, patchwork pattern of welfare programs necessitates intricate payment procedures that are often confusing to applicants and agency staff. Applicants are not sure of which program they may be entitled to participate in; this results in frustration and false starts in the application process, petitions for appeals, and litigation.

Not only the difficulty of the work, but also its volume reduce the quality of welfare administration. Because of the large caseloads and the complexity of processing a case under present Federal and State law, staff members have problems performing even routine functions properly. Frequent changes in welfare statutes and regulations necessitating the implementation of new policies further complicate the system. The workloads, in turn, lead to high rates of staff turnover, low morale, and inadequate training and supervision.

Rigid Civil Service regulations and antiquated and narrowly defined job descriptions inhibit management's ability to adjust workloads to meet crises. For example,

Civil Service job descriptions for computer technicians do not coincide with the current computer technology. In many cases, Civil Service rules and union contract requirements conflict.

As a result of the variable funding requirements, cumbersome budgetary processes, required employee ceiling levels, Civil Service requirements, and negotiated union agreements, City management does not have enough flexibility to react promptly to the ever-changing rules and regulations and to caseload shifts arising from program changes. For example, HRA was recently given less than 30 days to recertify the eligibility of over 93,000 cases of Supplementary Security Income Benefits for food stamps. Under normal workloads, 5,000 food stamp applications can be processed each week.

HRA, in its initial submission of its management plan outline to the deputy mayor for administration, identified 45 wide-ranging internal improvement projects that might be undertaken to improve efficiency at the City level. As an example, the institution of eligibility verification by non-labor-intensive means (computer matching of income at the City and State levels) has contributed to a decrease in ineligibles on the rolls.

For fiscal 1977, HRA proposes to reduce its outlays by \$60 million through administrative efficiencies, reductions of local option program grants, and eligibility redefinitions.

#### Policy implications of eligibility determination

Eligibility criteria in these programs favor the families headed by females over intact families (the former receive more generous earnings disallowances and more liberal Medicaid coverages). The exit levels for reduction of benefits vary widely, and also favor the female-headed families. A working family must earn \$11,500 to achieve a standard of living equal to a New York City welfare family taking advantage of all opportunities. As a result, rather than acting as a supplemental program to help distressed families to get through hard times, the program often discourages people from working.

#### Selected issues relating to welfare

Based on interviews of HRA officials, we identified the following issues:

1. Can the administration of HRA programs be effectively changed without the corresponding changes at the State and Federal levels?
2. Can there ever be efficiency and economy in the administration of welfare programs as long as Federal and State regulations continue to be inequitable, overlapping, confusing, conflicting, and constantly changing?
3. Considering the multilevel funding of these programs, should there be built-in incentives for the City to become more efficient?
4. As long as HRA is acting within its budget, need there be multilayered and cumbersome approvals of its day-to-day decisions?
5. Will the installation of the "most modern accounting and budgeting systems" greatly affect the present administration of the welfare programs?

These issues perceived at the local level indicate that there is an intergovernmental problem. Effective changes in basic policy cannot be made by the City alone, but only with the participation of all levels of Government.

#### HEALTH AND HOSPITALS CORPORATION

##### Background

HHC, which operates the City's municipal hospital system, is composed of 17 operating hospitals and additional neighborhood family care facilities. This system is the major provider of health care services to the City's indigent population. Initial planning for fiscal 1976 called for a total budget of \$1.058 billion.

Although the City has provided public hospital services since the 1700s, not until 1929 were the various independent boards and hospitals consolidated under a Department of Hospitals. In the late 1960s this system was critically analyzed by a number of health experts, who concluded that both the provision of patient services and the management by the Department of Hospitals were in "complete disarray." Mayor Lindsay established a special study commission which reported that "conditions in the city hospitals are not only deplorable but, under existing arrangements, irremedial." The commission recommended that a separate public benefit corporation be established to operate the hospitals.

In 1969 the State legislature established HHC as a public benefit corporation. In 1970 HHC took control of the municipal hospitals. The Corporation's general charter was to establish a system which would permit legal, financial, and managerial flexibility in the delivery of high-quality, comprehensive medical care, particularly to those who could least afford such services.

HHC's board of directors includes five senior City health and welfare officials, five members appointed by the mayor, and five members designated by the city council and appointed by the mayor. A 16th member is elected by the board of directors to be the Corporation's chief executive officer. The board, although nominally the policymaking body for HHC, is restrained by numerous Federal and State regulations and is now subject to review by the Emergency Financial Control Board and its operating arm, the City's Office of Management and Budget. Management at the Corporation level is handled by a central office, which is responsible for accounting, overall budgeting, labor relations, financial planning, and other headquarters-type functions.

In addition to improving operations, HHC was directed to establish community advisory boards to enable residents to participate in the affairs of each hospital. This procedure was intended to increase community involvement and make each hospital more responsive to its community's needs. The community boards vary in size from 20 to 40 members (Bellevue Hospital, for example, has 31 board positions). Most board members are drawn from the community, but several represent hospital employees. The Bellevue community board identified its main functions as judging the scope and quality of service, determining the range of community health needs and assisting in planning, cooperating with other planning agencies, and assisting in the budget process by helping to define hospital policies. The boards are only a few years old, and have played a limited role both because of their inexperience and because of the limits set by their authorizing legislation. Since each board is concerned with its own hospital, its goals often conflict with HHC goals, especially those involving hospital closings and personnel reductions.

### Funding

Financial support can be identified in terms of both sources and programs. In terms of sources, funds are derived from government (Federal, State, City), private third-party

payers, and patients. In terms of programs, the main sources are Medicaid, City tax levy funds, Medicare, private insurers, matching State funds under the State Mental Health Program, and self-pay. The largest single program source of funds is Medicaid, which in 1974 provided 68 percent of the inpatient revenue. The HHC budget submission of January 12 projects a fiscal 1977 State and Federal Medicaid collection of \$342.4 million, which will generate a mandatory \$138.3 million in matching City Medicaid support. Medicare is expected to provide \$109 million, and other patient-related sources, \$83.7 million. Total anticipated revenues for services, including the City's matching Medicaid payment, are \$676.4 million, while expenses are estimated at about \$1.03 billion. The difference will be paid by City tax levy and by additional decreases in service.

#### Management issues in the health area

Two reports, one by the New York City Productivity Council, the other by the State Department of Health, considered how much autonomy each hospital's executive director should have. The Department of Health concluded that the authority and control of each director over budget and staff should be increased. The Productivity Council suggested that an experiment be tried in which one director is given substantially more autonomy. Determining the proper allocation of control between hospital management and Corporation management is difficult. Corporation management is presumed to have broad knowledge of needs and an understanding of the total programs and services it is trying to provide; the hospital executives have detailed knowledge of their hospital's needs. At times of major change, such as a substantial budget reduction, the power of organizations tends to become concentrated at the higher management levels. The recommendations made in the above reports should be considered with careful regard to the situation within which the Corporation is now operating.

The area of labor productivity should be carefully analyzed. Mechanisms exist to reward superior individual performance. If workers view a productivity program as a way to eliminate additional jobs, it will probably not be warmly received. At the least, both labor and management should share in the benefits of a productivity program. Determining the appropriate time and conditions to begin a productivity improvement program is probably a decision best left to hospital management. The Corporation office can help by providing technical support and policy guidelines.

Most municipal hospitals' physician and some of their technical services are provided by affiliation agreements between the hospital and a private voluntary hospital or school of medicine. For example, Bellevue is affiliated with New York University School of Medicine. Interns and residents are rotated among University Medical Center, a Veterans Administration hospital, and Bellevue. The senior physicians receive their faculty appointments from the university and are not employees of Bellevue. Problems of control and accountability exist under this arrangement.

Affiliation contracts are programed to cost \$150 million for fiscal 1977. In the past, these contracts have been criticized for being vague, for lacking effective means of measuring performance, for providing limited accountability of the amount and type of services provided, and for dividing responsibility between the executive director and the affiliation administrator. During the past year, the Corporation has completed the substantial task of reviewing and renegotiating its affiliation contracts. Each hospital is unique, and each had an affiliation contract renegotiated to meet its particular needs. In the coming year, the Corporation will want to review the results of the new contracts to determine that the criticisms of earlier affiliation contracts no longer apply.

The State Department of Health study also reported that HHC had a surplus of acute care beds and recommended that many of them be converted to skilled nursing care facility beds for long-term patients. Because the budget crisis prevents the Corporation from expanding its services, the decision was made to close all or major portions of three hospitals while reducing services and personnel in other hospitals as part of an overall budget reduction effort. We believe that the remaining hospitals must strive to continue to provide levels of service equivalent to those of private voluntary hospitals so that private patients, as well as Medicaid/Medicare patients, will be encouraged to use the municipal hospitals. In addition, private practice physicians apparently have limited professional access to the municipal hospitals. The situation should be studied to determine whether it would be beneficial if private physicians had freer access to the hospitals so that they could admit and care for private patients.

