New York City Office of Management and Budget
Patrick Peterson, Director

Memorandum

To: Mayor Michael R. Bloomberg
From: Patrick Peterson, Director, NYC Office of Management and Budget
Date: March 7, 2007
RE: Revised 2007-2010 budget and revenue projections

Problem: The city faces a $2 billion revenue shortfall each year from FY2008-FY2011, exacerbating budget deficits already present in out-years.

Solution: I recommend that you phase in your Property Tax Reduction Program, initiate a modest across the board cut in City expenditures, and open up a number of new revenue streams.

Alternatives: As an alternative to the above solution, you could re-negotiate the city's Personal Income Tax, pursue statewide Medicaid reform, and restore the Commuter Tax. These options would require state approval, which given currently appear unlikely. Instead of an across the board expenditure cut, you could target cuts to city agencies that consume significant resources, but these Departments (Police, Public Welfare, and Education in particular) have the ability to quickly and efficiently mobilize opposition.

The recently announced $2b revenue shortfall has forced you to choose from one of two options. The first is to cancel or delay your Property Tax Reduction Program (PTRP). The Second is to make either across-the-board or targeted expenditure cuts. Given the nature of the property tax, stated fiscal and governmental priorities, and relationship with Albany, PTRP should bear the primary burden for closing the revenue shortfall[1].

After you took office in 2002, the city was on the edge of a major fiscal crisis. The September 11 terrorist attacks introduced a depression on Wall Street and in the tourist industry, depriving the city of a major source of revenue. In response, you executed a 18.5% property tax increase in order to return the city to fiscal stability[2]. But as the city's economy improved, you intended to rollback these increases.[3] I propose that instead of a reduction program of $750 million in FY2008 increasing to $917m in FY2011 you phase in the reduction program at $114.4m beginning in FY2008, increasing to $630m by 2011.

Delaying the property tax reduction program will be politically unpopular, but is fiscally necessary.[4] You note in your Budget Summary that New York City's tax burden is high relative to the rest of the country, but a fiscal crisis like the one we are currently facing is not the time to cut revenue. Phasing in the PTRP will continue a regressive tax program. But an Independent Budget Office (IBO) study found that homeowners (especially those living outside Manhattan where household incomes are lower) pay the lowest share of the property tax, blunting its regressive nature somewhat.[5]

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[1] Note for example Dall W. Forsythe's *Memos to the Governor* (Georgetown Univ. Press, 2004): "The essence of budgeting is choice within constraint (p.34)."
[2] Diane Cardwell: "Bloomberg Plans To Cut Property Taxes" The New York Times, January 17, 2007/
[3] Michael Bloomberg. "Mayor Michael Bloomberg Presents $57.1 billion FY2008 Budget." Press Release, Office of the Mayor, January 25, 2007.
[4] Lee and Johnson (2003), for instance, note that "the property tax is the one most reviled by taxpayers, being regarded by many as the most unfair…[but is]the almost exclusive domain of local governments" (p.70).
[5] Devine, Theresa. *Twenty-Five Years After S7000A: How Property Tax Burdens Have Shifted In New York City.* NYC Independent Budget Office, Dec. 5, 2006.

Delaying of "phasing in" the PTRP will be politically unfavorable, especially since you stated each year since 2002 that you sought to lower it.[6] But one must note that the PTRP does not *raise* taxes, it simply holds off on *lowering* them. If phasing in the PTRP is introduced as a "phased in tax cut" rather than a "tax increase" it will find more support. During your 2004 Sate of the City address, you noted that it was imprudent to cancel the 2002 increase because the city's finances were "not out of the woods yet[7]." To put it simply, the city is still not out of the woods, and cannot yet afford this revenue-reducing program.

Your other option is to cut city expenditures. If you institute an across the board cut (between 2%-3.5% of expenditures), this would mean that funding levels would be frozen at slightly below their FY2007 levels until FY2011. All planned spending increases would need to be cancelled until FY2011, at which point the significant budget gaps left unresolved in your previous budget would still become a problem. The city would be cash-strapped, resource-starved, and unready to take on these out-year budget gaps.

