# Review of the Mayor's Executive Budget for Fiscal Year 2004

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# I. Executive Summary

The current financial crisis began during FY 2002 and was precipitated by several factors, including previous fiscal policies, slowdowns in the national and local economies, the attack on the World Trade Center, and revenue and pension fund investment losses due to the stock market downturn.

The City's fiscal condition deteriorated further during FY 2003 as a result of continued weakness in the economy, which necessitated additional actions to maintain budget balance and to narrow an $8 billion budget gap for FY 2004. Wall Street economic activity, which accounts for 21 percent of all wages paid in the City, generated $7 billion in profits in calendar year 2002—45 percent less than forecast in June 2002, and down from $21 billion in 2000.

The FY 2004 budget gap was the largest faced by the City, both in absolute dollars and as a percentage of City fund revenues, since the 1975 fiscal crisis. Through a combination of City and State actions, which raised taxes and reduced planned spending, as well as assistance from the federal government, the four-year financial plan (the "April Plan") now shows a $1 billion surplus for FY 2003 and a balanced budget for FY 2004 (see Table 1).

To ensure budget balance in FY 2003 and to narrow an $8 billion gap for FY 2004, agencies cut planned spending by nearly $2.5 billion since June 2002 and the City Council approved a mid-year property tax hike of 18.5 percent. These actions restored budget balance in FY 2003 and cut the FY 2004 budget gap to $3.8 billion. To close the remaining gap, the Mayor's Executive Budget for FY 2004 includes additional City actions of $695 million and assumes assistance from the State and federal governments ($2.7 billion and $200 million, respectively), and the Port Authority of New York and New Jersey ($200 million).

The State Legislature recently took actions, despite the Governor's vetoes, that were instrumental in helping the City balance its FY 2004 budget. The Legislature restored most of the cuts in education and health care that were proposed by the Governor in January 2003 to balance the State budget, and funded them with an increase in State personal income and sales taxes. The Legislature also approved a City aid program that would increase personal income and sales taxes on City residents. The impact of higher State and City personal income taxes, however, would be more than offset by a recently enacted federal tax reduction program. The State Legislature also agreed to annually transfer $170 million to the City over the next 30 years through the Local Government Assistance Corporation, which could effectively relieve the City of the debt service costs on bonds issued by the Municipal Assistance Corporation. The Governor contends, however, that many of the actions taken by the State Legislature are unconstitutional, and the potential for litigation adds a degree of uncertainty to the FY 2004 budget.

Nevertheless, the change in the City's short-term fiscal outlook is dramatic and FY 2004 budget balance would be achieved without draconian cuts to core municipal services—although the current plan does entail layoffs and painful service reductions. City funding to the Department of Education, for example, has been reduced to the lowest level permitted under State law at the same time the department is under pressure to meet more stringent federal and State educational standards. The April Plan assumes that the City-funded workforce, including both part-time and full-time employees, will be reduced by 13,854 employees between June 2002 and June 2004, including 5,100 layoffs. The Mayor has indicated that some of the layoffs and budget cuts could be rescinded if the municipal unions agree to provide $600 million in assistance, but the City has rejected the unions' proposals although the parties continue to negotiate.

Even after balancing the FY 2004 budget, the City will continue to face budgetary constraints for the foreseeable future. While City-funded spending is projected to grow at an average annual rate of 5.8 percent during the plan period, most of the growth is focused in areas largely outside the City's direct control. Pension costs are projected to rise from $1.5 billion in FY 2003 to $4.8 billion by FY 2007, an annual rate of 33 percent, which reflects pension fund investment losses. City debt service costs, despite deep cuts to the capital program, are projected to grow at an annual rate of 9.9 percent, and health insurance costs for both municipal employees and the indigent continue to grow faster than revenues.

Our review finds that the FY 2004 budget gap has been reduced to a manageable level, assuming implementation of the State budget (see Table 2). Although the out-year budget gaps have been greatly reduced they are still substantial, in part because the benefit from some of the actions authorized by the Legislature, such as raising taxes, will be phased out over the next few years. We estimate that the out-year gaps could total $3 billion in FY 2005 and about $4 billion in each of fiscal years 2006 and 2007. The size of the out-year budget gaps will also depend on the pace of the economic recovery and whether future wage increases for municipal employees will be funded entirely with productivity savings as assumed in the April Plan, which is a strategy the City has been unable to implement since the 1970s fiscal crisis.

Although the FY 2004 budget still includes some risks, the City has demonstrated its ability to manage the budget during these difficult times and to obtain needed assistance from the State and federal governments. The City will continue to look to the federal and State governments and the municipal unions for assistance, but the responsibility for balancing the budget remains with the City. Additional City actions will be needed to close the FY 2005 budget gap, and such actions are likely to focus on reducing costs because the City is unlikely to further increase taxes in the near future.

## Table 1
## Four-Year Financial Plan

(in millions)

| REVENUES | FY 2004 | FY 2005 | FY 2006 | FY 2007 |
|---|---|---|---|---|
| Taxes | | | | |
| General Property Tax | $ 11,176 | $ 11,579 | $ 12,002 | $ 12,446 |
| Other Taxes[1] | 12,414 | 13,136 | 13,967 | 14,837 |
| Tax Audit Revenue | 525 | 505 | 505 | 505 |
| Tax Program | 1,400 | 1,483 | 1,575 | 1,686 |
| Miscellaneous Revenue[1] | 4,316 | 4,558 | 4,052 | 4,077 |
| Unrestricted Governmental Aid | 555 | 555 | 555 | 555 |
| Anticipated Federal & State Aid | 600 | 1,050 | 1,250 | 1,250 |
| Less: Intra-City Revenues | (1,075) | (1,072) | (1,070) | (1,070) |
| Grant Disallowances | (15) | (15) | (15) | (15) |
| Discretionary Transfers | 775 | - - - | - - - | - - - |
| Subtotal: City Funds | $ 30,671 | $ 31,779 | $ 32,821 | $ 34,271 |
| Other Categorical Grants | 816 | 739 | 759 | 774 |
| Inter-Fund Revenues | 317 | 310 | 310 | 310 |
| Total City & Inter-Fund Revenues | $ 31,804 | $ 32,828 | $ 33,890 | $ 35,355 |
| Federal Categorical Grants | 4,464 | 4,363 | 4,347 | 4,357 |
| State Categorical Grants | 8,255 | 8,346 | 8,409 | 8,481 |
| **Total Revenues** | $ 44,523 | $ 45,537 | $ 46,646 | $ 48,193 |
| **EXPENDITURES** | | | | |
| Personal Service | | | | |
| Salaries and Wages | $ 16,095 | $ 16,099 | $ 16,102 | $ 16,106 |
| Pensions | 2,719 | 3,443 | 4,398 | 4,986 |
| Fringe Benefits | 4,797 | 5,057 | 5,354 | 5,651 |
| Subtotal - Personal Service | $ 23,611 | $ 24,599 | $ 25,854 | $ 26,743 |
| Other Than Personal Service | | | | |
| Medical Assistance | $ 4,238 | $ 4,387 | $ 4,531 | $ 4,535 |
| Public Assistance | 2,092 | 2,099 | 2,101 | 2,103 |
| All Other | 11,815 | 11,972 | 12,184 | 12,393 |
| Subtotal - Other Than Personal Service | $ 18,145 | $ 18,458 | $ 18,816 | $ 19,031 |
| Debt Service | 3,259 | 3,514 | 3,655 | 3,868 |
| MAC Debt Service | 531 | 490 | 492 | 494 |
| General Reserve | 300 | 300 | 300 | 300 |
| Discretionary Transfers[1] | (248) | - - - | - - - | - - - |
| | $ 45,598 | $ 47,361 | $ 49,117 | $ 50,436 |
| Less: Intra-City Expenses | (1,075) | (1,072) | (1,070) | (1,070) |
| **Total Expenditures** | $ 44,523 | $ 46,289 | $ 48,047 | $ 49,366 |
| **Gaps To Be Closed** | **$ - - -** | **$ (752)** | **$ (1,401)** | **$ (1,173)** |

