Analysis of the Mayor's Preliminary Budget: IBO's Reestimate of the Mayor's Preliminary Budget for 1999 and Financial Plan through 2002

March 23, 1998

Preface

This analysis of the Mayor's preliminary budget for 1999 was completed by the Independent Budget Office (IBO) as required by section 246 of the New York City Charter. It provides a follow-up to *New York City's Fiscal Outlook*, issued by IBO in January 1998. That report included a forecast of city finances under the assumption that existing spending policies and tax laws are allowed to run their course. IBO's *Fiscal Outlook* projections serve as the starting point for this report - our analysis of the Mayor's budget.

The framers of the Charter envisioned this report offering an extensive, detailed analysis of the Mayor's budget to provide the legislative branch with information and budget options to serve as grist for the budget negotiation process. Given the newness of IBO - this is only our second year - the evolution of this report is not yet finished. Each year, we intend to build upon the previous year's work until we have developed a comprehensive reference document for those individuals engaged in the city's annual budget adoption process. In order to develop such a tool, we will require a tremendous amount of cooperation from city agencies in providing information to us. Given the powers and responsibilities vested in IBO by the Charter, we are confident that such cooperation will be forthcoming in the months and years ahead.

Chapter 1 of the report provides a discussion of IBO's repricing of the Mayor's budget, major reestimates, and significant changes from our *Fiscal Outlook* projections. Chapter 2 provides our reestimate of the Mayor's revenue forecast along with a discussion and repricing of the Mayor's tax reduction initiatives. Chapter 3 contains an analysis of preliminary budget spending proposals, highlighting changes from 1998 levels and those areas where significant pricing differences with the Mayor's projections occur.

This report was completed under the supervision of C. Spencer Nelms, Jr. who heads IBO's Budget Analysis Division and Ronnie Lowenstein who leads our Economic Analysis Division. Frank Posillico and George Sweeting coordinated all spending and revenue projections. In addition to their programmatic responsibilities, Bernard O'Brien served as project manager for the report and Mark Schreiner as publication coordinator. A list of IBO contributors and their respective areas of responsibility follows at the end of the report.

Douglas A. Criscitello
Director

NOTES

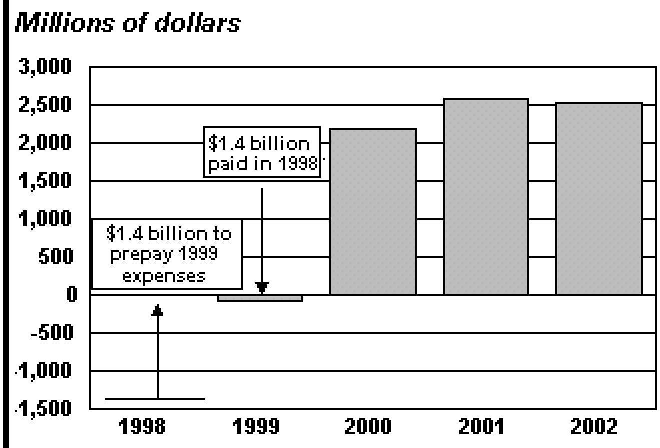
- The Mayor's Preliminary budget for 1999 is also referred to as the "January financial plan" or simply "financial plan."
- Unless otherwise noted, all references to years in both text and figures denote New York City fiscal years (July 1st to June 30th).
- Numbers in the text and figures in this report may not add to totals because of rounding.

Chapter 1
Overview

In January 1998, the Independent Budget Office (IBO) issued *New York City's Fiscal Outlook* unveiling our forecast of city finances assuming existing spending policies and tax laws are allowed to run their course over the next few years. That forecast provides a meaningful alternative reference point for elected officials, the public, and IBO to consider the Mayor's preliminary budget for 1999 and financial plan through 2002. This report, in turn, focuses on IBO's repricing (also referred to as our "reestimate") of the Mayor's financial plan and discusses the major initiatives included in the proposed budget.

As illustrated in Figure 1-1, our reestimate of the Mayor's plan indicates a balanced budget in 1998 followed by a surplus of $75 million in 1999. Although Figure 1-1 shows a balanced budget for the current year, in fact, we expect a surplus of nearly $1.4 billion to occur. Because the city is forbidden by state law to carry excess funds over from one fiscal year to the next, we have assumed (as does the Mayor's budget) that all current year surplus funds will be used to prepay 1999 debt service. Such a reduction in 1999 expenses contributes to the projected surplus in that year.

Figure 1-1.
IBO's Estimate of Budget Gaps Under the Mayor's Financial Plan



SOURCE: Independent Budget Office.

Beyond 1999, we project gaps of more than $2 billion annually. Our gap projections are higher than the Mayor's forecast by $367 million in 2000, $536 million in 2001, and $635 million in 2002. While the precise reasons for these differing gap estimates are detailed below, they result, more generally, from varying policy, economic, and technical assumptions that IBO has used to reprice the Mayor's proposals.

Such large out-year gaps could portend the need to cut services or raise taxes in the years ahead, particularly in the event of an economic downturn. It is important to note that the Mayor's financial plan through 2002 assumes continued growth in the local economy. In the event of an economic downturn, however, spending needs would increase-particularly for social programs-at a time when revenues would be decreasing, thereby making future budget gaps even larger. If this were to occur, the city would face an unenviable choice between increasing taxes in a slow economy or reducing spending when it is needed most.

