

Policy Analysis

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Routing

Budget Reforms to Solve New York City's High-Tax Crisis

by Raymond J. Keating

Executive Summary

New York City has careened from budget crisis to budget crisis for decades. Each crisis has led to a ratcheting up of taxes and reduced economic freedom for New Yorkers. As an entrepreneur, Mayor Michael Bloomberg might have brought innovative changes to the city's fiscal policies, but he has pursued anti-growth tax increases that the city cannot afford in the increasingly competitive global economy.

New Yorkers have faced increases in property taxes, income taxes, sales taxes, and tobacco taxes under Bloomberg. The mayor argued that tax hikes were needed to balance the budget. But the mayor's latest projections show that a large budget gap will open again in fiscal year 2006. Clearly, recent large tax hikes have not solved the city's deficit problem, yet some officials are already pointing to the future budget gap as an excuse for further tax increases.

Bloomberg's higher taxes have not solved the budget problem because they have fueled higher government spending. That effect is evident in recent budget revisions. Higher Wall Street profits and other factors caused FY04 revenues to be revised upwards by \$791 million. Not coincidentally, the new budget estimates include spending for FY04 that will be \$800 million above the previ-

ously budgeted level.

Between FY94 and FY04, New York's general fund spending increased 53 percent. High spending left the city with a debt load of \$5,083 per capita at the end of FY02. That compares to an average of \$2,262 per capita for 14 major cities surveyed by the New York City Comptroller's Office.

New York needs to downsize its government to cut the city's high tax and debt loads. Some city services should be contracted out to the private sector to save money and improve quality. Other services, should be privatized. The city workforce should be shaken up to cut costs and increase taxpayer value. New Yorkers need to press their elected officials to begin cutting spending to close the FY06 budget gap before the mayor claims that taxes need to be increased once again.

Budget cuts represent a formidable challenge for New York policymakers but are necessary if the city wants to reestablish itself as a leading center of growth and opportunity in America. The city can no longer coast on its impressive business history and must cut taxes to attract new employers. Mayor Bloomberg and other officials need to find creative ways to downsize the budget to increase private investment in the city and the economic freedom of New Yorkers.

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In his inaugural address on January 1, 2002, Mayor Bloomberg declared: “We cannot repeat the mistakes of the past. We cannot raise taxes.”

Introduction

New York City has careened from budget crisis to budget crisis for decades. Each crisis has led to a ratcheting up of city tax levels, which has reduced economic opportunities for New Yorkers. Reformers hoped that the arrival of Republican mayor Michael Bloomberg, a former business executive and entrepreneur, would change the city’s economic and budget direction. But Bloomberg has turned out to be one of the biggest tax hikers in the city’s history.

In his inaugural address on January 1, 2002, Mayor Bloomberg declared: “We cannot repeat the mistakes of the past. We cannot drive people and business out of New York. We cannot raise taxes. We will find another way.”¹ Unfortunately, those sentiments evaporated quickly as Bloomberg proceeded to support a series of large tax hikes that have increased burdens on virtually all New Yorkers and New York businesses.

Six months into his term, Bloomberg signed a bill raising the cigarette tax from 8 cents per pack to \$1.50—an 18-fold increase.² The cigarette tax increase caused job losses, fueled the black market and related crime, and did not bring in the predicted revenue.³ The mayor and other city officials, in their quest for more revenue, ignored the city’s experience with past cigarette tax increases.⁴ The *New York Daily News* reported that cigarette black markets “began to explode . . . with city and state taxes boosting the price of cigarettes, hundreds of streetwise hustlers are selling cheap tax-free smokes—an illegal but lucrative trade that is becoming nearly as cut-throat as dealing drugs.”⁵ The article noted that three slayings in Brooklyn were linked to the growing bootleg industry.

The tax hikes continued. In 2002 the city faced large budget gaps for FY03 and FY04.⁶ Rather than cut spending, Bloomberg proposed a large increase in property taxes to cover the budget gaps. With the help of the Democrat-controlled City Council, Bloomberg signed into law an 18.5 percent property tax increase—the largest tax increase in the city’s history—which took effect January 2003.⁷

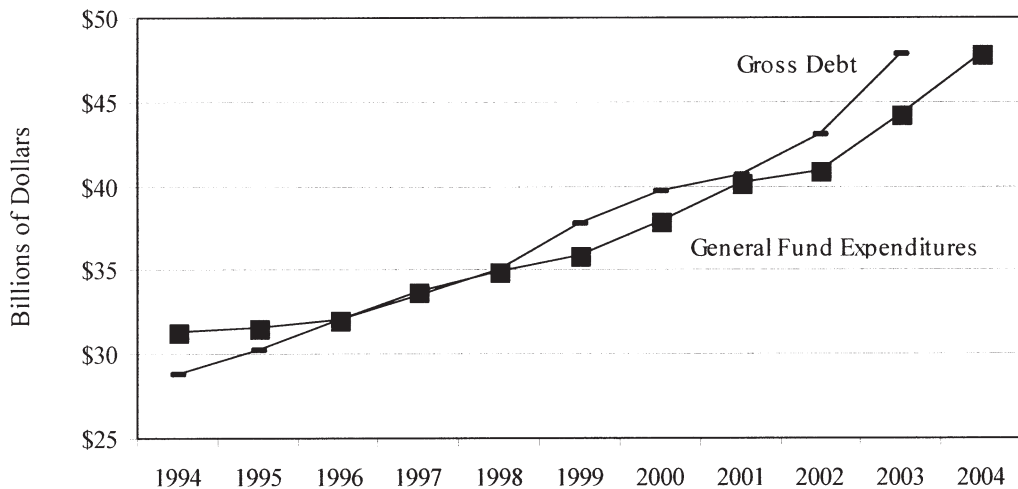
More tax increases were on the way in 2003. Top personal income tax rates and the retail sales tax were hiked, and a 25 percent property tax surcharge was slapped onto owners of residential rental property. All nonproperty tax increases in the city must be approved by the state legislature; these increases were passed by the Republican-controlled state senate and the Democrat-controlled state assembly, overriding vetoes from Republican governor George Pataki.