Expenditure	New York City	Other Localities
Education	23.6%	37.5%
Public Welfare	16.9%	3.7%
Health	1.9%	2.4
Police Protection	17.1%	4.9%
Interest on Debt	7.7%	4.3%
Source: Bureau of the Census, Statistical Abstract of the US (2001), Tables 425, 438, 436, 439, Adapted from Lee & Johnson (2003): 41		

New York City spends a disproportionate share of its budget on some services when compared to other US localities (see table at left). If you reduce expenditures to bring them in line with the shares spent by other localities, you would save $3.2b. But it is difficult to imagine such a re-distribution. The Administration for Children Services received a significant increase in funding (partly comprising the high public welfare expenditure) after a series of high-profile scandals[8]. The New York Police Department has historically commanded high budgets and the Commissioner's independent political capacity would make it difficult to reduce NYPD's budget without a fight. And the city can hardly reduce its existing debt service payments over the short term, although if it is a priority for you the city could achieve this fiscally responsible policy over the long-term.

Simply relying on expenditure cuts to finance the revenue crunch is shortsighted. In your 2007 Preliminary Mayor's Management Report (PMMR), which tracks the performance of city agencies, you said that: "the indicators shown in the PMMR demonstrate that we are continuing to build on five years of successful policies and are moving the City in the right direction[9]." According to the report, street cleanliness is at an all-time high, pothole repairs have increased, a record number of housing violations were corrected, class sizes continue to fall, the Department of Education's capital plan remains on schedule, the average stay for families in shelters fell, fewer people are using public assistance, and unemployment dropped (ibid.). Cutting back on city services would effectively penalize departments for their progress in these areas and would waste the City's previous spending on these initiatives, as all of these indicators would likely rise. City agencies should not be rewarded for unprecedented success with a 3.5% cut in funding.

Of the two options (phasing in the PTRP or cutting city expenditures), the least harmful to your legacy and City residents is to phase in the Property Tax Reduction Program. In my proposal, I suggest a modest expenditure cut and a slow phase-in of the PTRP. In addition, I propose a number of new revenue enhancements:

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[6] Bloomberg, Michael. "2003 State of the City Address." The Gotham Gazette. Website, Updated Jan. 23, 2003and accessed March 5, 2007. http://tinyurl.com/336aw2

[7] Bloomberg, Michael. *2004 State of the City Address.* Office of the Mayor of New York City, Jan. 8, 2004.

[8] New York 1. "ACS Commissioner Speaks Out On New Scandal" Website Updated January 27, 2006 and accessed March 5, 2007. http://tinyurl.com/2ty5lu.

[9] Bloomberg, Michael. *Mayor Bloomberg Releases 2007 Preliminary Mayor's Management Report.* PR-052-07, Office of the Mayor of New York City, Feb. 14, 2007.

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Budget Proposal	Difficulty	2008	2009	2010	2011
Tax Reduction Program	High	114.4	587.9	539.4	630.9
Toll the East River Bridge for Non-City Residents	High	357	357	357	357
Pay As You Throw	Med	0	250	250	250
Extend Mortgage Recording Tax	Med	50	50	50	50
Increase Municipal Workweek to 40 Hours	Low	118	241	367	367
Increase Fine for Recycling Violations	Low	94	102.5	111	114.5
Support Bottle Return Bill	Low	2.5	2.5	2.5	2.5
Tourist Fare on SI Ferry	Low	4.6	4.6	4.6	4.6
Cut Excess Reserves Payments	Low	700	200	200	200
Across the Board Cut	Low	575.8	308.4	163.8	168.9
ATB Percent:	--	1.00%	0.50%	0.25%	0.25%
Sum		2016.3	2103.9	2045.3	2145.4
Gap to be closed		$ (2,000)	$ (4,617)	$ (5,681)	$ (5,621)
Remaining gap		$ 16	$ (2,513)	$ (3,636)	$ (3,476)

The metric by which I propose new programs are to support revenue enhancements that reward positive behavior and levy fees on users that do not pay City taxes. These taxes are also conditioned on users ability to pay and the benefits received, which minimizes the regressive nature of the revenue enhancements and makes them fairer[10].