Absent an economic downturn, if history is any guide these out-year gap projections will get smaller as a result of changes to the Mayor's financial plan as each new fiscal year approaches. The negative consequences of last minute, incremental service reductions, tax increases, or an over-reliance on non-recurring revenues to pay for ongoing expenses, however, highlight the need for the city to plan strategically for its financial future. While the Mayor's budget contains an out-year gap closing plan, details are very sketchy. A more detailed systematic, long-term plan to close projected gaps would help eliminate budget year balancing scrambles, further improve the city's bond rating, and instill confidence in the citizenry that its government is behaving in a fiscally responsible manner.

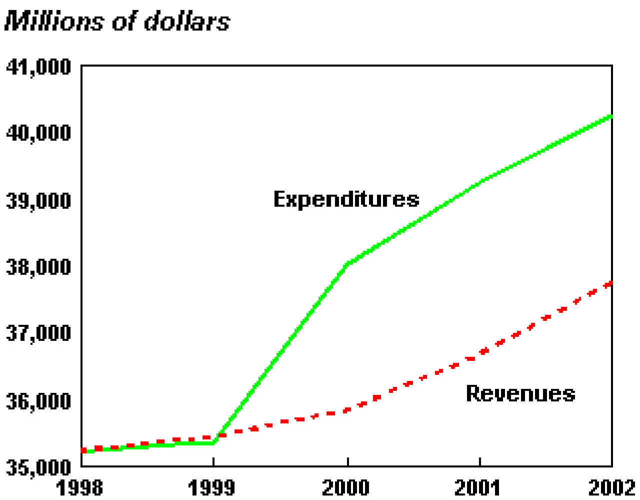
IBO's pricing of the preliminary budget suggests the Mayor's policies would substantially change the gaps projected to occur under existing laws and policies. Compared with IBO's baseline estimates of revenues and spending, our repricing of the Mayor's budget results in gaps $147 million lower in 1999, but higher by $332 million in 2000, $432 million in 2001, and $601 million in 2002.

Budget Summary

The preliminary budget reflects an improving local economy bolstered by the continuing record profitability of Wall Street securities firms. Such prosperity has allowed the Mayor to propose fewer spending reductions than in past years coupled with a reduction of certain taxes paid by New Yorkers. IBO projects that both city-funded and overall spending for 1999 would rise if the Mayor's budget was adopted in its entirety. The preliminary budget would result in expenditures of $35.4 billion in 1999, including $24.0 billion in city-funded spending - a 5.2 percent increase over 1998 when debt service prepayments are excluded.

As shown in Figure 1-2, we expect expenditures to grow at a substantially faster pace than revenues beyond 1999, leading to the large budget gaps discussed above.

Figure 1-2.
IBO's Estimate of Revenues and Expenditures Under the Mayor's Financial Plan



SOURCE: Independent Budget Office.

A key feature of the preliminary budget and financial plan is the proposed utilization of a projected $1.4 billion surplus in the current year. As noted above, all surplus funds must be fully spent each year. The city can, however, effectively carry over some of these funds by providing new appropriations to a reserve fund known as the budget stabilization account. The Mayor proposes a partial replenishment of $210 million for the account in 1999, which would be tentatively earmarked to help balance the gap in 2000.

The preliminary budget includes elimination of the commercial rent and clothing sales taxes, reductions in the real property tax on coops and condominiums, and personal income tax credits for subchapter S corporations and child care. The fiscal prudence of cutting taxes depends on anticipated spending requirements, the specific taxes under consideration and their simulative impact on the local economy, and on the sustainability of recently strong revenue growth. The larger question is whether the city will ultimately be able to afford the Mayor's tax program.

In the short term, however, the prepayment of 1999 expenses along with other factors such as an increase in forecast revenue growth next year would more than eliminate what had been a projected 1999 budget gap of more than $2 billion at the beginning of the current fiscal year.

pic3

IBO Reestimates

Figures 1-3 and 1-4 summarize significant differences between IBO's reestimated projections and the projections contained in the Mayor's preliminary budget. It must be emphasized that differing estimates of city revenues and city-funded spending have a direct impact on projected gaps, while varying estimates of state and federal aid have no net budgetary impact because such grants are fully expended.

Figure 1-3.
IBO's Repricing of the Mayor's Financial Plan (In millions of dollars)

	1998	1999	2000	2001	2002
Revenues:					
Taxes	20,034	20,146	20,358	20,708	21,135
Miscellaneous Revenues	2,738	2,707	2,471	2,398	2,460
State/Federal Categorical Aid	11,289	11,405	11,629	11,963	12,289
Other	1,165	1,193	1,376	1,600	1,855
Total Revenues	35,226	35,451	35,834	36,669	37,739
Expenditures:					
City-Funded	23,937	23,971	26,375	27,272	27,966
State/Federal Categorical Aid	11,289	11,405	11,629	11,963	12,289
Total Expenditures	35,226	35,376	38,004	39,235	40,255
IBO Surplus/(Gap) Estimate	**---**	**75**	**(2,170)**	**(2,566)**	**(2,516)**

SOURCE: Independent Budget Office.
NOTES: Excludes intra-city revenues and expenditures.

City Funds

Over the 1999-2002 period, IBO generally projects higher gap estimates in its reestimate of the Mayor's budget than those forecast by the Administration. The lone exception is 1999, when IBO projects a surplus of $75 million while the Administration forecasts budget balance. More specifically, IBO's re-pricing of 1999 yields $527 million more in baseline tax revenues, $491 million less in other revenues, and $39 million less in spending. Much of the difference in revenues results from

IBO's view that both personal and business income taxes will be significantly higher than estimated by the Mayor. These additional tax revenues will be, however, largely offset by our more conservative projections of miscellaneous revenues and unrestricted aid from the state and federal governments. Most of the difference in spending estimates-discussed in more detail below-can be found in projections for Medicaid and overtime pay for city employees.