[1] The City plans to transfer more than $1 billion in surplus resources from FY 2003 to FY 2004 by delaying the receipt of $775 million in revenue from the Transitional Finance Authority and TSASC until FY 2004, and by prepaying $248 million of FY 2004 subsidies and debt service costs in FY 2003.

# Table 2
## OSDC Risk Assessment of NYC Financial Plan
(in millions)

| | *Better/(Worse)* | | | |
|---|---|---|---|---|
| | **FY 2004** | **FY 2005** | **FY 2006** | **FY 2007** |
| **Gaps per April 2003 Plan** | **$ - - -** | **$ (752)** | **$ (1,401)** | **$ (1,173)** |
| **OSDC Budget Risks** | | | | |
| **Outside the City's Direct Control** | | | | |
| State Assistance | (207) | (1,175) | (1,837) | (2,333) |
| Port Authority Airport Lease Payments | (200) | (583) | (96) | (99) |
| Sale of Tax Benefits | (100) | - - - | - - - | - - - |
| Federal Assistance | 150 | (250) | (250) | (250) |
| **Subtotal** | **(357)** | **(2,008)** | **(2,183)** | **(2,682)** |
| **Estimation** | | | | |
| Police Overtime | (100) | (125) | (125) | (125) |
| Medicaid Costs | (50) | (150) | (150) | (150) |
| **Subtotal** | **(150)** | **(275)** | **(275)** | **(275)** |
| **OSDC Risk Assessment** | **(507)** | **(2,283)** | **(2,458)** | **(2,957)** |
| **Remaining Gaps to be Closed** | **$ (507)** | **$ (3,035)** | **$ (3,859)** | **$ (4,130)** |
| **Other Risks and Offsets** | | | | |
| General Reserve | 300 | 300 | 300 | 300 |
| Pension Fund Investment Performance[2] | 75 | 180 | 320 | 490 |
| Wage Increases at the Projected Inflation Rate | (750) | (1,200) | (1,700) | (2,300) |

[2] The pension funds earned about 2 percent on their investments through May 30, 2003, compared with an actuarial assumption of an 8 percent gain for the year. The April Plan, however, assumes a loss of 8 percent for the year. If pension fund investment earnings do not deteriorate during the balance of the current fiscal year, pension contributions could be lower than estimated in the April Plan.

# II. Fiscal Year 2003

The current financial crisis was precipitated by a number of factors, but the most significant were the slowdown in the national and local economies, the effects of the attack on the World Trade Center, and the downturn in the stock market that affected both revenues and pension fund investment performance.

The City adopted a balanced budget in June 2002 that included savings from agency actions and assistance from the State and federal governments and the municipal unions. It also relied heavily on nonrecurring resources, including $1.5 billion in bond proceeds (i.e., deficit financing) from the Transitional Finance Authority (TFA) to offset revenue losses related to the attack on the World Trade Center.[3] While nonrecurring resources helped to balance the FY 2003 budget, last June the City still projected a budget gap of $3.7 billion for FY 2004. As FY 2003 progressed, the City's financial situation deteriorated further, and adverse developments created a budget gap of $1.8 billion in FY 2003 and widened the FY 2004 budget gap by $4.4 billion, to $8.1 billion (see Table 3).

Revenue collections fell short of the City's projections last June, by nearly $1.1 billion in FY 2003 and by an average of more than $2 billion beginning in FY 2004. This was primarily due to continued weakness in the economy and Wall Street profits and bonuses that were lower than expected. In addition, the City achieved less than half of the $500 million in recurring savings that was anticipated from the municipal labor unions. Pension costs are now projected to exceed last June's projections by $104 million in FY 2003 and by more than $900 million by FY 2006, in large part because pension fund investment earnings in fiscal years 2002 and 2003 were lower than expected. The City was also unable to complete a planned lease financing arrangement to convey title to a private entity for tax benefits in FY 2003, and Medicaid and agency spending exceeded the City's overly conservative estimates. Moreover, the Governor proposed a budget in January 2003 that would have reduced City education aid and funding for health care and social services by $853 million in FY 2004.

To maintain budget balance in FY 2003 and to narrow the ballooning out-year budget gaps, the City implemented a mid-year property tax increase of 18.5 percent in January 2003 and cut planned agency spending. These actions generated $1.7 billion in FY 2003 and recurring resources of about $3.3 billion beginning in FY 2004. In addition, the federal government provided the City with $420 million in FY 2003 to reimburse the City for costs related to the attack on the World Trade Center, and the City also obtained one-time savings from debt refundings and by drawing down reserves. These actions

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

more than offset the impact of the adverse developments in FY 2003 and narrowed the FY 2004 budget gap to $3.8 billion.