Tolling the East River and Harlem Bridges for Non-City Residents will recover funds lost from the cancellation of the Commuter Tax while encouraging greater use of public transportation. After Albany canceled the city's Commuter Tax in 1999 the city lost a revenue source from non-residents. The loss of revenue is significant: if the Legislature had not eliminated the tax the City would collect $699m in FY2008[11]. Many non-city residents enter NYC via the nine bridges owned by the city. If the city tolled these bridges, it could recover up to $790m each year. If the city only charged non-city residents the toll, revenues would be $357m. The tolls serve as a method to recover the revenue loss from the elimination of the Commuter Tax and as a way to finance the provision of services to non-city residents. Non-city actors will view this proposal with significant resistance, but since it is not charged to city residents will likely not meet strong opposition here. This proposal also fits in with your policy aim to reduce expenditures by taxing negative behavior. Tolling bridges for non-city residents will reduce congestion and pollution in the City while increasing revenue. It, like your cigarette tax increase, rewards economically beneficial behavior.

Beginning a Pay As You Throw solid waste program will reduce municipal trash collection, reward environmentally conscious behavior, and provide a new source of city revenue. Currently, the solid waste disposal is financed through taxes. Pay As You Throw charges residents based on the amount of solid waste they dispose. An economic analysis of PAYT programs found that 7,100 communities participate (including 30% of the largest US cities), and have led to the diversion of 6.5 million tons of solid waste per year[12]. In *Budget Options 2007* the Independent Budget Office estimates that New York City would see up to a 27% reduction in solid waste put out for collection and a cost savings of $294 million. Residents would pay on average $90 per year if current solid waste rates continued, but if less waste was put out for collection the average would drop to $72 per household while still saving the city a significant amount of money. Skumatz notes that "PAYT programs are easy to implement and flexible for different city circumstances" (3PAYT is similar to your stated intention to reduce negative externalities by taxing this behavior, as the program discourages needless waste, encourages recycling, and punishes those residents who overburden city resources. A Pay As You Throw program, effectively marketed to city residents, could meet with low resistance (especially if the cost savings to average households and the environmental benefits of lower solid waste are stressed).

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[10] See Johnson and Lee, *Public Budgeting Systems,* 2003: p.66-7 for a discussion on tax fairness.
[11] Belkin et. al. *Budget Options For New York City.* New York City Independent Budget Office, Feb. 2007.
[12] Skumatz, Lisa and Freeman, David. *Pay As You Throw (PAYT) In The US: 2006 Update and Analysis.* SARA Economic Consulting Group, Boulder Co, 2006.

Extending the Mortgage Recording Tax (MRT) will make it fairer to all purchasers of homes. The MRT is assessed when mortgage equity is used to purchase residential homes, condo apartments, and commercial property,[13] but it is not assessed on co-ops. If the MRT were extended to all homes (this requires a change in State law), the City could earn $140m annually in additional revenue. Opposition to such a policy would be high in areas with high co-op penetration as residents may be concerned that the extension of the MRT would inhibit co-op transactions and ultimately depress market prices, but according to your Budget Summary, areas with high co-op density tend to also have high mean rents, and reduced market pressure could prevent further gentrification in these neighborhoods. Given that the population of the city has increased every year since you took office, it further seems unlikely that an extension of the MRT will lead to a mass exodus of residents – indeed, if market prices for co-ops *were* depressed beyond a negligible rate as a result of the MRT extension one may actually see a population inflow as more units become more affordable to the public.

Increasing the municipal workweek to 40 hours will bring city employment in line with other industries while making the City government more efficient. Increase the municipal workweek to 40 hours. Currently, the municipal workweek is 35 hours. In testimony to the US Senate Committee on Health, Education, and Labor & Pensions, Ellen Galinsky[14] stated that nationwide, men worked an average of 49 hours per week and women work 43.5 hours per week[15]. A Bureau of Labor Statistics study found that employees in New York worked on average 2.0 hours more per week in 2006 than they did in 2005.[16] Most New Yorkers already work a 40-hour workweek; increasing the municipal workweek would put City employees at par with their neighbors. If New York City municipal employees worked a full week, the first year of the program would generate $118 million in cost savings realized through lower hiring rates to compensate for the City's 10% attrition rate. Such a change would generate opposition among city employees and unions, but would likely be supported by city residents. This policy furthers your goal of a more efficient and effective City administration.