For 2002, IBO's gap estimate under the Mayor's policies is $635 million higher than amounts projected in the Mayor's budget. Our estimate of city revenues is $308 million lower due primarily to IBO's projection of slower growth in property taxes, partially offset by higher growth in personal and business income taxes. Our estimates for public assistance,` Medicaid, education, overtime pay for city employees, and other expenditures are $327 million higher than forecast by the Mayor.

Taxes. IBO's forecast of city tax revenues is higher than the estimates contained in the Mayor's budget for each year of the financial plan. Most of the difference between the two revenue estimates is attributable to IBO's more optimistic economic forecast. We project higher revenues over the near term, with $527 million of additional revenue in 1999 and $314 million in 2000. Beyond 2000, our estimates begin to approach those of the Administration; we are $176 million higher in 2001 but only $26 million higher by 2002. In all years, IBO's estimates of the Mayor's tax reduction program are similar to those projected by the Administration.

Figure 1-4.
Details of Pricing Differences Between the Administration and IBO (In millions of dollars)

	1998	1999	2000	2001	2002
Gaps As Estimated by Mayor	--	--	**(1,803)**	**(2,030)**	**(1,881)**
IBO Reestimates:					
Revenues:					
Taxes:					
Property	16	6	(80)	(147)	(253)
Personal Income	116	116	156	184	230
General Sales	(4)	21	(49)	(35)	(41)
Business Income	169	393	313	202	102
Real-estate Related	(6)	(9)	(26)	(28)	(12)
Tax Revenues	291	527	314	176	26
Tax Reduction Program	--	(22)	33	6	9
Unrestricted Aid	--	19	(3)	(6)	50
Other Revenues	--	(358)	(358)	(358)	(358)
Miscellaneous Revenues:					
Airport Rent	--	(330)	(140)	(135)	(35)
Coliseum Sale	(200)	200	--	--	--
Total Revenues	91	36	(154)	(317)	(308)
Expenditures:					
Public Assistance	5	(8)	(35)	(50)	(86)
Medicaid	--	(9)	(26)	(27)	(28)
Education	91	(6)	(50)	(37)	(80)
Overtime	(23)	(42)	(42)	(42)	(70)
Debt Service Prepayment	(164)	164	--	--	--
All Other	--	(60)	(60)	(63)	(63)
Total Expenditures	(91)	39	(213)	(219)	(327)
Total Reestimates	--	75	(367)	(536)	(635)
Gaps As Estimated by IBO	--	**75**	**(2,170)**	**(2,566)**	**(2,516)**

SOURCE: Independent Budget Office.
NOTES: Negative reestimates widen the gaps estimated by the Mayor. Positive reestimates narrow the gaps. Excludes intra-city revenues and expenditures.

Other Revenues. The Mayor assumes additional revenues from the state and federal governments as a result of certain legislative initiatives intended to benefit the city budget. IBO projects much lower revenues from these initiatives than does the Administration - $358 million less each year through 2002. We estimate the city will receive only $32 million of the $200 million anticipated by the Mayor from various state actions. Moreover, IBO does not project any additional unrestricted revenues from federal initiatives, although the budget assumes an additional $190 million in revenues from the federal government.

Miscellaneous Revenues. IBO forecasts miscellaneous revenues that are $200 million and $130 million lower than the Mayor's budget in 1998 and 1999, respectively. In particular, IBO believes there is insufficient time left in this fiscal year to complete sale of the Coliseum; we have shifted its sale into 1999. Furthermore, there is considerable risk as to both the size and the timing of past due and future airport rental payments from the Port Authority, which is the topic of an ongoing dispute. Accordingly, we have lowered the city's anticipated income from airport rent.

Public Assistance. IBO forecasts higher spending on public assistance than amounts projected in the Mayor's budget. The Mayor's plan assumes recently experienced welfare caseload reductions will continue through 1999, then stabilize over the 2000-2002 period.

Two provisions of the welfare reform law-increasing work quotas for adult welfare recipients and setting a five-year lifetime limit on federal assistance-will likely have a particularly strong impact on future caseloads and expenditures. While IBO projects a slower but more extended pattern of caseload decline for the Family Assistance (FA) program than foreseen by the Mayor, we expect the state- and city-funded Safety Net Assistance (SNA) caseload to soon bottom out and gradually start to rise again. We expect both caseloads to become increasingly made up of very needy and hard to employ individuals. Moreover, the five-year rule on federal eligibility is expected to lead to a shift of 62,000 FA recipients into the SNA program in 2002 Overall, IBO projects additional city spending on public assistance (over and above the Mayor's plan) of $8 million in 1999 growing to $86 million by 2002.

Medicaid. IBO estimates that Medicaid expenditures at the Human Resources Administration will slightly exceed those contained in the Mayor's preliminary budget. We expect the cost of certain services¾ intermediate care facilities, home nursing, and prescription drugs¾to exceed the growth rates reflected in the Mayor's plan even under the full implementation of managed care. Furthermore, the Mayor anticipates no growth for home attendant and housekeeper services while we project 1 percent annual cost increases. Accordingly, IBO projects more city spending on medical assistance - $9 million in 1999 rising to about $25 million each year thereafter - than contained in the Mayor's budget.

Education. Given that enrollment is a significant factor in determining education spending, IBO has developed a model to forecast Board of Education expenditures. Based on an econometric analysis completed by IBO, we forecast education spending would be $6 million higher than the Mayor's budget in 1999 rising to $80 million more in 2002. In addition to enrollment, IBO's estimate reflects the net impact of various mayoral initiatives, collective bargaining increases, pupil-to-teacher ratios, the number of teachers system-wide, and inflation.