Overall, tax hikes in the past two years increased the city’s tax burden by \$3.1 billion in FY04.⁸ Tax revenues grew 7.5 percent in FY03 and 13.2 percent in FY04.⁹ The recently passed FY05 budget offered no substantial relief from high-tax policies other than a \$400 property tax rebate. A rebate is the least efficient form of tax cut because it stimulates little economic growth and investment. Instead, it would be better to cut property tax rates because that would spur new investment by affecting marginal decisions by entrepreneurs.

In recent years city politicians claimed that taxes needed to be increased because spending had already been cut as much as it could be. But city spending has not been cut. Figure 1 shows a continuous rise in city expenditures during the past decade. Expenditures were projected to rise to \$47.8 billion in FY04, up 7.9 percent from \$44.3 billion in FY03.¹⁰

Tax increases will not solve the city’s budget problems because they have the effect of fueling higher spending. Indeed, Mayor Bloomberg’s budget noted that revenues for FY04 had been revised upwards by \$791 million, partly due to rebounding Wall Street profits.¹¹ Not coincidentally, the budget says that spending had been increased by \$800 million above the previously budgeted level. Thus, as soon as there is a rise in revenues, the city has rushed to spend it. This is the same mistake that the city made during the 1990s’ boom when rising spending was financed by the transitory boom in profits on Wall Street. The New York City Independent Budget Office noted: “Ongoing operating expenditures grew faster than sustainable revenues. Extraordinary Wall Street

Figure 1
New York City General Fund Expenditures and Gross Debt



Sources: City of New York, “Executive Budget FY2005,” April 26, 2004 (as updated June 28, 2004); and City of New York, Office of the Comptroller, “Comprehensive Annual Financial Report of the Comptroller for the Fiscal Year Ended June 30, 2003,” October 31, 2003.

profits helped fuel revenue surpluses that enabled the city to prepay some expenses for the next fiscal year, effectively masking the underlying imbalance.”¹²

The city has projected that deficits will be \$3.7 billion in FY06, \$4.5 billion in FY07, and \$3.7 billion in FY08.¹³ The gaps are expected to occur even though the city’s tax revenues are expected to rise from \$27.4 billion in FY04 to \$30.0 billion by FY08.¹⁴ New York’s comptroller has called for a new commuter tax to close future budget gaps.¹⁵ But that would simply drive more businesses out of the city and shrink the tax base. Since the source of future budget gaps is rising spending, the solution should be to restrain budget growth.

Mayor Bloomberg’s budget noted that key problems were Medicaid and employee pension and benefit costs growing at “explosive” rates. The budget implied that, since those are “nondiscretionary” costs, nothing can be done about them. That is not true. Ultimately, all government costs can be controlled and all spending cut by changing the law. For example, the city and state can reduce coverage of nonessential health services in order to cut Medicaid cost growth.

The key to getting New York’s budget on a sound footing is to reduce spending to levels that can be sustained by a moderate tax burden no higher than that in other major cities. This report will examine New York’s current tax and spending levels and then propose reforms that would decrease the cost of government and allow a reduction in taxes.

New York’s Big Budgets and Their Consequences

Lavish spending, high taxes, and too much debt drove New York to the brink of bankruptcy in the 1970s, but the city still follows many of the same bad budget policies. Despite claims that the city’s budget has been cut in recent years, spending has been rising steadily. Between FY94 and FY04, New York’s general fund spending rose from \$31.3 billion to \$47.8 billion.¹⁶ That 53 percent increase was about twice the increase in general prices (27 percent) during the period. Spending in FY04 is expected to rise by 7.9 percent over FY03.

Those increases have occurred despite a more than 50 percent drop in the city’s wel-

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fare rolls during the past decade and a substantial drop in the city's prison population. New York City's welfare caseload peaked in 1995 at 1,160,593 beneficiaries; it dropped to 418,770 by early 2003.¹⁷ That is a dramatic welfare reform success, but taxpayers have seen few savings.