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

(in millions)

| | *Better/(Worse)* | | | |
|---|---|---|---|---|
| | **FY 2003** | **FY 2004** | **FY 2005** | **FY 2006** |
| **Surplus/(Gaps) per June 2002 Plan** | **$ - - -** | **$ (3,729)** | **$ (4,224)** | **$ (4,590)** |
| **New Needs** | | | | |
| Shortfall in Revenues | (1,083) | (2,050) | (2,147) | (1,923) |
| Shortfall in Anticipated Savings from Municipal Unions | (223) | (296) | (291) | (412) |
| Pension Costs | (104) | (284) | (562) | (911) |
| Delay in the Sale of Tax Benefits | (100) | 100 | - - - | - - - |
| Medicaid Costs | (28) | (74) | (76) | (77) |
| Agency Spending | (293) | (587) | (465) | (423) |
| Impact of the Governor's Executive Budget | - - - | (853) | (853) | (853) |
| Cancellation of the Planned Sale of OTB | - - - | (250) | - - - | - - - |
| Increase General Reserve | - - - | (100) | (100) | (100) |
| **Subtotal** | **(1,831)** | **(4,394)** | **(4,494)** | **(4,699)** |
| **Resources** | | | | |
| 18.5 Percent Mid-Year Property Tax Increase | 837 | 1,727 | $ 1,800 | $ 1,875 |
| Agency Actions | 887 | 1,577 | 1,461 | 1,532 |
| FEMA Aid | 420 | - - - | - - - | - - - |
| Drawdown of FY 2003 Reserves | 360 | - - - | - - - | - - - |
| Debt Service | 205 | (64) | (2) | (6) |
| Pension Fund Valuation | 145 | 60 | 42 | 17 |
| **Subtotal** | **2,854** | **3,300** | **3,301** | **3,418** |
| **Net Change During FY 2003** | **1,023** | **(1,094)** | **(1,193)** | **(1,281)** |
| Surplus Transfer | (1,023) | 1,023 | - - - | - - - |
| **Budget Gaps per April Plan** | **$ - - -** | **$ (3,800)** | **$ (5,417)** | **$ (5,871)** |

Source: NYC Office of Management and Budget; OSDC analysis

# III. Fiscal Year 2004 Gap-Closing Program

Since June 2002, the City has had to close a cumulative budget gap of more than $8 billion for FY 2004. During FY 2003 the City raised property taxes by 18.5 percent and implemented agency actions that reduced the FY 2004 gap to $3.8 billion. To close the remaining gap, the April Plan assumes that the State will take actions that will generate $2.7 billion in FY 2004; that the federal government will increase assistance to the City by $200 million; and that the Port Authority of New York and New Jersey will increase its airport lease payments by $200 million (see Table 4).

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

| | *Better/(Worse)* | | | |
|---|---|---|---|---|
| | **FY 2004** | **FY 2005** | **FY 2006** | **FY 2007** |
| **Gaps per April Plan** | **$ (3,800)** | **$ (5,417)** | **$ (5,871)** | **$ (5,757)** |
| City Actions | 695 | 660 | 660 | 660 |
| State Actions | 2,705 | 3,172 | 3,464 | 3,575 |
| Federal Actions | 200 | 250 | 250 | 250 |
| Port Authority Airport Lease Payments | 200 | 583 | 96 | 99 |
| **Remaining Gaps to be Closed** | **$ - - -** | **$ (752)** | **$ (1,401)** | **$ (1,173)** |

Source: NYC Office of Management and Budget

The State faces its own budget crisis and must close a budget gap of $11.5 billion for the State fiscal year that began April 1, 2003. To close this gap, the Governor proposed a number of actions in January 2003, including borrowing $4 billion and reducing funding to education and health care by $2.2 billion. The State Legislature, however, is opposed to large reductions in these programs and in an extraordinary turn of events has approved its own budget, which restores most of the cuts and funds them with new taxes. The State Legislature also approved an aid program for New York City that would allow the City to raise the sales tax and a surcharge on personal income taxes, and that could effectively relieve the City of the debt service costs on bonds issued by the Municipal Assistance Corporation. These actions, in combination with the restoration of the budget cuts proposed by the Governor, would provide the City with an estimated $2.5 billion in FY 2004, $2 billion in FY 2005, $1.6 billion in FY 2006, and $1.2 billion in FY 2007.

The Governor is opposed to higher taxes and vetoed most of the Legislature's budget, including the program that would benefit the City. While the Governor proposed an alternative plan that would have provided the City with $1.8 billion in FY 2004, the State Legislature rejected the Governor's plan and overrode the Governor's vetoes with support from the Mayor. The Governor contends that certain elements of the Legislature's budget are unconstitutional and has encouraged taxpayers to initiate litigation. For example, the Governor believes that the City aid program is unconstitutional because it violates the requirement that program bills be single-purpose. In this case, the City aid program also includes assistance for the City of Buffalo. While the actions taken by the State Legislature would help balance the FY 2004 budget and make progress toward recurring budget balance, there remains the risk that elements of the State budget will be overturned by the courts or impeded by other obstacles.

## A. City Actions

Between January 1, 2002 and January 31, 2003, the City implemented agency actions with a cumulative value of $2.6 billion in FY 2004 (see Table 5). Most of these resources result from actions that reduced planned City-funded spending, including reestimates and actions that shifted costs to other levels of government, but a significant portion of the resources come from actions that affect basic municipal services.

The largest cuts took place in the Department of Education and the uniformed agencies. Funding for the Department of Education was reduced by $684 million at a time when the department is trying to meet stricter State and federal educational standards. Similarly, funding to the uniformed agencies, which include the Police and Fire departments, was reduced by $603 million at a time when concern about terrorism and safety are especially acute. The Police Department, for example, intends to reduce the size of the police force by 2,100 officers during FY 2004.

The agency program also includes a number of actions that increase projected revenues by $364 million in FY 2004. For example, the City received State approval last year to increase traffic fines ($62 million) and surcharges on landline and cellular phones to help fund the E911 program ($45 million). In addition, the City plans to hire 300 additional traffic enforcement agents to increase ticket issuances ($69 million), and the Department of Finance plans to increase audit revenues ($75 million).

The April Plan includes additional agency actions valued at $620 million in FY 2004, and similar amounts in subsequent years, which would increase the value of agency actions since January 2002 to $3.2 billion in FY 2004 (see Table 5). This latest round of budget cuts would reduce the City-funded workforce by 4,800 full-time and part-time employees, including 4,000 layoffs. On May 16, 2003, the City laid off 2,000 employees,[4] but it will take up to two months to complete the administrative process to remove all the employees from the City's payroll. City funding to the Department of Education would be reduced by another $179 million in FY 2004, to the

[4] The City laid off 1,068 employees prior to the April Plan.

lowest level permitted under State law. To offset the loss of funding, the department plans to reduce its workforce by 2,395 employees—mostly classroom paraprofessionals, school aides, and school-lunch workers.