Overtime. IBO also projects substantially higher spending (above the Mayor's budget) on city employee overtime costs - $42 million annually through 2001 and increasing to $70 million for 2002. Those higher costs are being driven by implementation of a drug eradication initiative by the Police Department and other initiatives involving agencies which provide social services.

Debt Service Prepayment. IBO projects the budget surplus in 1998 will be $164 million higher than estimated in the Mayor's budget. It is assumed that these funds will be used to prepay debt service costs scheduled for 1999.

State and Federal Categorical Aid

IBO forecasts higher state and federal categorical aid over the 1998-2002 period compared with amounts projected by the Mayor (see Figure 1-5). For 1999, IBO's projection for state and federal categorical aid is nearly $1.1 billion higher than the Mayor's. By 2002 this difference grows to $2 billion.

IBO's estimates of state categorical grants in 1999 is $349 million higher than the Mayor's, growing to $921 million by 2002. Education aid accounts for over two-thirds of the higher 1999 estimate. Similarly, IBO's projection of federal categorical grants is $742 million higher that the Mayor's in 1999, a difference which increases to $1.1 billion in 2002. Our estimates of education and health care account for nearly half of the 1999 difference, while aid for housing and police comprise a third.

Figure 1-5.
State and Federal Categorical Grants (In millions of dollars)

	1998	1999	2000	2001	2002
Mayor's Financial Plan	11,022	10,314	10,224	10,234	10,246
IBO Reestimate of Mayor's Plan	11,289	11,405	11,629	11,963	12,289
Difference	267	1,091	1,405	1,729	2,043

SOURCE: Independent Budget Office.

Comparison with Baseline Projections

IBO estimates enactment of the Mayor's budgetary proposals would change the gaps forecast in our baseline (or "current services") projections - which assume existing spending policies and tax laws are allowed to run their course over the next few years (see Figure 1-6). IBO's reestimate of the Mayor's tax reduction program projects lower tax revenues than our baseline by $259 million in 1999 and $765 million by 2002. Offsetting these reductions are increases in anticipated and miscellaneous revenues totaling $232 million in 1999, decreasing to $32 million by 2002. In addition, agency spending under the Mayor's proposals would be $174 million lower than current services projections in 1999 falling to about $140 million each year thereafter.

City Funds

Revenues. A major component of the Mayor's tax program is his proposal to accelerate the starting date of the already-enacted tax exemption for clothing priced under $100 and at the same time expand the exemption to cover all apparel sales, including footwear. IBO estimates that these changes would decrease sales tax revenues by $202 million in 1999 but by only $120 million in 2002. The additional costs associated with these new sales tax cuts would decline after 2000 because only clothing sales of $100 or more would be affected by the proposed full sales tax exemption in 2001 and 2002-sales of clothing costing less than $100 will already be exempt.

In the long run, the most costly of the Mayor's tax proposals are the complete elimination of the commercial rent tax and the extension of tax relief for coop and condo owners. IBO estimates that phasing out the commercial rent tax on leases in buildings south of 96th Street in Manhattan-the only area currently subject to the tax-would cost the city $388 million in 2002. Similarly, extending the coop-condo property tax abatement program, currently scheduled to expire after 1999, would cost $198 million.

Finally, the Mayor is proposing two relatively modest reductions in the city's personal income tax. The first would provide a credit against personal income taxes for resident shareholders of subchapter S corporations, similar to the credit enacted last year for small business owners who pay the city's unincorporated business tax. The second proposal would give city residents a personal income tax credit for a portion of their child and dependent care expenses. IBO projects that the subchapter S corporation and child care credits would reduce city personal income tax receipts by $34 million and $23 million, respectively, in 1999.

The increase of $200 million in 1999 miscellaneous revenues represents the shifting of proceeds from the sale of the coliseum. Given the short amount of time left in the current fiscal year, we do not expect the transaction to occur until 1999.

Other revenues - derived from the Mayor's state and federal agenda - would total $32 million in 1999 and each year thereafter. Because our current services baseline only recognizes enacted policy changes, none of those revenues are included.

Figure 1-6.
IBO's Current Services Baseline (In millions of dollars)

	1998	1999	2000	2001	2002
Gaps Under IBO Baseline	--	**(72)**	**(1,838)**	**(2,134)**	**(1,915)**
IBO's Scoring of the Mayor's Budget					
Revenue Changes:					
Tax Reduction Program	--	(259)	(504)	(604)	(765)
Other Revenues	--	32	32	32	32
Miscellaneous Revenues	--	200	--	--	--
Expenditure Changes:					
Agency Changes	--	174	140	140	132
Total Changes	--	147	(332)	(432)	(601)
Gaps Under Mayor's Budget As Estimated by IBO	--	**75**	**(2,170)**	**(2,566)**	**(2,516)**

SOURCE: Independent Budget Office.

NOTES: Negative numbers indicate increases in the budget gap.
Excludes intra-city revenues and expenditures.

Expenditures. City-funded spending for health and social services, along with environmental protection, cultural affairs, and finance programs account for over 80 percent of the $174 million in spending reductions below current services levels in 1999.