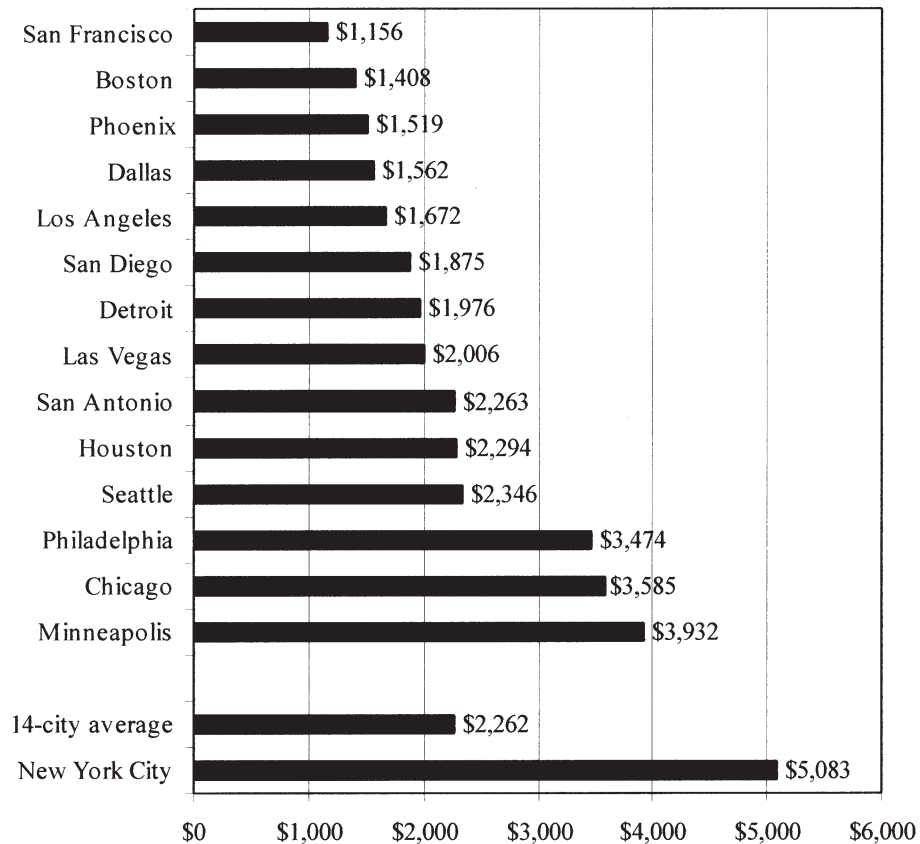
Excessive debt issuance has helped fuel the city's high spending. New York City's gross debt increased from \$26.1 billion in FY93 to \$47.8 billion in FY03, an 83 percent jump.¹⁸ New York City's debt far exceeds that of other major cities. New York City's comptroller compared 2002 per capita debt levels to a sample of 14 other cities, as illustrated in Figure 2. New York's debt of \$5,083 per person was more than double the 14-city average of \$2,262.¹⁹

Although debt-financed spending may seem like a free lunch to politicians, it ultimately ends up costing New York taxpayers more money. One cost of high debt is an increased debt service expense in the city budget. As a share of city tax revenues, debt service increased from 11.6 percent in FY90 to 14.5 percent in FY03, and it is projected to rise to 17.5 percent by FY07.²⁰

New York City's High Taxes

New York City is one of the highest-tax jurisdictions in the nation. New York not only imposes traditional local taxes, such as property taxes, it also imposes taxes that are usually the preserve of state governments. New York City has a property tax, a sales tax, a personal

**Figure 2
Per Capita City Debt in 2002: New York vs. 14 Comparison Cities**



Source: City of New York, Office of the Comptroller, "Fiscal Year 2004 Annual Report of the Comptroller on Capital Debt and Obligations," December 2003.

Table 1
Top Tax Rates: New York vs. State Average, 2003

Tax	New York State and City	U.S. State Average
Top individual income tax rate	12.15%	5.3%
Top corporate income tax rate	17.625%	6.7%
Gasoline tax (per gallon)	\$0.33	\$0.23
Cigarette tax (per pack)	\$3.00	\$0.71

Source: Author’s calculations based on data from the Federation of Tax Administrators, www.taxadmin.org. State average includes Washington, D.C.

income tax, a corporate income tax, and an unincorporated business tax. Those taxes come on top of New York State levies.

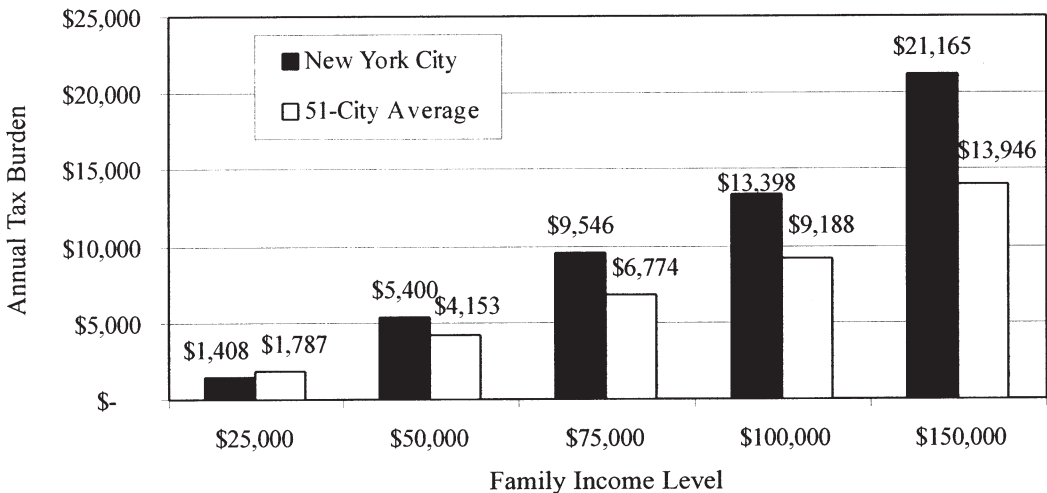
Table 1 shows combined New York State and New York City tax rates compared with the average for the 50 states. New York State’s top personal income tax rate is the 11th highest in the nation.²¹ But the combined state and city individual income tax rate for New York City is the highest in the nation.²² In 2006 the personal income tax rate is scheduled to roll back to 2002 levels, but those levels are still far too high.

Each year the government of the District of Columbia examines families at five differ-

ent income levels and calculates total state and local tax burdens in the biggest city in each state and in the District.²³ The study includes sales taxes, income taxes, property taxes, and other charges such as automobile taxes. Figure 3 illustrates some of the results. New York families at all income levels except \$25,000 pay far higher taxes than the average for other major cities. For example, a New York family earning \$75,000 pays 41 percent more than average. In New York a family at \$75,000 can be hard-pressed given the city’s high living expenses. New York’s excessive taxes exacerbate the financial difficulties that such families face in the city.