#### Issues in intergovernmental relations and responsibilities

Closing HHC facilities and improving physician accessibility are steps that can be taken at the HHC and City levels.

Other actions depend on City, State, and Federal coordination. A key issue appears to be whether the City and State want two hospital systems, one municipal and one private voluntary. Arguably, two systems operating under the proper ground rules could promote healthy competition that would benefit the users and payers.

Historically, people have generally preferred to be patients in the private voluntary hospital rather than in the municipal hospital. Municipal facilities often were not as well staffed and had the reputation of being for the indigent. With the advent of Medicaid, the poor now have a choice of hospitals. Although staff and facilities were massively upgraded at the municipal hospitals, they have lost the exclusive rights to care for the poor. The Medicaid patient may select his hospital based on location, reputation, or his physician's affiliation, but he need not consider the cost. There is no economic incentive for the patient to select a municipal hospital even though it may have a lower Medicaid rate than a neighboring voluntary hospital. One point is clear: neither the City nor the Corporation can allow the municipal system to become inferior to the private system. If this should happen, the municipal system could continue to exist only by massive subsidies or by forcing Medicaid/Medicare patients to use the facilities.

The apparent surplus of acute care beds may be due to the operation of outmoded facilities in both the public and private hospitals. The problem is one of eliminating the organizations and relocating the personnel operating obsolete beds regardless of whether they exist in the municipal or private sector. The result of the surplus will be a lower occupancy rate throughout the whole hospital system, both public and private. The City is penalized in two ways. With lower use of the municipal facilities, both the overall deficit and the Medicaid rate can be expected to increase, and Medicaid rates for the private voluntary hospitals will also be higher if their facilities are underused. Self-pay and private third-party insurance rates can be expected to be higher if the system has to support unneeded personnel and facilities.

There is a question of how costs could be reallocated among City, State, Federal, and private payers. Resources probably have been inefficiently allocated in both hospital systems. The issue now is to determine whether some of these misallocations can be alleviated and how any remaining excess costs shall be paid. The responsibilities, needs, and resources of both hospital systems, the patient population, and those who pay should all be considered in developing improved policies.

Policies which limit the ability of the municipal hospitals to compete fully with those in the private sector should be carefully reviewed and perhaps revised. The care and service provided by the municipal hospitals should be comparable to those provided by the private hospitals. Under such conditions, the municipal hospitals should eventually be as economically viable as private hospitals.

One area to be investigated is the control and approval of hospital Medicaid rates. If the State did not allow increases in Medicaid rates at high cost hospitals or set a ceiling, the Medicaid patient would be a less desirable patient. If this, in turn, resulted in a transfer of Medicaid patients from high cost voluntary hospitals to lower cost municipal hospitals (or even to lower cost voluntary hospitals), substantial benefits might accrue to both the City and HHC.

New York State now has control over all new hospitals and hospital expansion within the State. The power to rationalize the total hospital situation exists at the State level, subject to many forms of political pressure. A good case can be made that, regardless of corporate form (private or municipal), the hospital business is a public business. It receives tax abatements on its property; much of its funds are from Federal, State, and City governments; financial contributions are encouraged through tax deductions; and many hours of service are provided at no cost. If there are to be two hospital systems, then controls should exist to insure at least that the plans and actions of the two systems are not counterproductive and preferably that the systems are mutually supportive and complementary in meeting patients' needs.

## TRANSIT AUTHORITY

### Background

The New York City Transit Authority, a public benefit corporation created under State law, provides an important service to the many area residents who choose to purchase it. The Transit Authority, which operates transit facilities leased at no charge from the City, has a budget of approximately \$1.3 billion and employs over 44,000 people. The Authority's subsidiary corporation, the Manhattan and Bronx Surface Transit Operating Authority, operates certain bus lines. Its share of the total budget is \$165 million and it employs about 6,400 people.

Data from the March 25, 1976, revised Financial Plan indicates that the \$11.8 million expected deficit could in the worst case increase to \$118.1 million in fiscal 1977. The projected increase is mainly the result of smaller State and Federal subsidies. The City, however, expects the budget gap to be about \$50 million. In the Transit Authority's view, the term "deficit" refers to the gap between its expenses and all projected revenues, including City, State, and Federal subsidies, and not just the difference between operating expenses and farebox revenues.

Farebox revenues provided about 52 percent of the required revenues in fiscal year 1976 and are expected to provide about 57 percent in fiscal 1977. The main sources of operating revenue and their approximate amounts for fiscal 1976 were:

	<u>Amount</u>
	(millions)
Farebox	\$675
Triborough Bridge and Tunnel Payment (note a)	64
State operating assistance	70
State school transportation reimbursement	49
Federal assistance	131
City assistance	\$296
	<u>49</u>
	247

a/Payment required by the Public Authorities Law of the State of New York.

Of the Federal assistance, \$80 million is from section 3 funds of the Urban Mass Transportation Act of 1964, as amended. These funds are for capital improvements to mass transit and, although they may be used for operating expenses, they must be repaid soon to the capital expenditure side of the transit budget. The City support of \$296 million consists of reimbursement of reduced fares for the elderly and for school children (\$98 million), reimbursement for transit police (\$93 million), certain debt service payments (\$35 million), and a payment of \$70 million in operating assistance required in order to receive a matching subsidy from the State. About \$49 million of the school children's transportation subsidy is reimbursed by the State. The Transit Authority's expense budget does not include interest and principal paid by the City on City bonds issued for

transit purposes, an amount annually above \$150 million. This places total support from the City in fiscal 1976 at \$411 million.

#### The budget process for the Transit Authority

Budget instructions are sent to about 35 departments in December. Each department prepares a cost breakout by salaries and wages, material, and other (electric power, pensions, social security, health and welfare payments, and rentals). Budget hearings within the Transit Authority are held in February. The law requires budget information to be submitted to the Governor and various State legislative committees and to the mayor and City comptroller by May 1. These submissions, however, are to provide information only. The only approval legally required is that of the Transit Authority Board, which takes place in June. We were unable to determine how much coordination and negotiation occurs among the City, the State, and the Authority in preparing the Transit Authority budget.

The Emergency Financial Control Board has the authority to review and approve or disapprove the financial plan, a document separate from the budget. Some of this authority is exercised by the Office of Management and Budget, which acts as EFCB's agent and has greatly increased its involvement in the Transit Authority's planning process. One of EFCB's acts was to redefine the labor settlement reached between the Transport Workers Union and the Transit Authority. In the past year, after the Transit Authority had identified \$38 million in prospective savings, EFCB indicated that an additional 5-percent reduction (\$65 million) would be appropriate. The Transit Authority revised its planned savings to about \$100 million, and the actual identification of reductions was left to the Authority.

#### Issues in management control and intergovernmental relations

Three main issues confront the Transit Authority. The first is how the costs of service should be distributed among users; other citizens; and City, State, and Federal Governments. The second is the level of service to be provided. The third relates to productivity and efficiency and the extent to which Transit Authority management and labor can jointly achieve gains. The Authority has limited control over the first issue, an important role in dealing with the second, and a dominant position in addressing the third. Addressing

the third issue requires that the Authority's objectives be identified, for an overall level of service can be implemented in many ways, depending on the objectives.

### Distribution of costs

It is unlikely that the \$1.3 billion Authority budget can be generated wholly through the farebox. But it has been argued that the riders are not the only beneficiaries, that the economy of the City and the region also benefit, and that it is therefore equitable that the costs be borne by others than just the riders. The means of allocating the deficit is in only a limited sense an issue of Transit Authority management control. It is actually a policy decision involving the City, other local governments, State and Federal Governments, the Metropolitan Transportation Authority, the Transit Authority, and every special interest group that can make its voice heard. In addition to an increase in direct government subsidies, various flow-through forms of support have been suggested, including payroll, income, and property taxes; sales taxes; and automobile-based taxes and tolls.

Changes in the fare structure are another alternative, and one more directly controllable by the Authority. Fares are presently constant regardless of the length of ride or time of day; one exception is half-price fares during part of the weekend. A few other differential fare plans are operational. Changes in the fare structure can involve across-the-board fare increases and differential fare options, under which charges may vary by time of day, day of week, or length of ride. Substantial capital costs would be required to purchase turnstiles and rebuild station entrances to accept variable fares. Careful analysis is required to determine if this is an appropriate investment for the Authority's limited capital. The imposition of the new tax- or toll-based revenues would generally require the approval of the State legislature and the City.