- Health and social services funding would be $56 million lower than our current services projections. This is due in large part to the fact that our 1999 baseline estimates assume that employment will remain constant at city agencies involved in the delivery of these services. The Mayor's budget, however, contains staffing reductions. Moreover, a variety of cost savings initiatives included in the budget are expected to hold growth in non-personnel related spending to less than the rate of inflation.
- Department of Environmental Protection funding would be $49 million lower than our current services projections. Certain contracts related to wastewater pollution and sludge removal costs would not be funded beyond 1998, as assumed in our baseline.
- Department of Cultural Affairs activities funding would be $19 million lower than our current services projections because of cuts contained in the Mayor's budget. Such reduced funding is traditionally restored during the budget negotiation process with the City Council.
- Department of Finance funding would be $17 million lower than current services projections. This is largely due to a hiring freeze by the department and delays in implementing the city's document imaging system.

State and Federal Categorical Aid

IBO's current services forecast of state and federal categorical aid is based on current levels of funding, with adjustments made to accommodate projected program levels. Our reestimate of the Mayor's financial plan, however, assumes categorical aid consistent with policy changes proposed by the Mayor, which in many instances would result in less categorical aid than our baseline projections.

Figure 1-7.
IBO's Current Services Baseline: State and Federal Categorical Grants (In millions of dollars)

	1998	1999	2000	2001	2002
Current Services Baseline	11,250	11,535	11,811	12,206	12,596
IBO Reestimate of Mayor's Plan	11,289	11,405	11,629	11,963	12,289
Difference	(39)	130	182	243	307

SOURCE: Independent Budget Office.

Chapter 2
Revenue Estimates

Overview

IBO estimates that if the Mayor's policy proposals are adopted, total revenues from all sources would rise from $35.5 billion in 1999 to $37.7 billion in 2002. However, the outlook for each of the three primary revenue streams included in total revenues-tax revenues, miscellaneous revenues, and state and federal aid-varies significantly.

This chapter presents details of IBO's revenue forecast. The first section summarizes our economic outlook. The second section-which comprises the majority of the chapter-focuses on tax revenues. That section begins with an overview of IBO's tax revenue forecast, briefly contrasts our forecast with that of the Mayor, and provides a close look at Mayor's tax reduction program. The chapter concludes with IBO's forecast of miscellaneous revenues and state and federal aid.

Economic Outlook

The performance of the national and local economies are the fundamental factors underlying expectations for city revenues and expenditures. IBO expects economic growth in the U.S. to slow later this calendar year and through 1999, and the impressive recent growth in the city's economy to moderate as well.[1] We expect some acceleration for both economies beyond 1999. (IBO's economic forecast is contrasted with the Administration's most recent forecast in Appendix B.)

Recent Developments. The U.S. and the New York City economies both performed very well in 1997. U.S. employment increased 2.2 percent, or 2.7 million jobs, and the gross domestic product grew by 3.7 percent. In spite of this impressive growth, inflation slowed, with the consumer price index rising by just 2.4 percent in 1997 after increasing by 2.9 percent in 1996.

New York City had a strong 1997 as well. IBO estimates that total personal income grew by 8.7 percent, its fastest growth since 1992. Earnings in the service sector and in the finance, real estate, and insurance sector (FIRE) crossed the $50 billion mark. Growth in service earnings was 8.5 percent, the fastest rate since 1988. Growth in FIRE earnings has been strong since 1995 and the surge continued in 1997, as the sector posted a growth rate of 11.6 percent. City unemployment, however, remains high; an average of 9.5 percent of New York City's labor force was unemployed in 1997.

National Outlook. Two main factors underlie IBO's forecast of slower U.S. economic growth late in 1998 and through 1999. The currency and financial crisis in Asia will reduce U.S. exports to the region, and, as a result of changes in the exchange rate, increase U.S. imports. Even absent the developments in Asia, however, the recent rate of growth would be very difficult to sustain. National employment has been growing faster than the labor force since 1993, and the current unemployment rate is the lowest it has been since 1973. Labor shortages and wage pressures in some regions are expected to slow economic growth and push up inflation rates in 1999.

New York City Outlook. IBO expects economic growth in New York City to moderate, remaining relatively strong in 1998 but weaker in 1999. In spite of the continued strong performance on Wall Street, slower U.S. growth will dampen the city's FIRE sector earnings. Total personal income will rise 6.3 percent in 1998 but only 4.2 percent in 1999, before increasing at an average rate of 4.8 percent from 2000 to 2002. Growth in employment will also moderate, from 1.3 percent in 1998 to 0.7 percent in 1999 through 2001. Prices in the New York-Northern New Jersey region will rise more slowly than prices in the nation as a whole.

The expected moderation in city economic growth can be illustrated by IBO's projections for the city's two largest sectors-services and FIRE-for 1998 and 1999. Services have seen strong growth in both earnings and employment over the past few years. Service sector earnings growth will slow to 6.6 percent in 1998 and 5.4 percent in 1999, while employment growth will slow to 2.7 percent and 2.4 percent.

In contrast, recent growth in FIRE sector earnings has not been accompanied by commensurate employment growth. While FIRE sector earnings grew by 11.6 percent in 1997, FIRE employment grew by just 1.0 percent. IBO expects annual FIRE sector employment growth of just 0.9 percent in 1998, followed by a decline of 0.6 percent in 1999. Meanwhile, FIRE earnings will grow by 6.6 percent and 3.8 percent.

Tax Revenues

New York City tax revenues grew at a brisk 7.6 percent in 1998, thanks to strong recent growth in the city's economy. IBO expects that tax revenues will continue to grow in 1999 through 2002, but at a reduced rate. Slowing growth in the national economy and in Wall Street profits, plus a number of proposed tax reductions, lead IBO to project that tax revenues will grow very slowly in each year of the forecast period.

Baseline Tax Revenue Forecast

IBO projects baseline tax revenues-before accounting for the effects of the tax reduction program-to grow by 1.9 percent in 1999, 2.2 percent in 2000, and 2.2 percent in 2001, and 2.8 percent in 2002 (see Figure 2-1).