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Figure 3
New York City Taxes vs. 51-City Average for Families at Five Income Levels



Source: Government of the District of Columbia, Office of the Chief Financial Officer, “Tax Rates and Tax Burdens,” August 2003.

In 2003 New York had the highest unemployment rate of the largest 20 cities in the country. High taxes are the key cause of the problem.

In addition to taxes collected from families, New York has an array of other taxes that damage productive activities. Unincorporated businesses face a special 4 percent city tax, making the top combined state and city tax rate on those businesses a huge 16.15 percent. Corporations fare poorly as well. New York City imposes a corporate income tax of 8.85 percent, which is higher than the state tax rate in 40 states. The New York State corporate income tax and a 17 percent transit tax surcharge imposed on state business taxes in the New York City area create a top state rate of 8.775 percent. Thus, the combined state and city corporate tax rate is very steep at 17.625 percent.

The city also imposes a unique commercial rent tax on commercial tenants with annual rents over \$250,000 on property in Manhattan (south of 96th Street). In 2003 the tax ensnared 5,900 companies.²⁴ Revenues jumped in 2004 because the 18.5 percent property tax increase translated into higher rental payments for tenants with tax escalation clauses in their leases.²⁵

The state and city of New York both hiked sales taxes in 2003. The state boosted its sales tax from 4.0 percent to 4.25 percent, and New York City increased its sales tax from 4.0 percent to 4.125 percent. In addition, a special 0.25 percent sales tax is imposed for the Metropolitan Transit Authority. As a result, the total sales tax rate in New York City is now 8.625 percent. The increases in the city and state sales tax rates are scheduled to expire at the end of May 2005.²⁶ However, politicians are likely to try to extend those increases if spending keeps rising to create further budget gaps.

Consequences of High Taxes

Some New Yorkers may think that most of the burden of high taxes falls on the well-heeled. However, as the government becomes larger and drains more resources from the private sector, the prosperity of all New Yorkers is affected. The economy suffers because decisionmaking is much less efficient in the government sector than the private sector. Government officials channel resources to

special interests, are immune from market price signals, and have little incentive to control costs. As a result, large amounts of resources are wasted when additional taxpayer funds are secured by the government.

Higher taxes create disincentives for working, saving, investing, and entrepreneurial ventures in the city. High taxes on income and business profits are particularly damaging. Because high taxes reduce economic activity, average workers ultimately bear the burden of New York's big government in the form of reduced incomes and fewer job opportunities. In 2003 New York had the highest unemployment rate of the largest 20 cities in the country.²⁷ High taxes are the key cause of the problem. New York lost 195,000 net jobs between 2001 and 2003.²⁸ The city needs to pursue a tax-cutting strategy to lure back employers.

Both capital and labor are increasingly mobile and in search of the most hospitable economic climate.²⁹ Consider a 2003 study by economist Richard Vedder that looked at taxes and domestic migration.³⁰ Vedder split the states into two groups—25 high-tax states and 25 low-tax states—on the basis of state and local tax burdens as a share of personal income. From 1990 to 1999 low-tax states gained 2.05 million people in net domestic migration, while high-tax states lost 890,000. That pattern has continued in recent years. From 2000 to 2002 low-tax states gained 729,000 new residents, while high-tax states lost 371,000 people.

Those effects of taxes are an important reason why high taxation leads to reduced economic growth. A study by the congressional Joint Economic Committee looked at state personal income growth between 1960 and 1993 and found that state income in low-tax states grew almost one-third faster than in high-tax states.³¹ A study by the Federal Reserve Bank of Atlanta looked at state and local taxes and state income growth from 1960 to 1992. It found that high marginal tax rates and high overall tax levels were negatively related to economic growth.³² A study by Deborah Swenson of the University of California at Davis concluded that states

with higher taxes attract fewer new investments and plant expansions from foreign companies than do lower-tax states.³³

Taxes have a pronounced impact on the migration of jobs and capital at the local level because it is fairly simple for businesses and workers to migrate between cities within the United States. A 1991 study by the New York City Comptroller's Office found that high taxes contributed directly to the city's economic woes.³⁴ It concluded, "The rapid increase in the tax burden, which began in the 1960s and continued through the mid-1970s, was a factor that contributed to the economic downturn that led to the city's famous fiscal crisis of 1975-78."³⁵

New York City has not fared well over the years in terms of population and employment. Today's population of 8.1 million is just slightly larger than the 1970 population of 7.9 million. Meanwhile, the U.S. population has increased 41 percent since 1970. Similarly, New York City employment has increased only 6.4 percent since 1970, while U.S. employment has increased 75.1 percent.³⁶

New York City fell into recession along with the rest of the nation during the first quarter of 2001. But while the national recession lasted three quarters, New York City's recession lasted for two and one-half years.³⁷ It is true that the events of 9/11 took a toll on the city economy. However, tax hikes made the economic damage worse. One analysis estimated that job losses due to the city's recent tax increases totaled almost 91,000.³⁸

Businesses are already wary of moving to New York City because of terrorism. Thus it is vital that the city not pile additional disincentives to business location such as higher taxes. New York's elected officials have a responsibility to create a more inviting city and a more efficient government than ever before. Because of advances in telecommunications, city officials can no longer assume that entrepreneurs and businesses must be located in the Big Apple. In 1980, 40 percent of the U.S. securities industry was located in Manhattan. Today, just 25 percent of the industry remains in Manhattan.³⁹

Spending Reductions and Reforms

New York officials need to explore budget reforms and spending reductions to which the city has not given serious consideration in the past. Program terminations, privatization, and competitive contracting need to be on the table if New Yorkers are to solve the city's high-tax crisis. Taxpayers, not entrenched interests and coddled city workers, must become the focus of the city's budget process.