### Level of service

When service is reduced, attention should be paid to both the cost savings and the impact on various user groups. The best reductions may be those which present alternatives to the users. Service reductions can be expected to fall unequally on commuters, shoppers, and night travelers. The impact could be seen in longer delays and more crowded rides for commuters or loss of employment opportunities for citizens working night shifts. Passengers with a choice of alternative transportation or without an urgent need to travel might perceive the

transit system as too inconvenient. Lower standards of car maintenance or elimination of noise reduction efforts might deter those who can afford alternatives or do not need to travel. Additional subway lines are being planned or built, and although they will no doubt increase ridership, they will contribute little to a positive cash flow and more likely will add to the deficit.

The Transit Authority has identified a series of service cutbacks and their estimated savings:

	<u>Amount</u>
	(millions)
Elimination of air-conditioning	\$ 5.0
Elimination of special fare programs	17.5
Elimination of bus routes that duplicate subway lines	30.1
Elimination of some shuttle service and reduction in non-rush-hour service	17.1
Elimination of weekend bus service	17.6

This amounts to \$87.3 million in potential savings.

The key issue concerning level of service is how and where reductions shall be made. The Transit Authority must carefully consider those who will be affected. Other governmental units may want to have some input to the decision process. The Transit Authority would be wise to have some solid data on the numbers and characteristics of riders who would be affected under various alternatives.

#### Efficiency and productivity

Although cost reductions can be achieved by reducing the level of service, they can also be achieved through greater efficiency. Improvements in productivity and efficiency should be based on clearly defined objectives, capable management, incentives for both labor and management, and worker participation in the productivity improvement process. The Transit Authority management is constrained by labor contracts, and any revisions will flow from future collective bargaining agreements. The Authority, in identifying areas of possible savings, has noted that the elimination of bus service is subject to the union contract. A recent study by the Temporary Commission on City Finances claimed that over \$100 million annually could be saved by revising contract provisions and work rules, but contract talks are not scheduled

until 1979. The issue is to determine how labor and management can work together to achieve these savings for their mutual benefit.

The State Department of Audit and Control also identified a number of potential areas for productivity improvement in the maintenance and inventory control areas. Tying pay increases to productivity gains, as negotiated in the recent contract, appears to be a workable approach to achieving productivity gains.

## THE UNIFORMED SERVICES

### Background

Unlike many other City services, police, fire, and sanitation are funded almost completely from tax levy funds or general, nondirected Federal or State revenue sharing. The State and Federal governments do not have the extensive legal and financial involvements that they have, for example, in the education, welfare, and health areas. Police, fire, and sanitation are recognized as prime responsibilities of local government.

The net authorized fiscal 1977 budgets, exclusive of debt service, are \$929 million for the Police Department, \$395 million for the Fire Department, and \$481 million for the Environmental Protection Administration. Since these are labor-intensive services provided by the City, the labor cost component of the budgets is large--63 percent, 67 percent, and 58 percent, respectively. Consequently, any substantial improvements in efficiency and effectiveness will have to be based largely on the labor component.

### Management issues

The concepts of efficiency and effectiveness are basic to the management process. One measure of efficiency is the ratio of inputs to outputs; that is, the dollars or manpower which produce the hours on patrol, the number of tons of trash collected, or the miles of streets cleaned. Effectiveness, on the other hand, relates to the objectives and purposes of the effort: prevention of crime for the police, maintenance of the public health and a pleasant environment for sanitation, and in general providing the public with those services which it can or does reasonably expect.

Efficiency

A major problem hampering improved efficiency is the realization by both labor and management that, at a time of diminishing budgets, improvements in efficiency are all too likely to involve personnel reductions. There is no easy answer to the workers' justifiable fear of losing jobs. Early retirement in the uniformed services helps by allowing attrition to replace a large part of any layoff requirement, if the layoff can be stretched over 6 months or a year. A possible answer is to provide departments with reduced but fixed budgets so that efficiency improvements accrue to the benefit of the department and its personnel. But admittedly, pressure would exist to further reduce the budget of a successful department in the following year. In fact, recent proposals to link pay raises to future productivity increases would tend to reward those organizations which until now have been less efficient.

One way of addressing efficiency is to examine how the New York civil service system, work rules and collective bargaining, and the process of setting objectives and preparing budgets affect efforts to increase efficiency. Criticisms of the City's civil service system include: (1) excessively specialized job categories (not true for uniformed services categories), (2) a recruitment and promotion process that gives great weight to performance on a written examination and little or insufficient weight to job performance, (3) limited opportunity for entry at mid- and upper-level positions, and (4) limited means of rewarding workers for outstanding performance. The Police Department has been praised for its procedure by which the highest rank attainable by examination is captain; the Commissioner has the authority to assign captains to higher ranks based on his judgment of their performance. Some sources, notably the State Charter Revision Commission for New York City and the Citizens Union, a nonpartisan civic organization, argue that more responsibility for the personnel function should be given to the line agencies.

Besides the civil service regulations and procedures, there is a collective bargaining system under which labor and management negotiate about a number of areas, some of which previously had been wholly the responsibility of management. Control over hours, staffing of equipment, shifting of equipment and people to other locations, and various types of time-off situations are now subject to contract negotiation. As a result, management's flexibility in responding to new situations or better information has been limited. In the report to the Charter Commission titled "Reforming the Municipal

Labor Relations Process in New York City," the authors cite the "practical impact" clause of the New York City Collective Bargaining Law as having the result that:

"\* \* \* very few questions involving management of the City's work force remain under managerial control. This means that management innovations designed, for example, to increase productivity or lower costs must run the gantlet [sic] of collective bargaining, where, depending on the specific policy and/or influence of the union involved, change may be blocked or perhaps accepted with the quid pro quo of 'special' salary considerations \* \* \*."

The report went on to recommend that the clause be eliminated from the New York City Collective Bargaining Law to help restore innovative capacity to City managers. We question whether this is feasible. Apparently, labor and management are enmeshed voluntarily in a complex relationship of bargaining collectively and in good faith, and neither side will willingly and easily surrender their perceived victories of past struggles. Can the relationship revert to some earlier state or to a new state in which the powers of labor and management are clearly differentiated or to a condition where both labor and management are partners in striving for efficiency and productivity? Perhaps the issue can be phrased as a need for both management and labor to redefine their roles in response to broad social changes and to a present and probably long-term fiscal crisis.

### Effectiveness

Under ideal circumstances, all inefficiencies in operations should be eliminated before any cuts are made that diminish a department's effectiveness. In actuality, usually when staff reductions are made, part of the loss of output is recovered through increased productivity and part represents a real decline in services provided. The task of defining and measuring the effectiveness of programs represents a real challenge to management. This effort is important because the uniformed services provide very visible output to the public. Any decline in the output should have the least possible impact on the public's perception of its needs. Much of the effort of police, fire, and sanitation are concerned with prevention (prevention of loss from fire, from crime, from health hazards), and the development of effectiveness measures for "negative" objectives is a particularly difficult task.

The fiscal crisis has brought the Office of Management and Budget into a closer relationship with both mayoral and covered agencies regarding setting of objectives and budget preparation. (Mayoral agencies operate under a chain-of-command directly linked to the mayor; covered agencies operate outside of the mayor's line of authority.) This may tend to centralize management, while a number of authorities have repeatedly urged that management decision-making and responsibility be moved to lower organizational levels. The role of the agency's top management should be to develop goals and objectives and the budgets to meet them. Lower levels of management should be allocated the resources and responsibility to achieve the objectives. OMB's functions should be to approve the objectives, to evaluate how likely the budgets and plans are to achieve the goals, and to monitor departmental performance.

Departmental actions in  
fiscal 1976 and fiscal 1977

The departments have taken or plan to take a number of steps, which will either reduce costs or, rarely, increase revenues. In fiscal 1976 the Police Department instituted a program to increase revenues from car towing. This was to involve both an increased effort, using more police and private contractor tow trucks, and increased charges to the car owner. Annual additional revenues of \$1 million were expected. A saving of \$660,000 was planned by reducing the amount of money available for other than personnel services, which includes money for informants and for supplies and materials.

For fiscal 1977 the Police Department planned a reduction of \$39.5 million. Part of this is to be achieved by management improvements, such as reducing overtime through a prearraignment process, but most is to be saved by reducing staff by an estimated 1,575 personnel. This reduction, however, will not require an equivalent reduction in the amount of patrol time. Part of the staff reduction will be compensated by an increase in the annual number of tours of duty per patrolman. Since 1973 a patrolman's 8-1/2-hour tour of duty consisted of 8 hours of patrol time and a half hour for preparation and training. Patrolmen were given additional days of leave to compensate for the longer work week. The decision by the Impasse Panel of the Office of Collective Bargaining to eliminate 15 minutes of the nonpatrol time will have the effect of increasing the number of tours of duty by eight per man per year by eliminating part of the additional leave days. The City estimated that 185,000 extra tours of

duty would result from this decision. It demonstrates, however, that management cannot make such decisions unilaterally.