The property and personal income taxes, the city's largest sources of tax revenue, show steady positive growth in every year. The property tax is expected to grow by $988 million, or at an annual average rate of 3.2 percent, over the course of the forecast period, compared to annual growth of 2.3 percent for taxes overall. Much of this growth occurs in 2000 and is attributable to $175 million in coop and condo tax abatement programs that are scheduled to end in 1999. If these programs are extended, however, property tax revenue growth will be reduced by almost half in 2000, and reduced to 2.6 percent per year for the forecast period. Business tax revenues will grow by just 0.2 percent per year over the forecast period, thanks largely to general corporation tax reductions. The decline in sales tax revenues in 2000 can also be attributed to recent tax changes, as described below.

IBO's tax revenue forecast is more optimistic than the forecast contained in the Mayor's preliminary budget for 1998 and 1999, but similar for 2000, 2001, and 2002 (see Figure 2-2). Much of the difference in the near-term forecast is attributable to more recent economic data that allows IBO to project earnings and employment growth at levels greater than were expected just two months ago when the Mayor's budget was released.

Tax Reduction Program

The Mayor has proposed a tax program expanding the substantial tax reductions implemented over the past four years. As shown in Figure 2-3, IBO projects that the total cost of the Mayor's proposed reductions in sales taxes, commercial rent taxes, property taxes on coops and condominiums, and personal income taxes would total $259 million in 1999 and grow to $765 million in 2002. These reductions would offset roughly half of the underlying growth in baseline tax revenues.

Figure 2-1.
IBO's Revenue Estimates Under the Mayor's Proposals (In millions of dollars)

	1998	1999	2000	2001	2002
Tax Revenues:					
Property Tax	7,277	7,391	7,753	7,999	8,265
Personal Income Tax	4,755	4,814	4,934	5,000	5,140
General Sales Tax	3,044	3,178	3,164	3,228	3,354
Business Income Taxes	2,594	2,647	2,606	2,624	2,618
Real Estate-Related Taxes	843	859	884	935	989
Other Taxes (with Audits)	1,521	1,516	1,521	1,526	1,534
Total Taxes Before Reductions	20,034	20,405	20,862	21,312	21,900
Mayor's Tax Reduction Program	--	(259)	(504)	(604)	(765)
Total Taxes After Reductions	20,034	20,146	20,358	20,708	21,135
Miscellaneous Revenues	2,738	2,707	2,471	2,398	2,460
State/Federal Categorical Aid	11,289	11,405	11,629	11,963	12,289
All Other Revenues	1,165	1,193	1,376	1,600	1,855
Total Revenues	**35,226**	**35,451**	**35,834**	**36,669**	**37,739**

SOURCE: Independent Budget Office.

NOTES: Miscellaneous revenues are net of intra-city revenues.
All other revenues include unrestricted government aid, anticipated revenue, other categorical grants, inter-fund revenues, and disallowances.

Coop-Condo Abatement

The tax program calls for extending the existing coop-condo property tax abatement, scheduled to expire after 1999. The abatement is designed to reduce the disparity in tax burdens between owners of cooperative and condominium apartments, on the one hand, and owners of one-, two-, and three-family homes on the other. The current abatement will cost the city $92 million in 1998 and $160 million in 1999. If the program is extended, the cost would grow to $198 million by 2002.

Background. Most coop and condo apartment buildings in the city are assigned to tax class 2 for property tax purposes, while one-, two-, and three-family homes are designated as tax class 1. The city's effective tax rate (property tax as a percentage of market value) for class 1 is less than 0.8 percent.[2] In contrast, effective tax rates for most coops and condos are 1.7 percent and 2.1 percent, respectively-in both cases, more than double the class 1 rate.[3]

Advocates for coop and condo owners have long contended that the city should treat all homeowners equally, regardless of whether they live in apartment buildings or houses. In 1996, legislation was enacted to

Figure 2-2.
IBO's Reestimate of the Mayor's Revenue Forecasts (In millions of dollars)

	1998	1999	2000	2001	2002
Total Revenues Estimated by the Mayor	**34,868**	**34,324**	**34,583**	**35,257**	**36,004**
IBO Reestimates:					
Property Tax	16	6	(80)	(147)	(253)
Personal Income Tax	116	116	156	184	230
General Sales Tax	(4)	21	(49)	(35)	(41)
Business Income Taxes	169	393	313	202	102
Real Estate-Related Taxes	(6)	(9)	(26)	(28)	(12)
Tax Reduction Program	---	(22)	33	6	9
Miscellaneous Revenues					
Airport Rent	---	(330)	(140)	(135)	(35)
Coliseum Sale	(200)	200	---	---	---
State/Federal Categorical Aid	267	1,091	1,405	1,729	2,043
All Other Revenues	---	(339)	(361)	(364)	(308)
Total Reestimates	358	1,127	1,251	1,412	1,735
Total Revenues Estimated by IBO	**35,226**	**35,451**	**35,834**	**36,669**	**37,739**

SOURCE: Independent Budget Office.

NOTES: Miscellaneous revenues are net of intra-city revenues.
All other revenues include unrestricted government aid, anticipated revenues, other categorical grants, inter-fund revenues, and disallowances.

create a temporary three-year abatement that would begin to alleviate the gap in effective rates. The abatement reduces taxes on qualifying apartments by 1.25 percent in 1997, 10.75 percent in 1998, and 17.5 percent in 1999.[4] The legislation included a requirement that the city prepare a plan for a long-term solution that would gradually reduce the effective tax rate on class 2 coops and condos to the class 1 rate. Despite the promise that a more extensive reform would follow the three-year period, no plan was forthcoming and the Mayor's tax program now includes only a proposal to extend the abatement at its 1999 level.