Continuing the FY2007 payments to reserves and the Retiree Health Benefit Fund will help return the City to fiscal stability while ensuring its long-term fiscal health. I propose that you hold reserve transfers to their FY2007 level, recovering an extra $200m each year from FY2008-FY2011. Moreover, I recommend that you cancel the extraordinary $500m transfer to the Retiree Health Benefit Fund (your budget would retain its $1b yearly transfer). Both the reserve account and the RTBT remain solvent; once the City Returns to fiscal stability, you can accelerate transfers to these accounts.

A variety of other measures will capture revenue from non-residents and City residents engaging in suboptimal behavior. The city's fine for recycling violations is one of the lowest in the country, and a greater fine will increase revenue while discouraging excess solid waste. The municipal bottle refund bill, currently pending before the state legislature, extends the bottle deposit program to carbonated beverages in addition to beer and other malt beverages and returns the excess deposits to cities if the bottles returned is lower than the bottles sold. It is anticipated that this bill would generate $50 million annually. Finally, the city should charge a "tourist fare" on the Staten Island Ferry (which is currently free) for riders that are non-city residents. The Ferry's expenses are fast increasing, and the spillover a fare of $2 would generate an additional $4.5m in revenue.

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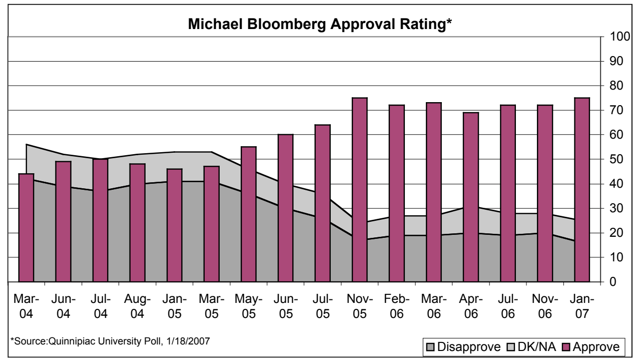
[13] Belkin et. al. *Budget Options For New York City.* New York City Independent Budget Office, Feb. 2007.
[14] Ellen Galinsky is the President of the Families and Work Institute, a think-tank affiliated with the labor movement
[15] Galinsky, Ellen. *Parents Raising Their Children.* Testimony Before the Workplace US Senate Committee on Health, Education Labor & Pensions Committee. Families and Work Institute, 2004.
[16] Bureau of Labor Statistics. "Productivity and Costs, Fourth Quarter and Annual Averages, 2006, Revised." Washington DC, 2006.

You are broadly supported by City residents and have the political capital necessary to make these difficult but necessary choices. A Quinnipiac University poll conducted in January 2007 found your approval rating at a historic high (75%), surpassing the approval rate recorded during this point in the Giuliani Administration. The percentage of New York City residents who disapproved of your performance was 16%, a number that remained low when disaggregated by gender, Party identification and even by race. More crucially, your support remains strong in each of the five boroughs (ranging from a high in Staten Island of 85% to a low in Queens of 77%).



Your proposals will not increase this approval rating: nobody wants expenditure cuts and increased taxes. But the expenditure cuts have been suggested in such a way to minimize political opposition. Only one of the proposals outlined above requires State legislative approval, and while some programs (specifically Tolling the bridges) will garner significant opposition upstate, the political re-alignment in Albany and a growing State budget battle will likely neutralize significant ire in Albany. While the City Assembly will not warmly receive your proposal, there is no proposal that will generate a titanic battle between you and the Assembly. Instead, you are likely to see generalized opposition that is relatively deep but not broad[17]. But during your fight to ban smoking and eliminate trans-fats from restaurants (not to mention your 2002 property tax increase) you faced a similar pattern of Assembly opposition. Moreover, since 2007 is not an election year, you will have less partisan pressure and more leeway in negotiating with the Assembly on a reasonable package of reforms[18]. 35% of the shortfall is financed from cuts to city expenditures, 31% from opening new revenue streams, and 5.7% from phasing in the PTRP, but the magnitude of these cuts means that delaying the property tax reduction program will likely receive much of the attention.