## Table 5
## Agency Gap-Closing Program

(in thousands)

| | January 2002 to February 2003 | | | April 2003 Agency Program | | |
|---|---|---|---|---|---|---|
| | Expense Reductions | Revenue Increases | Total | Expense Reductions | Revenue Increases | Total |
| **Uniformed Forces** | | | | | | |
| Police Department | $ 245,605 | $ 107,600 | $ 353,205 | $ 60,000 | $ - - - | $ 60,000 |
| Fire Department | 94,148 | 10,287 | 104,435 | 26,523 | 441 | 26,964 |
| Dept. of Correction | 160,183 | 1,200 | 161,383 | 13,767 | 120 | 13,887 |
| Dept. of Sanitation | 102,887 | 10,550 | 113,437 | 20,071 | 15,600 | 35,671 |
| **Subtotal** | **602,823** | **129,637** | **732,460** | **120,361** | **16,161** | **136,522** |
| **Health and Welfare** | | | | | | |
| Children's Services | 185,955 | 1,828 | 187,783 | 31,213 | - - - | 31,213 |
| Dept. of Social Services | 92,205 | - - - | 92,205 | 27,878 | - - - | 27,878 |
| Dept. of Homeless Services | 44,436 | - - - | 44,436 | 17,807 | - - - | 17,807 |
| Health & Mental Hygiene | 86,799 | 6,700 | 93,499 | 25,958 | - - - | 25,958 |
| **Subtotal** | **409,395** | **8,528** | **417,923** | **102,856** | **- - -** | **102,856** |
| **Covered Organizations** | | | | | | |
| Department of Education | 684,314 | - - - | 684,314 | 178,777 | - - - | 178,777 |
| Health and Hospitals Corp. | 17,972 | - - - | 17,972 | 10,082 | - - - | 10,082 |
| CUNY | 10,921 | - - - | 10,921 | 2,231 | - - - | 2,231 |
| **Subtotal** | **713,207** | **- - -** | **713,207** | **191,090** | **- - -** | **191,090** |
| Libraries & Cultural Affairs | 71,473 | - - - | 71,473 | 17,492 | - - - | 17,492 |
| Department of Aging | 49,703 | - - - | 49,703 | 8,211 | - - - | 8,211 |
| Department of Finance | 12,523 | 81,179 | 93,702 | 3,533 | 13,750 | 17,283 |
| All Other | 355,380 | 145,046 | 500,426 | 121,220 | 25,582 | 146,802 |
| **Total** | **$ 2,214,504** | **$ 364,390** | **$ 2,578,894** | **$ 564,763** | **$ 55,493** | **$ 620,256** |

Source: NYC Office of Management and Budget

The Police Department plans to reduce overtime expenditures by $60 million next year, primarily by eliminating targeted enforcement programs that are funded with overtime. These programs include Operation Condor and other narcotics and quality-of-life initiatives. In addition, the City plans to lay off one third of the cleaning staff in the City's homeless shelters, and also to reduce, by more than 50 percent, funds that provide aftercare services to help families avoid returning to shelters. The April Plan also eliminates subsidies for the Prospect Park and the Flushing Meadows zoos, which could result in their closure.

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

## B. State Actions

The April Plan assumes that State actions will generate $2.7 billion in FY 2004—more than two thirds of the resources needed to balance the City's budget. The State Legislature approved a budget that restores most of the budget cuts proposed by the Governor and also approved a City aid program. The aid program would allow the City to raise personal income and sales taxes, and authorizes the State to effectively assume the debt service costs on outstanding debt of the Municipal Assistance Corporation. These actions would benefit the City's financial plan by about $2.5 billion in FY 2004, but the level of State assistance would decline in subsequent years because the higher taxes are scheduled to be phased out and other initiatives have only short-term benefits (see Table 6). There remains the possibility, however, that the State will take additional actions to aid the City. For example, the City and the Metropolitan Transportation Authority are seeking to reach an agreement that would provide the City with additional budget relief.

**Table 6**
**Preliminary Analysis of the Impact of State Actions On New York City's Financial Plan**

(in millions)

| | FY 2004 | FY 2005 | FY 2006 | FY 2007 |
|---|---|---|---|---|
| **Anticipated State Aid** | **$ 2,705** | **$ 3,172** | **$ 3,464** | **$ 3,575** |
| **Impact of State Actions** | | | | |
| Personal Income Tax | 645 | 546 | 344 | 15 |
| MAC Debt Relief | 530 | 491 | 491 | 494 |
| Education Aid | 474 | 444 | 382 | 382 |
| Sales Tax | 391 | 380 | 276 | 283 |
| Financing Initiatives | 218 | 30 | 30 | 30 |
| Other | 240 | 106 | 104 | 38 |
| **Total** | **2,498** | **1,997** | **1,627** | **1,242** |
| **State Aid Shortfall** | **$ (207)** | **$ (1,175)** | **$ (1,837)** | **$ (2,333)** |

Source: NYS Legislature; NYS Governor; NYC OMB; OSDC analysis

*Personal Income Tax*

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

The City's surcharge would parallel the new three-year surcharge enacted by the State Legislature to help balance the State budget. The State surcharge also adds two new rate brackets and expands the use of rate benefit recapture provisions in order to eliminate the benefit of the lower rates at the bottom of the rate table for taxpayers in the three top-rate brackets. The effect would place these taxpayers into one of three flat rates. In general, we estimate that higher State and City personal taxes on City residents would cost about $1 billion, but would be more than offset by reductions in federal personal income taxes enacted by Congress (see "Federal Actions" for further discussion).

*Municipal Assistance Corporation*

The State legislature passed legislation that provides $170 million in annual assistance to New York City through the Local Government Assistance Corporation. Although the City has not yet stated its plans for the money, one proposal would create a new local benefit corporation that would issue debt to defease the $2.1 billion of outstanding Municipal Assistance Corporation (MAC) debt. MAC was created in June 1975 to provide financing assistance to the City during the 1970's fiscal crisis, when the City had lost access to the credit markets. The $170 million is about equal to the annual debt service costs of refinancing the outstanding MAC debt over a 30-year period. Under this plan, the State would effectively assume the cost of MAC's debt, relieving the City of about $500 million in annual debt service costs through FY 2008. While this transaction would benefit the City budget by $2.5 billion over five years, the cost to the State would total $5.1 billion over 30 years.

The ability to refinance the MAC debt on a tax-exempt basis would be subject to the provisions in the federal economic stimulus package that were enacted in the aftermath of the attack on the World Trade Center. This package permits New York City and New York State to each refinance up to $4.5 billion in tax-exempt bonds a second time until December 31, 2004. While the City has refinancing capacity under this package, MAC bonds may be ineligible. An alternative to tax-exempt refinancing would be to issue more costly taxable bonds, which are not subject to the limits that pertain to tax-exempt bonds.