Privatization and Competitive Contracting

Privatization and competitive sourcing of government services present big opportunities for cost savings. Experience with such reforms in cities across the country shows that private provision can save money and improve service quality. Billions of dollars of state and local assets have been sold or leased to the private sector during the past two decades.⁴⁰ One study found that 82 percent of cities that had opened the door to competitive sourcing of government services were satisfied or very satisfied with the results.⁴¹ In addition, most cities report that service quality has improved, and taxpayer savings have been as high as 60 percent on competitively sourced services.⁴²

Privatization is a worldwide trend that is being pursued by governments of all political persuasions. Privatization is no longer considered a radical reform, as governments on every continent have sold off electric utilities, airlines, railroads, and other businesses.⁴³ Airports have been fully or partially privatized in Auckland, Copenhagen, Frankfurt, London, Melbourne, Naples, Rome, Sydney, Vienna, and other cities. Even postal services are being privatized in Germany and a few other countries.

New York leaders need to modernize their policy thinking and begin identifying old-fashioned monopoly services that might benefit from a dose of competition and entrepreneurialism. One reform opportunity is the

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collection of garbage and recyclables, which can be improved by introducing competitive contracting. One recent proposal called for phased-in competition, whereby private companies and city workers would bid to provide services in 6 of 59 districts in 2004, 12 districts in 2005, and 24 districts in 2006.⁴⁴ It is estimated that this reform would save \$17 million in 2004, \$35 million in 2005, and \$71 million by 2006.⁴⁵

The city's Department of Corrections is also ripe for reforms. Between FY92 and FY02, the average daily inmate population in the city fell by 35 percent.⁴⁶ But over the same period, expenditures increased by 16 percent. The city missed an opportunity for substantial cost savings from the inmate decline. Looking ahead, the city should consider private options to create savings in the prison budget. Currently, three-fifths of U.S. states host private prisons, and the savings range from 5 to 20 percent.⁴⁷

Subsidies to private businesses should be cut. The city currently provides subsidies to private bus systems that cost taxpayers more than \$200 million annually.⁴⁸ Those subsidies should be ended, and private bus lines should be supported by fares and advertising. Mayor Bloomberg proposes to spend \$195 million to redevelop the Manhattan Passenger Ship Terminal for cruise lines and to spend \$71 million on the Brooklyn Navy Yard to aid industry.⁴⁹ Such "corporate welfare" should be cut. Instead of favoring some industries over others with taxpayer aid, the city should cut business taxes to encourage greater private investment in all industries.

City Workers and City Politicians

The City of New York has a notoriously expensive and inflexible workforce. The city has 224,000 municipal workers, including 90,000 in the public schools and 46,000 in police and fire services.⁵⁰ New York City compensation costs including wages, benefits, and pensions were \$24.4 billion in FY04, which represents half of the city's \$47.8 billion budget.⁵¹ Thus, savings in employee costs would go a long way toward reducing

the cost of government and creating budget room for tax cuts.

A recent report found that the average cost of a full-time New York City worker was \$82,722 in FY04, up 30 percent since FY 2000.⁵² Pension and benefit costs are rising particularly rapidly, with an expected increase from \$7.4 billion in FY04 to \$10.7 billion by FY08.⁵³ Between FY 2000 and FY03, benefits for U.S. private-sector workers increased 16 percent, but New York City workers received a 48 percent increase in benefits.⁵⁴

Another source of excess has been the rapidly rising costs of worker overtime. New York City overtime pay soared from \$449 million in FY97 to \$830 million in FY03, even after excluding overtime related to the World Trade Center attack.⁵⁵ Over the first seven months of FY04, overtime costs were up another 9 percent.⁵⁶ Clearly, overtime is being abused and the city needs to better schedule workers to reduce these costs.

City workers are not just well compensated, they are overly protected. In a 1999 study, *Governing* magazine and the Maxwell School of Citizenship and Public Affairs studied management in major cities across the nation. They noted of New York City's workforce: "Disciplining poor workers is difficult. Employees have a right to union representation anytime they're questioned about something that could lead to disciplinary action. The appeals process for terminations can take years."⁵⁷

Most of the contracts with unionized city employees have expired, so this year will be an important one in the battle to reform employment rules and excessive worker pay.⁵⁸ Mayor Bloomberg has declared that any future raises for city workers will have to be financed from productivity increases.⁵⁹ But more is required. The following are further reforms—some floated by various New York budget experts—that need to be undertaken:

Downsize the Political Class. New York City has a mayor, a city council with 51 members, five borough presidents, a public advocate, and many unnecessary commissions, such as a Taxi Commission, a Commission

on Women's Issues, and a Commission on Human Rights. Some of those offices can be downsized or phased out completely.

Although Mayor Bloomberg has chosen to receive a salary of only \$1 a year, his office will cost \$75 million in FY04.⁶⁰ Expenditures for the five borough president offices totaled \$23 million; the public advocate, \$2.4 million; the Taxi Commission, \$24 million; and the Commission on Human Rights, \$7.3 million.⁶¹ The Community Boards office will cost taxpayers \$12 million in FY04.⁶² City Council members earn \$90,000, the public advocate earns \$150,000, and the borough presidents earn \$135,000.

The political class lives very well at the expense of New York taxpayers. The city should eliminate the positions of borough president and public advocate. Community boards and numerous commissions should be eliminated. City Council salaries should be cut.