You have the political capital necessary to pass these difficult reforms, but it will take significant leadership from you to get the Assembly to act and for City residents to buy-in. This proposal aligns with your fiscal and governmental goals, will enable you to manage your relationship with Albany, and will ultimately support your mission to significantly reform the City. But you must act quickly to solve this problem.

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[17] In Forsythe, for example (p.45), it is noted that legislators respond to programs and taxes with a particular impact in their districts. The PRTP will have a city-wide impact (and as I noted before if the phase in of the program is marketed effectively much of the opposition may be neutralized) along with much of the new revenue streams. The Staten Island Ferry may generate local opposition, but in addition to your high approval rate there, it must be noted that City residents will not be charged the fare. Only the Mortgage Recording Tax will have localized opposition, and this can be effectively countered with a tax-fairness argument from you.

[18] Forsythe, 2004: p.51.

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Appendix A: Updated City Fiscal Situation

	2007	2008	2009	2010	2011
					Revenues
Taxes					
General Property Tax	12,941	12,227	13,377	14,506	15,459
Other Taxes	22,142	21,987	21,428	22,357	23,513
Audit Revenue	859	559	559	560	560
Tax Reduction Program	--	(1,298)	(1,403)	(1,489)	(1,584)
Misc. Revenue	5,422	5,440	4,818	4,844	4,867
Unrestricted Intergovernment Aid	340	340	340	340	340
Less: Intra-City Revenue	(1,417)	(1,337)	(1,344)	(1,345)	(1,345)
Dissalowances Against Categorial Grants	(15)	(15)	(15)	(15)	(15)
Subtotal: City Funds	**$ 40,272**	**$ 37,903**	**$ 37,760**	**$ 39,758**	**$ 41,795**
Other Categorical Grants	1,061	991	1,003	1,009	1,004
Inter-Fund Revenues	416	406	388	387	386
Total: City Funds and Inter-Fund Revenues	**$ 41,749**	**$ 39,300**	**$ 39,151**	**$ 41,154**	**$ 43,185**
Federal Categorical Grants	5,690	5,218	5,248	5,250	5,255
State Categorical Grants	9,981	10,588	11,335	12,112	12,161
TOTAL REVENUES	**$ 57,420**	**$ 55,106**	**$ 55,734**	**$ 58,516**	**$ 60,601**
					Expenditures
Personal Service					
Salaries and Wages	19,848	20,963	22,011	23,202	24,052
Pensions	4,866	5,575	6,151	6,208	6,208
Fringe Benefits	7,109	6,936	6,759	7,023	7,322
Subtotal: Personal Services	**$ 31,823**	**$ 33,474**	**$ 34,921**	**$ 36,433**	**$ 37,582**
OTPS					
Medical Assistance	4,948	5,380	5,222	5,376	5,535
Public Assistance	1,210	1,200	1,200	1,200	1,200
Pay As You Go Capital	200	200	200	200	200
All Other	16,703	16,475	16,936	17,381	17,710
Subtotal: Other Than Personal Services	**$ 23,061**	**$ 23,255**	**$ 23,558**	**$ 24,157**	**$ 24,645**
General Obligation, Lease, and MAC Debt Service	3,667	3,975	4,292	4,652	5,040
FY 2006 BSDT*	(3,751)	--	--	--	--
FY 2007 BSDT	3,937	(3,937)	--	--	--
FY 2008 BSDT	--	1,376	(1,376)	--	--
General Reserve	100	300	300	300	300
Subtotal	**$ 58,837**	**$ 58,443**	**$ 61,695**	**$ 65,542**	**$ 67,567**
Less: Intra-City Expenses	(1,417)	(1,337)	(1,344)	(1,345)	(1,345)
Total Expenditures	**57,420**	**57,106**	**60,351**	**64,197**	**66,222**
Gap To be Closed	**$ -**	**$ (2,000)**	**$ (4,617)**	**$ (5,681)**	**$ (5,621)**

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Appendix B: Summary of Changes

Budget Proposal	Difficulty	2008	2009	2010	2011	Change to
Tax Reduction Program	High	114.4	587.9	539.4	630.9	Expenditures
Toll the East River Bridge for Non-City Residents	High	357	357	357	357	Revenue
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