*Education Aid*

In January 2003, the Governor proposed reducing State education aid by $1.4 billion, including $478 million in aid to the City. The State Legislature, however, restored $374 million of the Governor's proposed budget cuts and took other actions that will provide the City with additional aid. The City would realize $62 million in each of fiscal years 2004 and 2005 by extending, from ten to twenty years, the repayment schedule for loans from the Municipal Bond Bank Agency for State education aid owed to the City from prior years, and by postponing debt payments for two years. In addition, the City would receive a State education aid advance of $30 million in FY 2004. The City would also continue to have flexibility in the use of resources for teacher recruitment and retention in hard-to-staff schools ($8 million). While the State Legislature did not appropriate resources specifically to extend the school day, sufficient resources should be generated from its actions so that the City should be able to fund this program itself.

*Sales Tax*

The State Legislature authorized the City to raise its sales tax by one eighth of a percentage point beginning June 1, 2003 and ending May 31, 2005. As part of the sales tax increase included in the budget adopted by the State Legislature, the exemption on clothing items that cost less than $110 was suspended from June 1, 2003 through May 31, 2004 (although this exemption would still be allowed during two one-week periods if approved by the City Council). The rate increase is estimated to be worth about $118 million in FY 2004 and $111 million in FY 2005, and the elimination of the clothing exemption would generate another $273 million in FY 2004 for a total of $391 million in that year. If the City Council approves the two one-week exemption periods, collections would be reduced by about $20 million. In addition, the City could realize recurring revenues if it chooses not to reinstate the clothing exemption in June 2004.

The City sales tax increase parallels an increase in the State sales tax also approved by the Legislature. The Statewide sales tax rate would be increased by one quarter of a point, to 4.25 percent, for the two-year period ending May 31, 2005. The suspension of the sales tax exemption for clothing items that cost less than $110 dollars would also apply. For City residents, the combined State, City, and Metropolitan Transportation district sales tax rate would now be 8.625 percent, compared to the current 8.25 percent. The combined rate results in $3.75 in additional tax for every $1,000 of taxable purchases. The elimination of the clothing exemption, however, has a much greater impact: Every $1,000 spent on smaller, formerly tax-exempt items would now cost an additional $86 in sales tax.

*Financing Initiatives*

The State Legislature enacted certain financing reforms that would provide the City with $218 million in FY 2004 and $30 million in subsequent years. These initiatives would allow the Battery Park City Authority to restructure its debt, which would facilitate the purchase of City-owned land and provide the City with $150 million in FY 2004. In addition, the City would be able to continue the use of swaps and floating rate debt, which would reduce debt service costs by $35 million in FY 2004 and by $30 million in subsequent years. In addition, the Dormitory Authority has refinanced debt on behalf of the City University of New York, which would generate savings of $15 million in FY 2003 and $18 million in FY 2004. The Legislature has not yet approved changes in the tax code that would enhance the lease financing arrangements relating to the sale of tax benefits to a private entity. The City was unable to complete this transaction during FY 2003 as planned, and the April Plan now assumes that the transaction will be completed during FY 2004 and that the City will realize $100 million.

*Other State Actions*

The State Legislature also approved a number of other actions that will generate $240 million in FY 2004, about $105 million in each of fiscal years 2005 and 2006, and $38 million in FY 2007. For example, the State Legislature accelerated revenue-sharing payments to the City so that they will be made in December 2004 instead of March 2005, which would allow the City to realize a one-time benefit of $73 million in FY 2004. The Legislature also authorized the City to sell 900 additional taxi medallions ($65 million annually during fiscal years 2004 through 2006); to levy a 25 percent property tax surcharge on absentee landlords of class one (small residential) properties ($45 million annually); a tax amnesty program for City businesses ($20 million in FY 2004); and to modify its business taxes to conform to State law on a trademark–loophole closing provision ($40 million annually). Currently, many corporations have transferred ownership of their trademarks to separate companies in low tax states. Royalty payments for the use of these trademarks are then made to these out-of-state companies, reducing corporations' New York State taxable income. These resources would be partially offset by additional health and social service costs.

## C. Federal Actions

The April Plan assumes that the federal government will provide the City with $200 million in assistance in FY 2004 and $250 million in subsequent years. The federal government recently approved an appropriation bill that includes $700 million in counterterrorism funds for high-risk cities. It is estimated that New York City could receive about $200 million and a significant portion could be used to help balance the City's budget in FY 2004. In addition, the tax reduction bill recently passed by Congress and signed into law by the president provides $20 billion in budget relief over two years to states and localities. The first $10 billion is targeted for Medicaid relief and it is estimated that New York City will receive as much as $290 million over the 15-month period ending June 30, 2004. The second $10 billion would be provided to the states in the form of revenue sharing and New York State would receive about $650 million. Whether New York City and other localities would share the benefit remains to be seen. Nonetheless, it appears that New York City will receive at least $350 million in additional federal assistance over the next 15 months—$150 million more than anticipated in the April Plan—but the level of assistance in subsequent years remains uncertain.

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

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

We estimate that the collective effect of the dividend/capital gains reduction, the acceleration of the planned rate reductions, marriage penalty relief, and expansion of the 10 percent rate bracket will save City residents approximately $3.2 billion in the first year, which would more than offset State and City personal income tax surcharges. In addition, the federal reduction would also benefit taxpayers with incomes lower than $100,000. Table 7 presents examples of average taxpayers at various income levels to illustrate the combined impact of the State and City personal income tax increases and the offsetting federal tax benefit.

## Table 7
## Impact of Changes in Federal, State, and City Personal Income Taxes on City Residents

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

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

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

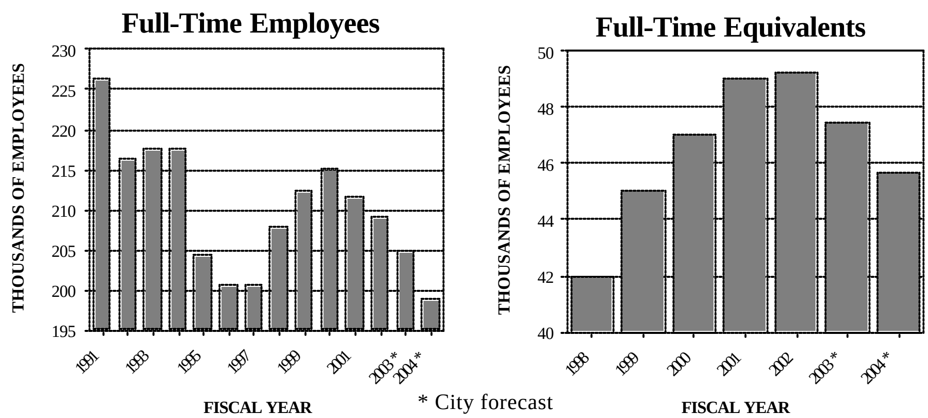
For years, the City has sought additional payments from the Port Authority of New York and New Jersey for leasing LaGuardia and Kennedy airports. The Port Authority is a bistate agency, which is effectively controlled by the governors of New York and New Jersey. Newark Airport recently reached a settlement with the Port Authority for a retroactive payment and an increase in future payments. The Governor promised to obtain $500 million for the City, and in the event that an agreement is reached with the City the Port Authority has set aside $350 million in its capital budget. The April Plan anticipates $200 million in FY 2004, $583 million in FY 2005, and nearly $100 million annually thereafter. It remains to be seen whether the City and the Port Authority will reach an agreement. In addition, there have been discussions between City and State officials about swapping the land under the City's airports for the World Trade Center site.