During fiscal 1976, the Fire Department started a program to reduce expenditures, mainly by eliminating units and reducing the staffing associated with remaining units. The latter point was also the subject of arbitration. Overtime pay is incurred when a tour of duty is extended, but it is also paid when a firefighter serves extra tours. These extra tours are served because the department finds it is less expensive to do its staffing through a combination of regular time and overtime rather than by employing enough firefighters so that no overtime would be needed. When a fire company is closed and its members made available to other units, there is a savings in overtime. This savings occurs because the staffing requirements are reduced even though the personnel roster is unchanged.

If attrition occurs, the overtime savings will be reduced at a rate that is commensurate with the attrition rate and offset by a savings of regular compensation. The department has eliminated some fire companies and reassigned nonfirefighting personnel to firefighting duties.

As a result, enough personnel will be freed for reassignment to fire companies that \$8.3 million annually will be saved on overtime expenditures. A further reduction in expenditures for fiscal 1977 of \$8.5 million is planned, part of which will be achieved by an estimated staff reduction of 127 personnel.

In the Department of Sanitation, fiscal 1976 budget reductions were made in overtime pay by eliminating all cleaning and collection on Sunday, reducing security staffing, and rescheduling vehicle maintenance to curtail Saturday work. Additionally, reductions in other than personnel services were achieved by cutting purchases of supplies, equipment, and materials. Annual savings in these two efforts were about equal, totaling \$2.6 million. Plans for additional economies in fiscal 1977 are based primarily on a reduction in cleaning and collection from five times to twice a week. The associated reduction in staff is estimated at 512, and the decreases in expenditures are programed at \$8.7 million.

In other cities, both in the United States and abroad, a number of mechanisms for improved efficiency in sanitation, including better equipment, competition from private haulers, flexible schedules, incentive systems, and crew size

adjustments for load conditions, have been implemented. These and other suggestions should be carefully evaluated and tested in New York.

### COLLECTIVE BARGAINING IN NEW YORK CITY

Labor costs are the largest single item of City expenditures--over 50 percent in recent years. Most of these labor-related costs are determined by a collective bargaining process involving over 95 percent of the City's employees; over 100 separate bargaining units; several City and independent agencies with collective bargaining authority; and the State oversight authority, the Emergency Financial Control Board. The result of that collective bargaining process can greatly affect city finances.

Increased labor productivity--regarded by both union and management officials as a key ingredient of a successful financial solution--can be achieved only through the cooperation of both sides of the collective bargaining process. The cost effectiveness of a functioning productivity improvement program could be substantial: a 1-percent change in labor-related costs represents about \$65 million in the City's current budget. However, productivity improvements may be difficult to identify and implement.

The unions are directly involved in the City's current financial situation. By approving of loans from the retirement systems of over \$3 billion, by cooperating in joint labor-management committees, and by agreeing to wage restraints for the duration of the Financial Plan, the unions have become involved in determining the City's future.

This section will discuss unresolved issues in two collective bargaining areas: the evolution of the collective bargaining process through the financial crisis and the advent of joint labor-management committees on productivity.

#### Collective bargaining issues

##### Issue: bargaining authority and accountability

The first issue complicating the financial crisis is the diffusion of the authority to conduct collective bargaining and the multilateral responsibility to fund cost impact items once they have been negotiated.

All public employee collective bargaining in New York is conducted under the State's Taylor Law. The Taylor Law permits a municipality to establish its own procedures for conducting labor relations as long as they are "substantially equivalent" to the State's. This law is known as the New York City Collective Bargaining Law. However, several major agencies, such as the Board of Education, the Transit Authority, and the Health and Hospitals Corporation, are legally independent of the mayor's office and are not covered by the City Collective Bargaining Law. These agencies are covered only by the Taylor Law.

For the mayoral agencies, the Office of Labor Relations conducts day-to-day negotiations on their behalf. Guidance and overall policy for the Office has been delegated by the mayor to the first deputy mayor.

The independent agencies negotiate directly with the unions. Before passage of the Financial Emergency Act of 1975, the law provided no role for the mayor, the Office of Labor Relations, or the Office of Collective Bargaining. The mayor was simply to be presented with a completed bill after the negotiations had ended.

One City official maintains that negotiations between the major independent agencies and their unions are not conducted at arm's length. He said these agencies' goals are to provide services, not to save the City money. Therefore, they have no incentive to keep labor costs low. Further, he feels that to avoid a rift in labor relations, the agencies have accepted high settlements.

Recognizing that they would eventually be responsible for these negotiated labor costs, the last three mayors have informally participated in behind-the-scenes negotiations. Since there was no formal mechanism for mayoral involvement with the major independent agencies, the extent of such involvement has varied. The State's Financial Emergency Act of 1975 was enacted to give the mayor authority to insure that the expenditures of all agencies receiving City funds--including the independent agencies--are within the plan.

Nonetheless, it is not evident that the Financial Emergency Act has clarified the lines of responsibility and authority. Our discussions showed that confusion exists about EFCB's role in the collective bargaining process. EFCB maintains that it merely insures that all labor contracts are within the plan's framework and that it does not participate in the collective bargaining process. On the other hand, one

State official praised EFCB's director for heading off a strike by the Transit Workers Union this spring. Further, both the director of EFCB and the chairman of the Municipal Assistance Corporation--a new member of EFCB--were present at the June negotiations between the City and the Municipal Labor Committee. Regardless of whether EFCB involvement in bargaining sessions is beneficial, the Financial Emergency Act expires in 1978 and the Board will supposedly be disbanded.

The Board of Education/United Federation of Teachers contract is an example of the effect of this diffuse process. In September 1975, the teachers and the Board of Education agreed on a new 2-year contract. EFCB later ruled that the contract was invalid because it was not within the plan due to a negotiated salary increase. As of September 1976, the efforts of the Board, the teachers, and the mayor have not produced an agreement.

Thus, the issue of fragmented bargaining authority and funding responsibility remains open.

Issue: the future of codetermination

Since the advent of the financial crisis, the unions and City management have increasingly cooperated in determining the City's future. Although widely practiced elsewhere, the concept of codetermination is new to New York City. Labor relations during the late 1960s and early 1970s were heated, strikes were rampant, and many thousands of workdays were lost to strikes.

The unions have taken several steps in their role as codetermining partners with the City. They approved the retirement systems' loans and have cooperated in using attrition and work rule adjustments to avoid layoffs.

The unions have also cooperated with the City by lobbying in the State legislature to enable the City to levy additional taxes and in the U.S. Congress to seek additional Comprehensive Employment and Training Act funds.

Finally, the most recent labor agreements with the Transport Workers Union and the Municipal Labor Committee have increased the degree of codetermination by providing for joint labor-management committees to improve productivity.

This cooperation did not come automatically, and nothing guarantees that it will continue. City, State, and union officials constantly reminded us that "it has to happen" and that this is the "real thing." However, according to one City official, (1) union cooperation is due partly to the fear of precipitating a bankruptcy in which a court might abrogate union gains of the past decade and (2) City cooperation is due partly to the fear of a strike that would further deteriorate City services and the quality of life. Nonetheless, a strike recently occurred before agreement was reached on layoffs in the Health and Hospitals Corporation. And it is still uncertain how the unions will use the leverage they have gained from their financial involvement or what success the joint labor-management committees will have.

Issue: the politicization of  
the collective bargaining process

City unions have long been involved in electoral politics. Realizing that influence in the City council and State legislature can often mean favorable contract settlements, they have actively campaigned for candidates in State and City elections.

The Stavisky-Goodman Law demonstrates the effect of politics on the collective bargaining process. When the City began to initiate cuts to education provided for by the plan, the Teachers Union realized that the Board of Education budget would be cut by \$150 million more than it had anticipated. The teachers were influential in mobilizing support from the Board of Education, other unions, and the Parent-Teacher Association to pressure the legislature to pass a private bill affecting only the City. This law, by requiring that the City devote a certain percent of its budget to education, would have restored the \$150 million cut and indirectly would have prevented the City from adopting innovative techniques in money management and budgetary control.

One City official believes that this approach could be widely used in the future. Whenever a union cannot accomplish its ends by collective bargaining, it may seek redress in the State legislature. A State official, however, believes that the Stavisky-Goodman bill was a "fluke" that cannot be repeated.

Even though the Stavisky-Goodman Law was invalidated by the State supreme court in August 1976, the case is under appeal, and the fact remains that successful lobbying initially influenced the passage of this law. Additionally, courts are another dimension in the collective bargaining process.