Increase Work Hours to Reduce the Workforce. City employee work schedules should be brought in line with private-sector standards. One step would be to require that the 80,000 "nonmanagerial civilian" employees (those who are not teachers, uniformed employees, or senior officials) work full 40-hour weeks.⁶³ That change would allow for the elimination of about 8,500 positions and thus save \$498 million annually.⁶⁴ After all, similar federal employees have a 40-hour week, as do most local employees nationally, including those in Los Angeles, San Francisco, and Washington, D.C.⁶⁵

Another reform would be to cut the excessive number of days of vacation and holidays of New York City workers. City employees not only receive 12 paid holidays, but most of them also get three weeks vacation after one year on the job, four weeks after the fifth year, and five weeks after the eighth year.⁶⁶ Vacation time should be reduced to enable the workforce to be downsized.

Increase Teacher Classroom Time. The share of teachers' time spent on classroom instruction should be increased to reduce costs. One idea is to eliminate sabbaticals for teachers, principals, and supervisors. Current-

ly, teachers with 14 years of service can take a one-year sabbatical at 70 percent pay and full benefits, while those with 7 to 14 years of service can take six-month sabbaticals at 60 percent pay.⁶⁷ In 2001, 1,600 city teachers were on sabbaticals.⁶⁸ That is excessive, especially given that teachers work only 180 days (36 full weeks) a year. Eliminating sabbaticals for teachers and administrators would save the city's budget about \$88 million annually.⁶⁹

Another idea is to eliminate the teacher preparation period. New York City teachers work six hours and 40 minutes a day including the preparation period.⁷⁰ Substituting teaching time for this period would allow for the elimination of about 10,300 positions and create annual savings of \$764 million.⁷¹

Optimize Firefighter and Police Schedules. New York City firefighters work 48 hours every eight days.⁷² Firefighters in San Francisco and Washington, D.C., work 48 hours every seven days, and in Milwaukee and Louisville they work 56-hour weeks.⁷³ Shifting New York to schedules similar to those in other localities would save tens of millions of dollars annually.⁷⁴ Police schedules should also be adjusted. The Citizen's Budget Commission found that \$251 million could be saved annually by rescheduling workdays, shifting officers out of office jobs, and reducing overtime costs.⁷⁵

Cut Pensions. New York City has faced dramatic growth in its pension costs in recent years. The city's pension costs—for 180,000 retirees and 250,000 active employees—have risen from \$1.1 billion in FY01 to \$2.5 billion in FY04 and are projected to rise to \$4.5 billion by FY08.⁷⁶

Stock market losses have increased pension costs, but so have overly generous collective bargaining agreements and state legislation.⁷⁷ One way to cut future costs is to move away from the current defined-benefit plans to defined-contribution plans. Under the current system, city contributions rise during bad economic years, and costs are pushed higher when labor unions lobby for enhanced benefits.⁷⁸

The shift toward defined-contribution plans could begin with all new city employees. The city would contribute a set amount

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to employee plans, which would establish stable and controllable future costs. If this reform were started with employees hired in 2005, savings have been estimated at \$8 million in 2005, \$43 million in 2006, and \$85 million in 2007.⁷⁹

Control Rising Health Benefit Costs. The rising cost of health insurance coverage has taken a toll on individuals, businesses, and governments across the nation. For New York City, benefit costs for city workers—primarily health care—are expected to rise from \$4.9 billion in FY04 to \$6.2 billion in FY08.⁸⁰

Mayor Bloomberg's budget claims that health care and pension spending is "nondiscretionary," implying that nothing can be done about rising costs. But all government costs can be controlled by changes in the law. For example, New York City workers currently do not pay anything toward their health care coverage. By contrast, New York State workers pay 10 percent of the cost of individual health insurance coverage and 25 percent of family coverage, while federal employees generally have a 25 percent co-pay.⁸¹

The law should be changed in New York to require city workers to contribute to their own health coverage to control rising costs to taxpayers. Shifting to a system of contributions similar to the federal program would save about \$508 million annually by FY06, according to city budget expert E. J. McMahon.⁸²

Parks, Recreation, and Culture

The city's Department of Parks and Recreation maintains 550 tennis courts, 63 swimming pools, 13 golf courses, 6 ice rinks, 4 sports stadiums, and many other entertainment facilities.⁸³ The department's budget in FY04 is \$396 million.⁸⁴ Many activities of this department could be operated by private-sector organizations or completely privatized. There is no reason, for example, for the government to be in the golf course, ice rink, or stadium business. Those activities could be fully supported by paying customers, which would reduce taxpayer costs and likely increase service quality. The city's golf courses used to be run by the city and they were in

a poor state of disrepair and lost money.⁸⁵ After the courses were contracted out to private firms, they were upgraded and turned into moneymaking ventures.⁸⁶ The next step is to fully privatize them.

New York City is also heavily involved in funding leisure activities through the Department of Cultural Affairs. The city funds more than 700 museums, performing arts groups, gardens, and other cultural activities at a cost of \$162 million in FY04.⁸⁷ Many of these activities are welfare for the well-to-do and should be left to the private sector. New York City is a top cultural capital of the world, and the arts will not disappear if politicians stop doling out subsidies. Instead, art lovers and art patrons would be free to spend their own money for their own preferred artistic activities, which would be good for taxpayers and the city's diverse art culture.

Social Services

The number of New York City residents on welfare (Temporary Assistance for Needy Families) has been cut in half since 1996.⁸⁸ The share of the city's population on welfare has fallen from a high of 16 percent to about 5 percent today.⁸⁹ This is all good news. Unfortunately, there has not been a commensurate drop in overall spending on social services, which account for 21 percent of the city's budget.⁹⁰ From FY96 to FY03, Department of Social Services expenditures fell from \$7.3 billion to \$6.1 billion.⁹¹ But a new Administration for Children's Services was created in FY97, and its budget soared from \$1.4 billion the first year to \$2.3 billion by FY03.⁹² Total social services spending increased from \$7.9 billion in FY96 to \$9.3 billion in FY03.⁹³ Although welfare reform in the 1990s got many New Yorkers to enter the workforce, taxpayers have seen few cost savings.