Fiscal Impact. IBO projects that extending the abatement would cost the city $175 million in 2000, $187 million in 2001 and $198 million in 2002. These estimates, which are somewhat higher than those provided in the Mayor's preliminary budget, take into account IBO's estimates of assessment growth for different types of properties and a gradual increase in the number of qualifying properties. In 2002, the reduction in city revenues accounts for 25 percent of the tax program's cost and equals 2.4 percent of baseline property tax revenues.

Other Considerations. When evaluating proposed tax reductions targeted at resolving a particular inequity in a tax, it is appropriate to take a broad view. Do other inequities in the tax result in greater hardship and therefore have a greater call on the revenues being forgone?

In the case of the city's property tax, the disparity in tax burdens between owner-occupied apartments and houses is much smaller than the disparity in burdens between owner-occupied apartments and rental apartment buildings. The effective tax rate on rental buildings is 4.6 percent, nearly three times greater than the rate on coops and more than double the rate on condos. Given that much of the property tax nominally paid by landlords of rental buildings is passed along in the form of higher rents, this burden is largely borne by tenants who in general have lower incomes than owners of coops and condos. As a result of higher effective tax rates and lower incomes, property taxes weigh more heavily on renters than owners. This suggests that if the city's goal is to reduce inequities in the property tax, it may well be more effective to apply the funds to cutting taxes on rental properties.

IBO has begun work on a comprehensive study of the differentials in tax burdens among all types of residential properties. Using property tax data that the Administration released six months after it was requested and too late to be used in the current report, the study will include a more detailed analysis of the current abatement program and the distribution of abatement benefits.

Commercial Rent Tax

The tax program includes a proposal to eliminate the commercial rent tax (CRT) over three years beginning in 2000. While as recently as 1994 the CRT accounted for $629 million, or 3.5 percent of all tax revenues, previously enacted reductions have already substantially lowered projected CRT collections. By 2002, the cost of totally eliminating the tax would be $388 million-1.6 percent of the city's tax revenues.

The CRT is paid by commercial tenants based on their rental payments. Since September 1995, only leases in buildings south of 96th Street in Manhattan have been subject to the tax. Tax liability is determined by a single flat rate applied to the base rent; tenants whose base rent is below a threshold are exempt. A sliding-scale credit, which phases out as taxable rent increases, helps to moderate what would otherwise be a steep rise in the marginal tax paid on rents just over the full-exemption threshold.

Recent History. Although the CRT tax burden has been reduced several times since its peak in 1977, in the last four years the city has made the most dramatic changes, significantly decreasing both the number of tenants subject to the tax and the liability of the remaining taxpayers. These reductions account for over 90 percent of the precipitous fall in CRT revenues from $629 million in 1994 to $340 million in 1998.[5]

Limiting the tax to Manhattan properties south of 96th Street has a relatively modest revenue impact of $59 million for 1998, or 18 percent of the total reductions enacted since 1994.[6] One potential benefit from eliminating the CRT everywhere except Manhattan is to encourage economic development outside the city's central business districts. Moreover, by eliminating the burden on businesses that contribute little to the tax base, the efficiency of the tax is increased. However, taxing firms located in different areas of the city differently undermines one of the desired attributes of a tax system, horizontal equity, which holds that taxpayers with equal ability to pay be treated equally.

The liability threshold below which a tenant is exempt from the CRT has been increased in a series of steps from $11,000 to $100,000.[7] Increasing the threshold has added some progressivity to the tax by exempting tens of thousands of small Manhattan businesses with modest rental costs.[8] Although one would expect such a large increase in the threshold to result in a precipitous decrease in collections, because little commercial rent tax was paid by the exempt firms, the cost of this change-$115 million in 1998-accounts for only 35 percent of the total reductions enacted since 1994.

For firms still subject to the CRT, the most important change has been a reduction in the effective tax rate accomplished by discounting the amount of rent subject to the tax. Beginning in March 1996, the effective tax rate on commercial rents in Manhattan south of 96th Street was reduced from 6.0 percent to 4.5 percent. Because it affects all taxpayers, this change costs the city more in tax revenues; in 1998, this reduction in the effective tax rate will reduce CRT liabilities by $150 million, or 46 percent of total reductions since 1994. Under legislation enacted last year, the effective tax rate will decline further to 3.9 percent in September 1998 at an additional cost of $39 million in 1999 and $59 million by 2002.

Proposed Changes. The preliminary budget calls for gradually eliminating the CRT between 2000 and 2002. In the first year the effective rate would be lowered by one-third, reducing CRT revenues by $105 million. In 2001, the effective rate would be cut by another third, bringing the cumulative loss in revenues to $242 million. Finally, in 2002, the CRT would be eliminated at a cost of $388 million.[9]

IBO's estimates of the cost of eliminating the CRT are slightly lower than the Mayor's which project revenue reductions of $106 million in 2000, $244 million in 2001, and $396 million in 2002. The differences are attributable to slight variations in economic assumptions which yield slower growth in IBO's projection for baseline CRT revenue than the estimates in the Mayor's financial plan.

The CRT and the City's Tax Structure. It is likely that elimination of the CRT would yield economic benefits for the city, if for no other reason than by removing a feature of city's tax system which is unique and highly visible. No other major U.S. city taxes commercial rents. As a result, the tax has always been controversial and is often cited as evidence of the city's high business tax burden and as an impediment to economic development. Although landlords would be likely to increase rents to capture some of their tenants' savings, the cost of locating a business in the city's primary business districts is likely to be lower without the CRT. This should make it easier to attract and retain business and jobs in these areas.