On the other side of this issue is the question of what happens to the collective bargaining process when the legislature can supersede a negotiated contract by freezing wages or regulating bargaining on pensions. Thus, this issue remains: Will labor relations issues be solved through collective bargaining or by some other, more politically expedient means?

Issue: synchronizing the collective bargaining and budget process

The problem of labor contracts being settled after the fiscal year's budget has been approved is common to cities with active unions. Whenever a labor contract is settled after the budget has been approved, any additional labor costs--unless there is padding in the budget--will have to be funded by borrowing. The New York City budgeting process has usually not provided for this contingency.

One of the city charter revisions requires that:

"a. So far as practicable, each collective bargaining agreement covering city employees shall be executed prior to the commencement of the fiscal year during which its provisions shall first be in effect."

The catch is the first four words of the charter revision. One City official maintains that negotiating a labor settlement before completion of the budget process could be difficult. In the past, there has been no incentive to expedite contract negotiations because unions were usually assured of retroactive settlements. Unions or management could avoid confrontation with the City council by simply waiting until the budget was approved before agreeing to a final contract settlement.

Some City officials believe that, since the City cannot afford and the Financial Emergency Act forbids any salary increases through 1978, synchronization is less necessary because labor costs are now almost totally predictable. Nonetheless, the issue of whether the budget and collective bargaining processes can be synchronized will remain after 1978.

Issue: wage settlements after 1978

Although virtually everyone agrees that freezing salaries until 1978 will help balance the budget, many fear that pent-up

union demands will explode in high-priced labor settlements in 1979. Other observers, recognizing that the financial crisis will not end in 1978, say that regardless of union and agency demands, little money will be available for salary increases in the years to come and the City may have to resist these demands.

### PRODUCTIVITY ISSUES

Like any other fiscal entity, New York City is caught between three conflicting pressures: the need to provide more and better services; employee pressure for higher wages and more satisfying jobs; and the inability, both legal and fiscal, to afford higher costs. It is not surprising, then, that the last two major settlements in the City called for joint labor-management committees on productivity. Pursuant to EFCB guidelines, both agreements, one between the Transit Authority and the Transport Workers Union and the other between the Municipal Labor Council and the City, allow for no salary increases and make cost-of-living adjustments subject to productivity savings. The former agreement allows for cost-of-living adjustments to be paid only to the extent that quantifiable cash savings can be generated through an increase in labor productivity without a decrease in service. The latter agreement contains a somewhat broader definition, including quantifiable cost savings, other savings, and increased revenues.

The idea of productivity bargaining is not new. Its modern origin is commonly cited as England in the 1960s. Unfortunately, the initial success was not transferable to all sectors of the British economy. One reason given by a National Commission on Productivity report is that there were too many "phony" agreements, wherein labor and management conspired to circumvent government wage and price guidelines. Whether the City achieves real productivity savings or only fictitious savings will depend on how the following issues are resolved.

#### Issue: difficulties in measuring productivity

Productivity is most simply defined as the ratio of input to output. However, measuring input and output is a difficult and inexact task. Input is generally measured as workdays per year required for any function. This, however, measures only one input, labor, and completely ignores capital investments.

Output also creates measurement problems. The output of some activities is easy to measure--tons of refuse collected or number of subway passengers carried. However, some functions do not lend themselves to quantification. Such measurements as number of agencies audited, number of patients healed, or number of students taught may not be legitimate.

For the short run, the City seems to have circumvented these measurement problems by adopting its own working definition of productivity, which will be a simple measurement of performance against the budget for a given fiscal year. Thus, if an agency is budgeted for \$121 million and spends only \$111 million without reducing services, it has provided \$10 million in productivity savings. However, the definition of what constitutes a reduction in service has not been resolved. For example, if the 88th and 84th Street entrances to the 86th Street subway station are closed, does this annual savings of 2,190 staff-days also represent a reduction in service?

Most officials we interviewed felt that most short-run savings will be generated by the relatively easy method of attrition and by "squeezing water from the budget." These "easy" cuts meant slashing certain agencies to the bone. Thousands of police, fire, and sanitation employees have been laid off; deep cuts were made at the City university; and the invalidation of the Stavisky-Goodman Law will mean thousands of layoffs in the school system. At a certain point then, it becomes questionable whether these cuts increase productivity, under the City's working definition, or merely reduce services. In any event, once these "easy" cuts are made, the City and the unions will require a more sophisticated method of measuring productivity in new productivity improvement programs.

The final management issue concerns whether productivity should be measured citywide or by agency. The obvious advantage of the agency-by-agency method is that it clearly assigns responsibility and, therefore, rewards to a particular group. At least one union official said that his union would prefer to be judged on its own.

But there are several drawbacks to the agency-by-agency approach. First, some agencies' output is not easily quantifiable. Withholding cost-of-living adjustments from them because their productivity could not be measured would be unfair. Other agencies may be already operating efficiently and may not be able to generate any productivity savings.

Thirdly, in most productivity plans, support staff, such as clerk-typists, are credited for the productivity of the entire agency. Thus, clerk-typists performing identical work at different agencies could be paid at different rates. Finally, in a City as highly unionized and politicized as New York, paying any agency a cost-of-living adjustment different from another agency would be difficult.

Thus, the issue of how productivity will be measured and how it will be rewarded remains to be resolved.

Issue: union rights and management prerogative

Work rules, whether or not they are formalized in a contract, exist in all places of work. Once they have become the "rule of the shop," both unions and workers are reluctant to change them, fearing that changes can only benefit the employer.

For example, in certain City agencies the night differential officially begins at 4:30 p.m. Some of the employees of those agencies may work a 9 to 5 shift, thereby earning one-half hour of night differential each day. Savings would result if the night rate began at 5 p.m., but unions, fearing a loss of pay for their members, have been unwilling to discuss the issue.

Unilateral exercise of certain management prerogatives can also be counterproductive. When the Sanitation Department recently purchased new trucks, they did not consult the workers. As a result, the new equipment was higher off the ground and more difficult to handle, thus damaging productivity.

Thus, both entrenched work rules and management rights may hamper increased productivity. Throughout our discussions both union and management repeated that they did not want to open these areas to discussion but felt that they had to. Whether they are merely paying lip service to the spirit of cooperation or whether it will become a reality remains to be seen.

Issue: incentives

A recent report of the New York City Productivity Council begins dismally with the question: "Why should municipal employees work harder? They get paid in any case, and receive virtually no rewards, nor recognition, nor satisfaction even from a job well done." No productivity plan can work unless it supplies an incentive.

The first issue is the nature of the incentive. Both the Transit Workers Union and Municipal Labor Committee agreements made cost-of-living adjustments the reward for increased productivity. However, the theoretical basis for such adjustments is not to increase real income but to prevent it from decreasing. The City agreements make it necessary for employees to increase productivity to maintain real income. Further, an outside force--inflation--determines the size of the adjustments.

Finally, money is not the only factor that motivates a work force. Many studies of New York discuss the demoralization of the work force and the need to revitalize the civil service. One State official cited the need for not only a 3-year budgetary plan, but also a 10-year plan of "retiring, retraining, and reorganizing" the bureaucracy.

Whether the necessary incentives, both monetary and psychological, can be made part of a productivity program remains an open issue.

### NEW YORK CITY REVENUE AND EXPENDITURE FORECASTS

For the best results, forecasts of New York City budgets should be based on a model of the City's economy and reflect the interrelatedness between the budget and the economy. However, time, cost considerations, and data availability prohibited us from constructing and implementing such a model. Instead, projections were developed and based upon the fact that tax revenues are determined by the statutory tax rate and the tax base to which that rate is applied. It is assumed that the tax rate will not change over the forecast period of 1978-85. However, changes in economic conditions generate changes in the tax base. For example, sales tax revenues obviously depend on consumer spending. With a constant rate, changes in sales tax revenues collected are related to changes in the base. A general economic upturn will increase consumer spending and increase the sales tax base.

New York City's revenues are divided into four categories: (1) general fund revenues, (2) Federal and State intergovernmental aid, (3) real estate taxes, and (4) other miscellaneous revenues. Different sets of factors affect each of these revenues. This appendix discusses these four revenues sources and presents the underlying assumptions for the revenue forecasts and the two sets of assumptions underlying the forecasts of the national economy. Finally, the assumptions underlying the expenditure forecasts are discussed.

#### TAX REVENUES

To forecast tax revenues, both the tax rate and the level of the tax base must be forecast. The tax rates are set autonomously by the City. Several factors must be considered in forecasting the tax base. The first concerns the legal definition. The City legally defines the tax base, and it can define new tax bases. It can also repeal certain taxes; and it can modify a tax base by exempting or newly including certain types of sales in the sales tax base.