Medicaid

Medicaid is in severe financial crisis nationwide, with spending rising at 9.9 percent annually during the past five years.⁹⁴ Unfortunately, the Medicaid crisis is worse in

Table 2
New York City's Medicaid Cost Explosion (millions of dollars)

Medicaid Service	FY01	FY04	Increase
Hospital inpatient	\$685	\$856	25%
Pharmacy	\$358	\$698	95%
Long-term care	\$484	\$590	22%
Prepaid care	\$181	\$535	196%
Clinic	\$197	\$213	8%
Hospital outpatient	\$174	\$195	12%

Source: City of New York, Office of the Comptroller, "The State of the City's Economy and Finances, 2003," December 15, 2003, p. 18.

New York than in most states. Medicaid spending accounted for 31 percent of personal health care spending in New York in 1998 compared to 16 percent nationwide.⁹⁵ New York State's Medicaid spending per beneficiary was \$7,646 in 2000, almost twice as high as the U.S. average of \$3,936.⁹⁶

New York City's Medicaid costs are expected to increase 49 percent between FY 2000 and FY05.⁹⁷ Enrollment in New York City Medicaid has exploded from a fairly stable 1.8 million people prior to 2001 to more than 2.5 million today because of the loosening of eligibility rules.⁹⁸ About one in four city residents is now a recipient.⁹⁹ Table 2 shows the dramatic increases in New York City's Medicaid costs in the past three years.

New York City taxpayers are directly hit by Medicaid's costs because the city pays for 25 percent of the program's spending. (The state pays 25 percent, and the federal government pays the other 50 percent.) About a dozen other states shift part of Medicaid costs onto local governments, but none to the extent that New York does.¹⁰⁰

Medicaid and other programs with a shared federal-state-local structure breed fiscal irresponsibility because states expand programs beyond what they would if the costs were borne solely by state taxpayers. New York's Medicaid provides many optional services that are not required by federal rules, including eyeglasses, physical therapy, dental services, home health care, and cosmetic surgery.¹⁰¹ Medicaid also subsidizes hospitals,

nursing homes, and home health care services, and those services have costs that are disproportionately high in New York.¹⁰²

New York has expanded eligibility for Medicaid to families far above the poverty line even though this coverage is not required by federal rules. New York City's Medicaid costs have exploded as a result of former mayor Rudy Giuliani's plan to enroll the uninsured, Gov. George Pataki's program to expand coverage to families earning up to 150 percent of the poverty level, and a recent program to fast-track new enrollees.¹⁰³

Reforms need to cut out-of-control Medicaid costs in order to stabilize the state's and the city's budget outlook. New York should limit Medicaid eligibility to those who are below the poverty line. The state should cut the number of medical services that are covered to get its program in line with coverage in other states. For example, if Medicaid coverage were pared back to exclude dental care and transportation services, the city would save more than \$40 million annually.¹⁰⁴

In addition, the city needs to work with the state and federal governments to push for an overhaul of the program's basic structure. One promising reform idea is to shift Medicaid spending to a voucher program, under which recipients would choose between various health care options and competitive providers. That would move away from the current central-planning structure toward a less costly and more responsive consumer-driven structure.

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Education

The New York City public school system is plagued by many problems, but lack of funding is not one of them. In 2000 New York City's per pupil school spending of \$9,472 exceeded the \$6,606 average for the 100 largest U.S. school districts by 43 percent.¹⁰⁵ New York City ranked fifth highest in per pupil spending among the 100 districts.¹⁰⁶

What did New York City get for this extravagant spending? It did not get good student performance: Only half of New York City students finish high school within four years, and students perform poorly on standardized tests.¹⁰⁷ But all that spending did buy a lot of school administrators: although the number of pupils in the system in 2000 was about the same as in 1950, the public school bureaucracy grew from about 200 workers in 1950 to 4,900 by 2000.

In a recent case involving school funding, New York State's Court of Appeals examined the failures of New York City public schools.¹⁰⁸ The plaintiffs in the case blamed inadequate funding for the failures. The state agreed that the schools were a failure, but it blamed mismanagement. Chief Judge Judith Kaye said the schools were a "systemic failure," citing abysmal graduation rates and noting that more than a third of third graders were "functionally illiterate."¹⁰⁹

The court majority took an activist stance and required the state to examine whether the schools were receiving enough funding. But in a dissent, Judge Susan Phillips Read noted that the city's per pupil spending is higher than that of all but four states.¹¹⁰ Read also noted that the supposed link between funding and failure in city schools "amounts to nothing more than an article of faith."¹¹¹

In fact, New York's experience makes clear that ever greater spending on schools does not result in improved education. Nationally, numerous statistical studies have shown that there is no significant relationship between spending on public schools and educational achievement.¹¹² Higher spending does not lead to higher test scores or education quality.

Rather than increasing spending, New

York should inject more competition into the public school system. Competition would put pressure on the government schools to make more efficient use of taxpayer money and to increase quality. Per pupil school costs are typically lower for private schools than for government schools. New York should introduce school vouchers to allow students in failing public schools to attend lower-cost, higher-quality private schools.

Housing

New York City's government has done untold damage to the city housing market over the decades, wasting billions of taxpayer dollars in the process. Most infamous, the mass construction of high-rise public housing in the mid-20th century and related "urban renewal" programs were a disaster. Government housing has been poorly built and maintained, and it has created concentrated and sustained pockets of poverty and hopelessness in New York.