# IV. Downsizing the Workforce

The City has faced difficult financial times in the past and each time it has responded by scaling back the size of its workforce. During the 1970s fiscal crisis, the City reduced full-time staffing levels by nearly 61,000 employees, or more than 20 percent. This was accomplished through attrition and by laying off tens of thousands of employees, including teachers, police officers, and firefighters. In FY 1991, the City-funded workforce was reduced by about 10,000 employees through attrition, early retirement, and 4,000 layoffs. During fiscal years 1994 and 1995 the workforce was reduced again, by 18,337 employees over an 18-month period, with the assistance of large severance programs funded by the Municipal Assistance Corporation.[5]

**Graph 1**

***CITY-FUNDED WORKFORCE***




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

Source: NYC Office of Management and Budget; OSDC analysis

During fiscal years 1998 through 2000 the full-time workforce grew by 14,000 employees (mostly police officers and teachers), funded with unanticipated tax revenues from the Wall Street boom. The workforce contracted during fiscal years 2001 and 2002 but was still larger than in FY 1996, by 8,500 employees (see Graph 1). There was also a large increase in the number of part-time employees between FY 1998 and FY 2002, as agencies compensated for cuts in staffing during fiscal years 1995 through 1997 and the Department of Education staffed summer and other remedial programs with per-session teachers.

[5] The MAC-funded severance programs implemented during fiscal years 1994 and 1995 attracted 13,854 employees, producing an estimated $470 million in savings but at an initial cost of $264 million.

Cutting the City's workforce without affecting basic municipal services is more difficult now than in the past because a greater percentage of the workforce is comprised of teachers and police officers. In June 2002 they accounted for 56 percent of the City workforce, compared with 45 percent in FY 1991. Teachers and all uniformed employees made up 70 percent of the workforce in FY 2002, compared with 59 percent in FY 1991. In contrast, the number of employees assigned to the Parks Department and health and welfare agencies declined, from 17 percent of the workforce in FY 1991 to 10 percent in FY 2002—a reduction of 16,350 employees, or 43 percent.

Since June 2002, the workforce has been reduced through a hiring freeze, attrition, early retirement, and layoffs. An early retirement program authorized by the State last June attracted 4,411 full-time employees. Layoffs have already occurred in the Department of Education (342), Department of Sanitation (541), and the Police Department (61), and the April Plan contemplates 4,000 more.

The City has recently changed the way it reports the size of its workforce. In prior years the City only reported the number of full-time employees. More recently, it has begun to report the number of part-time employees, measured as full-time equivalents. In addition, the City recently reclassified certain employees of the Department of Education from part-time to full-time employees. After adjusting for these reclassifications to enable comparison with prior years, the full-time City-funded workforce is scheduled to contract by 10,260 employees between June 2002 and June 2004. Consequently, the City-funded full-time workforce would be reduced to 199,000 employees by the end of FY 2004 (see Graph 1). This would be lower than the FY 1997 level by about 1,600 employees, and the lowest number of City-funded employees since FY 1985. The part-time workforce would decline by a total of 3,594 full-time equivalents between June 2002 and June 2004, a reduction of 7 percent. Most of the reduction in the part-time workforce would be concentrated in the Parks Department, which would lose 3,300 part-time employees—70 percent of the June 2002 level.

In total, the April Plan assumes that the mayoral agencies, the Department of Education, and the City University of New York will reduce their full-time and part-time workforces by 13,854 employees between June 30, 2002 and June 30, 2004 (see Table 8). The most significant changes in staffing levels are described below.

- The Department of Education plans to reduce its City-funded workforce by 1,848 employees in FY 2004. The reduction primarily entails cuts in the number of school aides, family paraprofessionals, and counselors, which would be achieved largely through layoffs.
- The Police Department intends to cut the cadet class scheduled for July 2003 by 1,900, reducing the police force to 34,774 officers by the end of FY 2004. This represents a reduction of 5,980 officers since a peak of 40,754 police

officers in October 2000, which effectively returns the police force to the FY 1993 level. The department plans to add 300 traffic enforcement agents in FY 2004 in an effort to generate more ticket revenue, but attrition and early retirement would reduce the civilian workforce by a net amount of 316 employees.

- The Fire Department would reduce the number of firefighters by 470, primarily by reducing manning in 53 engine companies and by closing 8 engine companies. (The City recently announced that it intends to close 6 instead of 8 engine companies.) The union representing the City's firefighters is suing to stop both these actions.
- The Department of Correction would cut the number of uniformed employees by 1,122 because of a decline in inmate population. The department anticipates that about 400 employees, mostly correction officers, would be laid off.
- The Department of Sanitation would reduce the number of uniformed employees by 936, primarily by reducing waste collections to as little as once a week in certain areas and instituting biweekly recycling collections, with more than 50 percent of the employee reductions coming from layoffs.
- The Department of Parks and Recreation would reduce its workforce by about 3,500 employees, a reduction of 55 percent from the June 2002 level. These actions could negatively impact park cleanliness and maintenance efforts.
- The Administration for Children's Services (ACS) would reduce its staff by 1,511 employees. One third of the reduction would come from transferring employees to the Department of Social Services, one third would come from layoffs, and the balance would come from attrition and early retirement.
- The Department of Social Services reduced its workforce by 943 employees in FY 2003, primarily through attrition and early retirement. The workforce would increase in FY 2004 by about 1,050, but more than half of the increase (568 employees) will be attributable to the transfer of employees from ACS.
- The Department of Health and Mental Hygiene would reduce its staff by 746 positions, including 324 layoffs, which would reduce the number of public health assistants and eliminate Hepatitis B immunizations in City schools.