Once a tax base is legally defined, however, three other factors can affect its level. One is the impact that the tax rate has on the size of the base. If the City imposes a personal income tax or increases the personal income tax rate, citizens may be motivated to move from the City to escape the tax burden. (This decreases the size of the personal income tax base and may also affect the size of other bases, such as the sales tax and property tax bases.) The strength of this motivation depends on

several factors, such as the level of personal income tax in areas around the city and the services, such as education, police protection, and housing, in the surrounding areas. Similarly, increases in the general corporation tax rate or the sales tax rate can prompt corporations to move from the city or shoppers to purchase goods and services outside the city. Again, the magnitude of these shifts depends on many factors. How quickly the shift occurs depends on the nature of the tax; it is much easier for consumers to change shopping habits than for a corporation to relocate.

Another factor that affects a city's tax base is the level of national economic activity. Fluctuations in aggregate economic activity may cause substantial variations in the level of the city's production, income, profits, and sales. Thus, to forecast a city's tax collections, national economic conditions and their effect on the city's tax base must be forecast. Some cities, of course, will feel the impact of changes in the national economy more than others.

#### REAL ESTATE TAX REVENUES

The responsiveness of the real estate tax base to changes in tax rates is not immediate. Residents of one area may move to another area in response to high property tax rates. Normally, however, the property is sold or rented to another. High property taxes tend to make a property less desirable, and this is reflected in lower market values. Consequently, increases in real estate tax rates may result in a lower real estate tax base. The real estate tax base is less sensitive to rate changes than are the personal income, corporate income, and sales tax bases.

#### USER CHARGE REVENUES

Tax revenues and user charge revenues are closely related. User charge revenues result from a charge imposed by a city on the use of a particular good or service it provides. The provision of water, electricity, and public transportation by a city is usually financed partly by charges imposed on their use. Bridge and tunnel tolls are also considered user charges. The level of user charge revenues collected by a city depends on the rate imposed by the city and the level of use by the city's residents. Forecasting user charge revenues requires a forecast of the rates and the usage. The demand for city-provided goods and services, usually public utilities, tends to be more stable than the demand for most privately provided goods and services. Consequently, most short- un forecasts of user charge revenues depend on a

simple extrapolation of past collections. Over the long run, however, deviations from past trends can become substantial if the underlying causes of the demand, such as population growth, industrial growth, and city income levels, change.

### INTERGOVERNMENTAL AID

There are two forms of Federal and State intergovernmental aid. The first is the restricted or categorical grant. These revenues must be used for a purpose specified by the government providing the funds. Usually, the city is required to provide some matching funds for this purpose. The second is general or unrestricted revenue sharing. These funds can be used by the city for any purpose and require no matching funds. They are allocated by a formula that depends on various demographic and fiscal characteristics of the city and the State.

Several factors must be considered in forecasting intergovernmental aid. The first is the overall level at which the Federal or State program is funded. This depends on the political climate and the fiscal conditions of the government funding the program. Changes in the demographic and fiscal conditions of the city specified in the allocation formulas must also be considered. For example, if the level of funds provided depends on population or some measure of tax effort and a city expects changes in these, the level of intergovernmental aid it receives will change. Finally, a city's receipt of categorical grants will decrease if it reduced its funding of programs supported by these grants. Forecasting the level of a city's receipts of intergovernmental aid requires a forecast of the level of funding of intergovernmental aid programs, a knowledge of the aid formulas, and a forecast of the city's expenditures on supported programs.

### QUANTITATIVELY BASED PREDICTIONS

1. Personal income tax on residents: Income tax collections in a given time period equal the sum of withholding deductions payments on current year's liability plus final payments on previous years' liabilities, less funds owed to those who had overpaid taxes in previous years.

However, no attempt was made to separate collections into these components. Instead, we assumed that over the fiscal year, the net sum of refunds and final payments is proportional to the sum of withholding and declaration payments and that, therefore, fiscal year collections may be treated as though they were composed solely of withholdings and declarations. This assumption allows us to

specify collections solely as a function of current tax law and current income. The forecast is adjusted for refunds.

Forecasts for fiscal year income tax collections are made by first constructing a tax rate for a single individual earning an average income and taking the standard deduction. In constructing the tax rate, a statute tax rate, tax brackets, the dollar value of an exemption, the percentage standard deduction was used. This constructed rate and a forecast of New York City income are then used to forecast fiscal year personal income tax exemptions.

2. General corporation tax: Revenue from this tax is forecast as a function of rate and estimated base. As with the personal income tax, no attempt was made to define the corporate liability as a separate time series distinct from collections. Fiscal year collections from the general corporation tax were assumed to be a function of the statute corporate tax rate applied to net income allocated to New York City, and the fiscal year average of corporate profits for nonfinancial corporations to pay more or less of their tax liability in the form of declarations payments rather than at the time they file their returns. (An expanded model would separate corporate collections into declarations, final payments, and refunds, treating each separately as a function of tax liability--also modeled separately--and business conditions.)

We also assumed that the percentage of corporate profits taxable by New York City declined in recent years. However, it seemed best to define the City's corporate tax base as a share of national profits. This was accomplished by creating a ratio of the number of large (100 or more employees) corporations in the City to the number national profits allowable to the City. 1/

3. Sales tax: The New York City sales tax is now administered by New York State. Sales tax revenue was defined as the statute rate times the estimated base. The City's estimated share of national consumption forms the tax base. That share is estimated to be the ratio of wages and salaries in the City to national wages and salaries, times the fiscal year average of national consumption. (This equation could be improved by explicit modeling the

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1/Such data may be found in County Business Patterns, Bureau of the Census (annual).

elements of consumption which are taxed, omitting those which are exempt from the tax.)

4. Commercial rent tax: This tax is imposed on tenants' property "occupied or used, or intended to be occupied or used, for carrying on any business, profession, or commercial activity." The rate of the tax is progressive with annual rent.

Fiscal year collections from the commercial rent tax are a function of the consumer price index for shelter in New York City and a weighted average of the lowest and highest statute rate of the tax.

5. Utility tax: The base of this tax is revenue received by privately owned utilities and is estimated as the product of "estimated output" and a price index.

6. Stock transfer tax: The New York City stock transfer tax rises from 1.25 cents per share sold on stock valued at \$5 or less per share to 5 cents per share sold on stock valued at more than \$20 per share. A surtax of 25 percent has been levied since 1966.

Lacking data on the distribution of share sold by price of share, we specified collections as a simple linear function of trading volume in the New York and American Exchanges. (The inclusion of an effective tax rate defined for the aforementioned dates on the distribution of shares sold by price of share would improve this equation. In addition, a well-specified submodel of the determinants of trading volume, in particular one which accounts for the relative decline of the American Exchange, would also improve forecasts of this tax.)

7. Unincorporated business tax: This is a 4-percent tax on the income of unincorporated business. Before January 1, 1971, the tax did not apply to lawyers, dentists, engineers, or veterinarians.

Fiscal year collections from the unincorporated business tax were defined as a function of the fiscal year average of New York City proprietor's income and a dummy variable defined to capture the higher percentage of income taxed when lawyers, etc., were included in the base.

#### QUALITATIVELY BASED PROJECTIONS

1. Other general fund: Those general fund revenues not forecast with an econometric model were projected by simply insuring that their respective bases remained constant in

real terms so that the dollar value of revenues increased with the inflation rate.

2. Federal and State grants-in-aid: Intergovernmental grants to the City were projected under the assumption that they would remain constant in real terms and that both the Congress and the State legislature would increase the grants to keep the City's buying power constant.

3. Real estate tax revenues: For real estate tax revenues, an inflationary forecast did not seem appropriate. The City's population has declined, as has the demand for housing and office space. The supply of housing in the City is falling, but at a slower rate than the demand for housing--both forces combine to drive down the market value of housing. It appears that the supply of office space is increasing. This, coupled with the decrease in demand for the space, will force the value of office space down quickly. Given this picture of the City's real estate market, we assumed that real estate tax revenues will remain constant in nominal terms, but decline in real terms, over the period of the forecast.

4. Other sources of revenue: This is a collection of miscellaneous revenue sources totaling about \$300 million in fiscal 1977. The bases of most of the entries in this category of revenues are not known. Therefore, we held the revenues constant in real terms--nominally increasing it by the rate of inflation.

#### REVENUE FORECASTS

As noted in chapter 2, a forecast of revenues depends to some degree on a forecast of national economic conditions, including inflation. Currently, large econometric models of the national economy are used to forecast national economic conditions. For example, New York City has constructed an econometric model to forecast some of its general fund tax revenues on the basis of forecasts of the national economy, and we developed an alternative model for the same purpose, as well as projections for intergovernmental revenues. The two economic scenarios chosen are the following:

Sustained growth: This is based on slow but steady growth in the U.S. economy, accompanied by low rates of inflation. Monetary policy is assumed to be moderately expansive to avoid the threat of a credit crunch in 1977.