It is a myth that private housing markets cannot provide decent homes for the urban poor.¹¹³ Excessive government regulation and taxation greatly exacerbate the affordable housing problem. Rent controls, high income and property taxes, costly construction standards, import barriers on lumber, and other regulations reduce the return to private housing investment and dissuade developers from constructing low-income housing.¹¹⁴ The government has created a vicious cycle of more regulations, more damage to housing markets, and then more spending to "solve" the problems created by government. Housing market expert William Tucker explains some of New York's problems:

Since 1943, New York has had "temporary" rent control. . . . Builders have fled, and vacancy rates never rise above 3 percent (national vacancies are now 10 percent). . . . Since the 1970s, New York City has spent \$10 billion building and renovating housing, much of it for the middle class. This is on top of

the city's 180,000 units of federal public housing—more than the next ten cities on the list combined. Only last week, in the midst of a budget crisis and a potentially devastating transit strike, Mayor Bloomberg announced yet another plan to borrow another \$5 billion to subsidize 65,000 new housing units, many of them for the middle class.¹¹⁵

To get out of the vicious cycle, New York should deregulate housing markets and allow entrepreneurs to provide housing for people at all income levels. After all, private businesses provide food, clothing, and thousands of other products for people of all incomes and tastes. Rather than pile one housing program on top of another, policymakers should focus on removing barriers to entrepreneurs in the low-income housing industry.

Howard Husock, a housing policy expert at Harvard University and the Manhattan Institute, notes that before the federal government's large-scale intrusion into housing in the 1930s, private markets provided decent low-cost housing relative to standards of the day.¹¹⁶ When low-cost housing is private and unsubsidized, it improves over time. Tenants in private housing tend to be temporary, as they have every incentive to earn more and move up the ladder to better housing.

New York City needs to reevaluate its failed housing strategy and abandon misguided public housing, zoning, taxing, and rent control policies. The city's public housing units should be privatized, rent control ended, taxes reduced, and counterproductive zoning measures rolled back. Taxpayers could save some \$363 million annually in expenditures by the Department of Housing Preservation and Development, and proceeds from housing privatization could be used to reduce the city's debt load.

Economic Development

New York City taxpayers fund subsidies to businesses through the Economic Develop-

ment Corporation and the Department of Small Business Services. Those agencies cost \$90 million in FY04.¹¹⁷ The city makes life tough for businesses by imposing high taxes and excessive regulations, and then it funds development agencies to try to solve the problems that it created. "Economic development" really means politicians and bureaucrats doling out subsidies and narrow tax breaks to satisfy special interests. By contrast, real economic development occurs in private competitive markets where entrepreneurs must meet the actual needs of the broader public.

New York City should eliminate business subsidy programs and repeal onerous taxes and regulations, which would create opportunities for all businesses, not just the ones with incestuous relations with city hall. The city should shift its economic development strategy from a government-driven model to a model emphasizing entrepreneurial businesses in a low-tax and light-regulation environment.

Debt Reform and Reduction

New York City's debt far exceeds that of other major cities. As noted, New York's per capita debt was \$5,083 in 2002, which was more than double the average of \$2,262 of 14 comparable cities.¹¹⁸ The city's gross debt increased from \$26.1 billion in FY93 to \$47.8 billion in FY03.¹¹⁹ New York needs tighter legal restrictions on debt issuance because politicians have bent the current rules to avoid making needed spending tradeoffs in the budget.

The state constitution limits New York City's outstanding debt to 10 percent of the five-year average value of taxable real property in the city. However, elected officials have found ways to issue debt outside that limitation. In the late 1990s, the city set up the Transitional Finance Authority to issue debt backed by earmarked sources.¹²⁰ Debt service costs on TFA bonds now run about \$1 billion annually.¹²¹ In 1999 the Tobacco Settlement Asset Securitization Corporation was created to issue debt backed by revenues from the

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national tobacco settlement.¹²² The Municipal Assistance Corporation was established to issue debt backed by sales tax revenues.¹²³ The city also uses capital lease obligations to finance debt. In those arrangements, the city enters into an agreement with another entity for construction of a building or other asset, with the city making lease payments to cover debt service.¹²⁴

Those complex financial arrangements make the government budget too complicated for average citizens to understand and more difficult for taxpayers to control. A tighter constitutional limit should be established to restrict such excess debt issuance and make government more transparent. Meanwhile, state and city officials should begin a multiyear process of reining in the city debt and unwinding the complex mechanisms that sustain it.

Conclusion

New York has struggled in recent years in the wake of the terrorist attacks of 2001, the downturn in the stock market, and the sluggish economy. But city politicians have exacerbated the city's economic and budget troubles by walloping New Yorkers with huge tax increases. As a result, the local economy has been much slower to recover from the recession than the national economy.

New York's politicians spend much of their time finding new ways to suck resources out of the city's once-vibrant private sector. Instead, they should be considering reform options to downsize New York's government to meet the new competitive realities of the global economy. The continual reappearance of "budget gaps" in the city's finances reveals that there are structural problems on the spending side of the budget, not a shortage of revenues.

After the fiscal crisis of the 1970s, the goal was to get New York City back into the debt markets and to balance the budget. Once the city reentered the debt markets, spending accelerated, and fiscal crises continued to

recur. Today, the city's fiscal goal should be not simply to balance the budget but to give citizens a high-quality government at the least cost and to maximize economic freedom for all New Yorkers. The goal should be not just fiscal stabilization but economic stabilization and growth.

As a major business and financial center, New York should have the lowest unemployment rate in the country, not one of the highest. Although the New York economy started to recover in 2004, the 200,000 jobs lost since 2001 may never come back unless policymakers make the city's economic climate more attractive. Key industries such as financial services no longer have most of their employees in New York because of advances in communications technology. New York City needs to work much harder than it has in the past to make itself a competitive location for businesses, both big and small. By downsizing the government, New York could implement major tax reductions and regain its place as the premium world center of growth and economic opportunity.

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