# Table 8
## City-Funded Staffing Levels

*Increase/(Decrease)*

| | | Fiscal Year | | | Annual Change | | Two-Year Change |
|---|---|---|---|---|---|---|---|
| | | FY 2002 | FY 2003 | FY 2004 | FY 2003 | FY 2004 | |
| **Public Safety** | | **83,778** | **81,462** | **78,892** | **(2,316)** | **(2,570)** | **(4,886)** |
| Police Dept. | Uniformed | 36,790 | 36,878 | 34,774 | 88 | (2,104) | (2,016) |
| | Civilians | 14,521 | 13,777 | 14,205 | (744) | 428 | (316) |
| Fire Dept. | Uniformed | 11,314 | 11,327 | 10,844 | 13 | (483) | (470) |
| | Civilians | 4,530 | 4,459 | 4,311 | (71) | (148) | (219) |
| Correction | Uniformed | 9,893 | 8,836 | 8,771 | (1,057) | (65) | (1,122) |
| | Civilians | 1,511 | 1,435 | 1,451 | (76) | 16 | (60) |
| District Attys. & Prosecutors | | 3,864 | 3,375 | 3,323 | (489) | (52) | (541) |
| Probation Department | | 912 | 904 | 798 | (8) | (106) | (114) |
| Other | | 443 | 471 | 415 | 28 | (56) | (28) |
| **Health and Welfare** | | **25,137** | **22,986** | **22,774** | **(2,151)** | **(212)** | **(2,363)** |
| Social Services | | 10,258 | 9,315 | 10,366 | (943) | 1,051 | 108 |
| Children's Services | | 7,889 | 7,419 | 6,378 | (470) | (1,041) | (1,511) |
| Health and Mental Hygiene | | 4,564 | 3,904 | 3,818 | (660) | (86) | (746) |
| Homeless Services | | 2,054 | 2,079 | 1,970 | 25 | (109) | (84) |
| Other | | 372 | 269 | 242 | (103) | (27) | (130) |
| **Environment & Infrastructure** | | **18,777** | **16,670** | **13,771** | **(2,107)** | **(2,899)** | **(5,006)** |
| Sanitation | Uniformed | 7,680 | 6,681 | 6,744 | (999) | 63 | (936) |
| | Civilians | 2,067 | 1,821 | 1,822 | (246) | 1 | (245) |
| Dept. of Transportation | | 2,320 | 1,977 | 1,992 | (343) | 15 | (328) |
| Parks & Recreation | | 6,323 | 5,789 | 2,811 | (534) | (2,978) | (3,512) |
| Other | | 387 | 402 | 402 | 15 | - - - | 15 |
| **General Government** | | **8,269** | **8,512** | **8,353** | **243** | **(159)** | **84** |
| Finance | | 2,364 | 2,262 | 2,293 | (102) | 31 | (71) |
| Law Department | | 1,312 | 1,239 | 1,220 | (73) | (19) | (92) |
| Citywide Admin. Services | | 1,406 | 1,455 | 1,468 | 49 | 13 | 62 |
| Taxi & Limo. Commission | | 424 | 478 | 482 | 54 | 4 | 58 |
| Investigations | | 322 | 291 | 268 | (31) | (23) | (54) |
| Board of Elections | | 356 | 323 | 327 | (33) | 4 | (29) |
| Info. Technology & Telecomm. | | 392 | 706 | 609 | 314 | (97) | 217 |
| Other | | 1,693 | 1,758 | 1,686 | 65 | (72) | (7) |
| **Housing** | | **1,467** | **1,452** | **1,494** | **(15)** | **42** | **27** |
| Buildings | | 863 | 832 | 911 | (31) | 79 | 48 |
| Housing Preservation | | 604 | 620 | 583 | 16 | (37) | (21) |
| **Department of Education** | | **112,687** | **112,647** | **110,799** | **(40)** | **(1,848)** | **(1,888)** |
| | Pedagogues | 91,110 | 92,367 | 92,387 | 1,257 | 20 | 1,277 |
| | Non-Pedagogues | 21,577 | 20,280 | 18,412 | (1,297) | (1,868) | (3,165) |
| **City University of New York** | | **5,750** | **6,066** | **6,066** | **316** | **- - -** | **316** |
| | Pedagogues | 3,465 | 3,972 | 3,972 | 507 | - - - | 507 |
| | Non-Pedagogues | 2,285 | 2,094 | 2,094 | (191) | - - - | - - - |
| **Elected Officials** | | **2,667** | **2,624** | **2,529** | **(43)** | **(95)** | **(138)** |
| **Total** | | **258,532** | **252,419** | **244,678** | **(6,113)** | **(7,741)** | **(13,854)** |

Source: NYC Office of Management and Budget; OSDC analysis

# V. Covered Organizations

Covered organizations are semi-autonomous agencies subject to the Financial Emergency Act, which include but are not limited to the Board of Education,[6] the Health and Hospitals Corporation, and the New York City Transit Authority. The City has a financial relationship with these agencies and may be called upon to provide additional funding to help balance their budgets.

## A. Department of Education

In recent years, the City, State, and federal governments promulgated new educational standards that established measurable performance goals for students, teachers, and schools. These policy changes occurred in the context of substantial increases in funding for education from all levels of government. Between fiscal years 1997 and 2003, City funding to the Department of Education (excluding pensions and debt service) increased by 53 percent and the State contribution increased by 50 percent. The FY 2004 budget, however, signals an end to the recent large increases in funding for education.

Between January 2002 and February 2003, the City reduced its contribution to the Department of Education by $684 million from the level previously planned for FY 2004. Though it faces fiscal constraints, the department has until now avoided cuts to core classroom services by shifting expenditures to the State and federal governments or to the capital budget; reorganizing central and district-level administrative functions; implementing a centralized purchasing system; and by realizing savings from higher-than-planned attrition.

The Mayor's Executive Budget for 2004, however, would reduce City funding by another $179 million, which would bring the total reduction in City funding for FY 2004, since January 2002, to $863 million. To maintain budget balance, the department intends to lay off 2,700 paraprofessionals, aides, and counselors—the equivalent of 1,813 full-time workers. The department also intends to reduce funding for custodial services and contracts to community-based organizations, reduce the number of sabbaticals, review all education contracts for potential efficiencies, eliminate funding to teachers and principals for discretionary purchases of books and other materials, eliminate optional summer school programs, and cut administrative spending by 3.5 percent, which could result in additional layoffs.

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

State law prohibits the City from reducing its funding for education (excluding pension and debt service) from one year to the next, unless there is a reduction in City revenues. The FY 2004 budget includes City funding of $4.8 billion, the same level as in FY 2003—and the minimum level permitted under the law. When pensions and debt service are included, City funding for education would rise to $6.4 billion in FY 2004, an increase of $675 million compared with the level that was forecast for FY 2003.

In January 2003, the Governor proposed large reductions in education aid to localities to help balance the State budget, including a reduction of $478 million for New York City's public schools. The State Legislature, however, restored $374 million of the Governor's proposed budget cuts and took other actions that will provide additional resources for education. While the State Legislature did not appropriate $275 million to extend the school day as it did in FY 2003, sufficient resources were generated from its actions so that the City should be able to fund this program itself.