Cyclical pattern: This is based on strong, real growth in the Gross National Product, high rates of interest in 1977, and a possible recession in late 1978 or 1979.

These two scenarios were used in generating the forecasts for the econometric portion of the general fund revenues and to generate the Gross National Product deflator used to project the remaining revenues and expenditures when such a rate was used.

### EXPENDITURE FORECASTS

Expenditure projections were generated by subtracting out debt service, holding the remaining expenditures constant in real dollars, increasing them by the inflation rate (Gross National Product deflator) forecast by the Data Resources, Incorporated, national econometric model. Debt service was held constant in dollar terms, falling in real terms.

### SUMMARY

Several qualifications should be mentioned. The revenue forecasts do not pick up any feedback effects from changes on the expenditure side of the budget. With increases due to inflation adjustments, this is not an important issue for these projections. Also, the inflation forecasts are for the U.S. economy. Thus, to the extent that these projections are higher or lower than the New York City inflation rate, the projections must be adjusted.

Finally, with more resources, especially more time, and assuming the appropriate data was available or could be generated, a theoretically more desirable model could be built--one that included more of the tax revenues and, possibly, user charge revenues. Expenditure forecasts by functional category could be used to generate estimated Federal and State inter-governmental aid. Such a model would be very useful in forecasting more accurate revenues and expenditures and could prove especially useful in the City's budgetary and program planning.

**The City of New York    Office of the Mayor    Office of Management and Budget**

Municipal Building  
New York, N.Y. 10007

Donald D. Kummerfeld  
Director

January 28, 1977

Mr. Dennis Dugan  
Associate Director  
Program Analysis Division  
United States General Accounting Office  
Washington, D.C.

Dear Dennis,

We have reviewed your report, "The Long-Term Fiscal Outlook for New York City." In the main, it is a thoughtful examination of the broader aspects of the City's current and long term fiscal difficulties, and we are impressed with the overall portrayal and breath of view of the report.

We concur with your conclusion that Federal and State action will be necessary if the City is to be restored to fiscal health. As aptly pointed out in your report, many of the City's problems are endemic to all Cities, are related to the entire economic outlook of the Northeast, and are tied to the economic conditions of the entire country. We agree that the City's problems, and the solutions to those problems are complex and not entirely within the City's control. We are pleased that your report recognizes that changes in Federal or State policies will relieve us from the burden of these uncontrollable areas. Mayor Beame in his introduction to the report "Program to Eliminate the Budget Gap, FY 78", dated 1/6/77, stated "The recovery of N.Y.C. will be possible only if the coalition of interest in the unions, financial community, State and Federal governments, and public at large continues to work together". (emphasis ours). He states further on in his introduction, "We cannot and should not absorb the full impact of the required savings alone". In the introduction to your report you state, "We believe that the solution involves a complex combination of actions that to be fully effective need to be developed in concert with each other."

It is obvious from the foregoing that the City is in general agreement with your report when it concludes that State and Federal action could help ameliorate the financial situation.

For the short-term problem we reaffirm our intent to balance our budget for FY78. Our plans are detailed in the report (mentioned earlier) entitled, "Program to Eliminate the Budget Gap, Fiscal Year 1978". This program was issued by the Mayor on 1/6/77 (copies were furnished to G.A.O. representatives on 1/25/77). We will continue to implement the austerity programs detailed in that report, to assure a balanced budget in 1978. During the past year and half the City has demonstrated its ability and resolve to effect the needed program reductions to balance its budget. The City is on or ahead of target in achieving the reductions outlined in the Mayor's March 25, 1976 program to close the FY 1977 Budget gap. For those few items which were not achieved, the City developed a substitute program which more than assure full accomplishment of the Fiscal year reduction goals to be carried forward to FY 1978.

In the introduction to your report, you state the Federal problem in the form of the following question, "If more Federal assistance is needed for New York City, are there specific policies (new or old) that the Federal Government can adopt within the general framework of fiscal Federalism which could help New York City?" We offer the following comments.

Proposals for aid:

The General Accounting Office's discussion of alternatives for aid to New York City and other areas facing similar financial stringencies are sound and helpful.

Aid to localities and encouragement of their self-help efforts are in the interest of the Federal Government. The return to the Federal Government in the form of increased taxes, lower social welfare expenditures due to increased employment, and higher income makes it in the Governments own best interest to foster development. Aid to the cities is repaid manyfold.

Discussions in the G.A.O. report include standby countercyclical measures, changes in the revenue-sharing program to give additional weight to factors that are indicative of a declining economic base, and suggestions for investment incentives for slower-growing localities. In addition, we would like to suggest that the Government consider recognition and aid for local development projects such as New York City's Economic Development Plan which utilizes the joint efforts of Government and industry to improve the economic climate.

There are several approaches that the Federal Government can adopt within the general framework of fiscal Federalism which would aid New York City:

1. Administrative actions increasing financial aid.
2. Assistance in securing financing
3. New legislation
4. Modifications of certain regulatory policies.

1. Administrative Actions:

The Federal government can provide substantial assistance to New York City by taking certain administrative actions that would add to the City's revenues, permit savings, or eliminate the threat of disallowances. The proposed actions constitute an opportunity, in many instances, to correct longstanding inequities and restore administrative balance to Federal urban programs. Some proposals would benefit New York City alone and would have minimal impact on the Federal budget. Others would have broader national fiscal impact.

Among the priority administrative actions with budgetary impact in fiscal 1978 are these:

- Westway: Final contract approval of the key transportation and economic development project, (recently approved by the Secretary of Transportation), could generate a net of approximately \$80 million in revenue for the City in fiscal 1978 through sale of the right-of-way.
- Community Development: By using regionally adjusted poverty figures (as suggested by the GAO) in determining the amount of CD block grants, the City's CD funding level would be increased by \$15 million.
- Revenue Sharing: Illegal aliens should be counted as part of our population base, and the Stock Transfer Tax should be included as part of the local effort. Together these would generate \$28 million.
- Title XX: When Titles IVa and XVI were replaced by Title XX of the Social Security Act, the City and State were in the process of submitting documented claims for services rendered under the old titles. These claims have not been fully paid. The City's outstanding share is \$120 million, while the State share would be approximately \$634 million. This matter is in litigation involving several states.

- Public Housing: The Federal government should pay housing authority police costs for Federal projects (\$16 million) and acquire State and City projects (\$35 million).
- Welfare: Expanding SSI disability eligibility (for children, alcoholics and addicts) and expediting cumbersome SSI disability eligibility procedures would save the City (and State) \$12 million.
- Drug Enforcement: Federal funding of drug law enforcement activities as part of the effort to provide New York City with a fair share of such funds would save the City \$34 million.

In addition to those proposals with budgetary impact in 1978, a series of other administrative actions have also been identified which have beneficial fiscal or economic impact but would not provide budgetary relief in 1978. Other proposed corrective action would eliminate a threat of hundreds of millions in disallowance which could be imposed unless certain administrative policies are changed.

## 2. Financing

A Federal program is needed for municipalities temporarily excluded from public and private debt markets to raise long-term and short-term financing. The most effective program would be a Federal guarantee or insurance of municipal securities. Neither would require a direct outlay of Federal funds and both would help municipalities to continue to sell their securities during the temporary period, facilitating their eventual return to the market, and thereby avoiding dissolution of the self financing process.

As a "last resort" measure, under crisis conditions, the Federal government might have a borrowing program, such as the Seasonal Loan Act, in effect to aid Cities in crisis. However, disincentives associated with the reporting and control requirements and the higher interest rate paid on Federally assisted borrowing would discourage all but essential use.

## 3. Legislation

The City's legislative priorities are:

- Extension of the Title I Public Works program by \$2 billion nationally, that would provide the City with an additional \$100 million for badly needed capital projects and badly

needed construction jobs. (The National League of Cities has asked for \$3.9 billion which would provide New York City with approximately \$200 million.)

- Increased Authorization for Title II Public Works (countercyclical): Increased authorization for countercyclical revenue sharing is needed if the City is to receive its 5th quarter payment (July 5, 1977) of \$16 million. Without such increased authorization, funds will be exhausted because of a projected national shortfall. Title II should also be extended for an additional four quarters to combat continuing high unemployment, with the City receiving incremental revenues of \$40 million in fiscal 1978 and \$15 million in fiscal 1979.
- Welfare Reform: The City supports full federalization of welfare cost beginning with full federal assumption of the City share at the earliest possible date. This should be done in a manner to achieve administrative savings, equal treatment nationally (with benefit related to cost-of-living) and a meshing of income security with job-creation and job training efforts. The City's annual share of welfare costs is \$441 million.
- Health Reform: The Federal government should similarly assume the local share of medical assistance costs, savings the City \$511 million annually. As a second phase effort, the Federal government should expand coverage for the medically indigent who do not currently qualify for medicaid.
- Mass Transit: New York City, with 33 percent of the mass transit ridership in the nation, receives only 10 percent of the operating assistance grants. This inequity should be corrected.

#### 4. Regulatory Policies

Various environment and transportation policies have the cumulative effect of placing urban areas like New York at a grave economic disadvantage, without achieving improvement in the environment, or significant savings. These should be reviewed with a consistent eye toward helping urban economic development.

In addition to the above solicited programs, the City is moving to revitalize its fiscal and economic base, specifically the development of the following item.

#### Economic Recovery Program

The report notes how New York City's fiscal situation is vitally affected by the condition of the local economy, and conversely, how the City's very high and continually rising taxes have adversely affected the local economic base. Various federal measures to help strengthen the economic base are mentioned. As you know, we have recently completed a detailed study aimed at securing a fundamental change in the City's policies as they affect our economic base. The proposed five-year economic recovery plan includes capping the real estate tax, reducing the commercial occupancy tax, eliminating the sales tax on machinery and equipment through a tax credit process, and a general commitment to reduce business taxes where possible. A great many other steps designed to improve the local business climate are also set forth. The program has been launched by the City Administration. Various implementing steps will require the approval of the Emergency Financial Control Board and state or local legislation.

The program inherently recognizes many of the points made in your report about the relationship between the City government and the local economic base. It is an attempt to deal as directly and effectively as possible with the problem at the local level. Your report specifically outlines the policy alternatives for providing economic stimulation at the federal level, or for providing special aid for impacted areas. You may now want to consider adding some additional material dealing with possible federal actions when a local recovery program is adopted in such impacted areas.

Also of noteworthy importance are the following items.

#### Financial Plan:

As an indication of New York City's ability to forecast 1978 revenues it can be noted that the FY 1976 revenue estimates were below target, as was desirable. As year end, the estimate was \$47 million less than the actual totals. Our provision for contingencies, then, was adequate. For FY 1977, the half-year revenue collections are now substantially ahead of the original estimates. Also, we have now received countercyclical revenue sharing payments that were not part of the original plan. Monthly collections of individual taxes are generally following the estimated patterns.

**Budgetary and Forecasting Procedures:**

The report notes the necessity of better budgetary and fiscal information systems, and better revenue and expenditures forecasting procedures for cities. To this end, New York City is currently implementing an Integrated Financial Management System (IFMS) to provide detailed, computer-accessible expenditure and revenue information by agency and subject category, this is the first step in a program making each agency responsible, in detail, for monitoring and estimating each revenue in relation to its associated expenditure programs. This is a pioneering effort. As the Report notes, the City also forecasts economically-sensitive tax revenues by regression equations. This is also a pioneering development in urban fiscal management--a monthly and annual breakdown of revenues is in use. The City's experience in the new accounting and forecasting systems will be of benefit to other localities.

Specific comments relative to the Appendixes attached to the draft report, were discussed at a meeting held on 1/25/77 between GAO representatives and N.Y.C. Office of Management and Budget personnel, and it was agreed that those comments would be incorporated into the final GAO report.

The following were among the other significant items agreed on:

- . Chapter II of the GAO report was being modified by GAO and would be forwarded to OMB.
- . Debt service rates would be removed from projections and held constant.
- . Receipt of title II money (approx. \$110 million) would be mentioned in the report.
- . Figures indicating projections of revenue and expenditures would be updated per OMB suggestions. Possibility that a caveat be inserted to the effect that these numbers change rapidly in this dynamic fiscal situation.
- . NYC's "Program to Eliminate the Fiscal Gap FY 78" would be considered in preparing final report.
- . Excerpts from NYC's "Economic Recovery Program" would be included in report.

If there any questions concerning this response please call me.

Sincerely,

A handwritten signature in black ink that reads "Donald D. Kummerfeld". The signature is written in a cursive style with a large, looped initial "D".

Donald D. Kummerfeld  
Director, Office of Management  
and Budget



State of New York  
Emergency Financial Control Board  
For the City of New York

270 Broadway  
New York, New York 10007  
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Stephen Berger  
Executive Director

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Mayor, City of New York

Harrison J. Goldin,  
Comptroller, City of New York

William M. Ellinghaus

David I. Margolis

Felix G. Rohatyn

January : , 1977

Mr. Francis X. Fee  
Regional Manager  
United States General  
Accounting Office  
26 Federal Plaza  
New York, New York 10007

Dear Mr. Fee:

I have reviewed with my staff the drafts of the GAO reports Concerning New York City's Longer Term Fiscal Outlook and Interim Assessment of New York City's Performance and Prospects Under Its Three Year Emergency Financial Plan.

[See GAO note, p. 160.]

The "Long Term Outlook" report raises several important issues with which I strongly agree. New York City's economic base has been declining for some time and at least part of this decline can be attributed to the actions of previous administrations which built a tax and service structure that is inhospitable to business and the middle class and could not be sustained by the region's declining economic base. It is also true that the City's budget is made up of many expenses which are largely uncontrollable such as pension costs, debt service, some social service and health costs, and to some extent, collective bargaining contracts. The point that the City has seriously weakened its economic base in order to serve its short term political and budgetary needs is a point that has been made in the past and is still valid. Most importantly, I agree with the report's recognition of the fact that major federal policy shifts are needed to address some of the problems of the nation's cities. As the report makes clear, the federal government has in the past directed specific forms of aid on a regional and categorical basis so a

precedent for a changed federal role in urban affairs does exist. The shift in investment of national resources to the sun belt and away from the Northeast must be reversed. Discriminatory Federal reimbursement formulas for such areas as social services, health care and transportation must be changed.

The "Short Term Outlook" report also makes several points which I feel are important. The report correctly points out that there was never a guarantee that a balanced budget in FY 1978 combined with management and budgetary improvements would enable the City to meet all of its credit needs in the private credit market by FY 1979. It was felt that such actions would, however, contribute to the restoration of the City's credit rating.

The report also recognizes the stability that the financial plan has provided to the City and the progress that has been made so far under the plan. These are all issues that are frequently overlooked but are properly acknowledged in the report. The most important issue that the report recognizes is that many of the problems faced by New York City and other cities in this country are intensified, if not caused, by economic and social conditions which are outside of local control. As Governor Carey pointed out in testimony before the Senate Committee on Banking, Housing and Urban Affairs on December 21, 1976, because of New York State's own tenuous position in the private credit market, there is a limit as to the amount of assistance that the state can provide to New York City. If the City cannot meet all of its credit needs privately by FY 1979, then it has no other options but to turn to the federal government for some form of assistance. These are issues that have been raised locally for some time and I feel that it is good that they are finally being raised in a new forum.

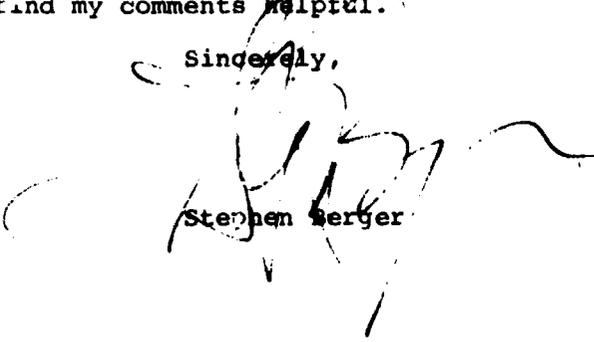
[See GAO note, p. 160.]

[See GAO note.]

The fact that the role of the federal government in local affairs is particularly confused is underscored by these two reports. The "Long Term Outlook" report gives a number of precedents for federal involvement in local affairs and describes a number of ways in which this might be done. In contrast, the "Short Term Outlook" report describes such activities as counter to our "decentralized form of government" and sees any form of government loan or loan guarantee program as acceptable only if the terms of such aid are made punitive. Since this report praises the determination of those in the City and State governments and seems to indicate that they are acting in good faith, it is somewhat unclear as to why the City needs additional inducements to seek credit through the private market. This is particularly difficult to understand since the report admits that many of the City's problems are not within the City's powers to address.

I appreciate the opportunity to comment on the GAO reports and I hope that you find my comments helpful.

Sincerely,



Stephen Berger

GAO note: Deleted materials were comments by the Executive Director stating that the two reports had conflicting conclusions concerning the City's prospects for balancing its budget by June 30, 1978. The language of both reports has been clarified.