The equity and adequacy of the State system of education finance have been the subject of an enduring lawsuit. *Campaign for Fiscal Equity v. State of New York* charges that New York State's system of education finance denies children their right to a sound basic education, in violation of the State constitution. In January 2001, Supreme Court Justice Leland DeGrasse ruled in favor of the Campaign for Fiscal Equity (CFE), ordering the State to reform its education funding mechanism by September 2001. New York State appealed the ruling and the State Appellate Division ruled that the State was not obligated to provide more than an eighth-grade education. Subsequently, the Governor and the plaintiffs entered into settlement negotiations but were unable to reach an agreement. CFE appealed to the Court of Appeals, which heard arguments on May 8, 2003, and a ruling is expected by July 2003.

In June 2002, the State increased mayoral accountability for New York City's public schools. Since then, the Mayor has embarked on an ambitious reform program, asking to be judged on whether there is an improvement in educational performance. Certain elements of the Mayor's program, such as his proposal to restructure the management of community school districts and reduce the number of special education evaluators, have encountered opposition from some members of the State Legislature and parents. According to City officials, the Mayor's reforms would redirect existing resources to the classroom and could mitigate the impact of reductions in City and State funding. According to the Chancellor, the district management reorganization would produce 5,000 new seats by September 2003 and 3,000 more seats by June 2004, free $125 million in existing resources for other purposes, and transfer a large number of teachers back to the classroom.

## B. Health and Hospitals Corporation

The Health and Hospitals Corporation (HHC) ended FY 2002 with a cash balance of $340 million, but expenses are running higher than revenues during FY 2003, which would reduce the year-end cash balance to $192 million by June 30, 2003. These resources, combined with savings from cost reductions and other actions, should be sufficient to close a projected budget gap of $294 million for FY 2004. Nevertheless, HHC could face increasing budget gaps in future years, and maintaining existing service levels will become increasingly difficult, especially in light of the fiscal constraints on the City and State.

HHC projects budget gaps of $521 million in FY 2005 and about $650 million in each of fiscal years 2006 and 2007. To close these budget gaps, HHC assumes it will be able to obtain additional State or federal funding of $211 million in FY 2005, $452 million in 2006, and $432 million in 2007, which appears unrealistic. HHC's gap-closing program also counts on annual savings of $50 million from reducing the workforce by 1,000 employees during FY 2004, achieving higher-than-planned enrollments in public health programs, and restricting purchases of non-medical supplies; and $150 million annually from revenue enhancements and other cost reductions that have not been fully specified. The challenge for HHC will be to maintain fiscal stability without diminishing the safety net that assures access to quality health care services for the indigent.

In FY 2002, HHC treated approximately 488,000 uninsured patients, absorbing hundreds of millions of dollars in costs that were not reimbursed. A critical revenue-generating strategy is to increase enrollment in public health insurance programs. HHC plans to enroll 5 percent of its uninsured patients—about 24,000 persons annually—in Family Health Plus. The FY 2003 target appears achievable; by February 2003, 19,000 persons were enrolled in Family Health Plus. In addition, 18 percent of all New York City Medicaid managed care beneficiaries use HHC facilities, including managed care enrollees who are enrolled in HHC's own plan as well as those who elect to receive care at HHC although they are enrolled in other managed care plans. Increasing managed care enrollments is another way HHC can reduce its out-year budget gaps.

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

## C. New York City Transit Authority

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

Amid mounting questions from elected officials, transit advocates, and union representatives about the MTA's finances, the State Comptroller-elect requested a review of the December 2002 financial plan even before assuming office on January 1, 2003. On January 3, 2003, members of the Comptroller's staff met with MTA budget officials, but many of the Comptroller's questions were not answered. Responses to questions in subsequent correspondence did yield some useful information, but overall the MTA's responses were unsatisfactory. On February 19, 2003, the State Comptroller took the extraordinary step of issuing subpoenas for records and testimony from officials of the MTA for information regarding the financial plan that was approved by the MTA Board on December 18, 2002 (the "December Plan").

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

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

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

The failure to disclose the availability of these resources to the public foreclosed any consideration of fare options other than those proffered by the MTA, which made the public hearing process a sham. In subsequent events, a State Supreme Court judge found that "the hearings were based on the false and misleading premise that the MTA was in worse financial condition than it knew itself to be" and ordered the MTA to hold new hearings based on accurate financial information and to roll back the fare increase. The MTA has appealed the ruling and has requested that the rollback of the fare be put on hold until its appeal is heard.

# Appendix A
# Nonrecurring Resources In Fiscal Year 2003

The FY 2003 budget includes nearly $4.0 billion from nonrecurring and other short-term actions (see Table 9). These actions helped the City balance the budget but will provide no long-term benefit. Borrowing in one form or another will free $3.6 billion for use in the operating budget during the course of fiscal years 2003 though 2007, with 80 percent of the proceeds dedicated to fiscal years 2003 and 2004. Future taxpayers will have to repay these “loans” at a cost of $5.4 billion and will receive no services in return.

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

| | |
|---|---|
| Deficit Financing | $ 1,500 |
| Federal Aid | 799 |
| Debt Refunding | 565 |
| Phase-In Pension Costs | 277 |
| MAC Reserves | 250 |
| Municipal Bond Bank Loan | 206 |
| Education Resources | 203 |
| Health Insurance Savings | 100 |
| TSASC | 90 |
| **Total** | **$ 3,990** |

Source: OSDC analysis

Our estimate of nonrecurring resources includes the following.

- $1.5 billion in TFA bond proceeds to reimburse the operating budget for revenue losses associated with the attack on the World Trade Center.
- $799 million in federal aid to reimburse costs related to the attack on the World Trade Center.
- $565 million from debt refundings, including those that generated one-time savings, but at the expense of higher costs in the future.
- $277 million and declining amounts in subsequent years from phasing in certain pension costs over a ten-year period, which will be repaid with 8 percent interest.
- $250 million from the Municipal Assistance Corporation by accelerating the receipt of reserve funds that were established with bond proceeds.
- $206 million in loans from the New York Municipal Bond Bank. The City intends to borrow against State education aid owed to the City from prior

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

- $203 million for educational programs, including nonrecurring State education aid and resources set aside in a trust account to settle a lawsuit but no longer needed.
- $100 million from drawing down assets of the Health Stabilization Fund, pursuant to a January 2001 agreement with the municipal unions.
- $90 million in bond proceeds from TSASC (tobacco bonds) to fund the operating budget of closing the Fresh Kills landfill. Accounting principles prevent the City from using TFA or general obligation bonds to capitalize the cost of eliminating an asset, but a State law allows TSASC to fund these costs with bond proceeds.