Although the CRT is usually high on advocates' lists of taxes to abolish, an argument can also be made for retaining the tax for its ability to more quickly capture growth in commercial property values. Under this view, the commercial rent tax is a compliment to the city's tax on real property. The CRT was created in 1963, when the city was approaching a constitutional limit on the size of its property tax levy.[10] Prohibited from raising the necessary revenue through the property tax, the city turned to a tax that allowed it to capture growth in the value of commercial properties by taxing the rents which underlie the buildings' market values.[11]

Although the constitutional limit is no longer a significant factor in the city's overall tax structure, the CRT continues to function as a complement to the property tax. Under the real property tax law, assessment increases for commercial buildings (excluding increases attributable to physical improvements and new construction) are phased-in over five years. Thus, the city does not immediately receive the revenue benefits of improving market values.[12] Given that most assessment increases subject to the phase-in requirement are attributable to improving rental incomes, the CRT allows the city to capture some of these increases earlier than would have otherwise been the case.

Child Care Credit

The Mayor also proposes to give resident taxpayers a personal income tax credit for a portion of their child and dependent care expenses. If enacted, IBO estimates that the credit would reduce the city's PIT receipts by $23 million, or 0.1 percent of tax revenues, in 1999.

Figure 2-3.
IBO's Reestimate of the Mayor's Tax Reduction Program (In millions of dollars)

	1998	1999	2000	2001	2002
IBO Estimate of the Tax Reduction Program					
PIT Credit for Dependent and Child Care	---	(23)	(22)	(20)	(19)
PIT Credit for Share of S Corp GCT Liability	---	(34)	(35)	(38)	(39)
Sales Tax: Raise Clothing Exemption to $500	---	(185)	(141)	(90)	(93)
Sales Tax Exemption on Clothing Above $500	---	(17)	(25)	(26)	(27)
Commercial Rent Tax Elimination	---	---	(106)	(242)	(388)
Co-op/Condo Property Tax Relief	---	---	(175)	(187)	(198)
Total	---	(259)	(504)	(604)	(765)
Mayor's Estimate of the Tax Reduction Program					
PIT Credit for Dependent and Child Care	---	(27)	(28)	(29)	(31)
PIT Credit for Share of S Corp GCT Liability	---	(34)	(35)	(38)	(39)
Sales Tax: Raise Clothing Exemption to $500	---	(162)	(178)	(101)	(103)
Sales Tax Exemption on Clothing Above $500	---	(14)	(24)	(25)	(25)
Commercial Rent Tax Elimination	---	---	(106)	(244)	(396)
Co-op/Condo Property Tax Relief	---	---	(166)	(173)	(180)
Total	---	(237)	(537)	(610)	(774)
Difference	---	(22)	33	6	9

SOURCE: Independent Budget Office; Mayor's Preliminary Budget for 1998.

A Piggybacked Credit. The proposed Dependent and Child Care Credit (referred to simply as the child care credit) would take effect in tax year 1998 and provide a credit against personal income taxes (PIT) for expenses incurred to care for children under 12 years of age and other qualified dependents, such as the physically or mentally incapacitated. The credit would be available to all city residents who are working or looking for work. Under the proposal, the amount of credit that taxpayers could claim against the PIT would equal 50 percent of the existing New York State child care credit-a credit which itself is pegged to the federal credit.

The federal child care credit equals 30 percent of eligible expenses for households with adjusted gross incomes of up to $10,000. For incomes greater than $10,000, the rate is reduced by one percentage point for each $2,000 of additional taxable income up to $30,000, and remains constant at 20 percent for all incomes above that level. Eligible expenses are capped at $2,400 for one dependent and $4,800 for two or more dependents, so the maximum amount of federal credit allowed under current law would be $1,440 (30 percent x $4,800). The federal credit is not refundable, which means that some taxpayers cannot benefit from the entire credit allowed under law because their (pre-credit) liabilities are too low.

The New York State credit is equal to 20 percent of the allowable federal credit for households with incomes above $30,000, and up to 28 percent for those with lower incomes. State taxpayers may claim these percentages of the entire allowable federal credit whether or not the entire amount is taken on the federal tax form. Unlike the federal credit, the state child care credit is refundable.

Like the state credit, the city's proposed child care credit is also refundable. With the proposed city credit equal to half the state credit, the maximum amount of PIT credit a resident taxpayer with two or more qualified dependents would be able to claim is $201 (50 percent x 28 percent x $1,440). A taxpayer whose child care credit exceeds his or her pre-credit liability would receive a check for the difference. would be $101.

New York City Income Taxes and the Working Poor

On March 19th, IBO released a fiscal brief, New York City's Tax on the Working Poor, prepared at the request of Public Advocate Mark Green. The brief focuses on the rising numbers of low-income, working New Yorkers who are burdened by city personal income tax liability, even though their incomes are low enough to escape state and federal income taxes. This trend is problematic, both in terms of equity and efficiency. Taxing the income of households struggling to escape from poverty strikes many observers as unfair. Moreover, to the extent that taxes on income act as a disincentive to work, taxing the earnings of the working poor may well be counterproductive and increase the difficulties inherent in moving welfare recipients into the workforce.

IBO projects that for tax year 1998, nearly 100,000 households will pay personal income tax to New York City but not to the state and federal governments¾more than triple the number of such households in 1993. The problem is particularly severe for single parents, who account for over 70 percent of affected households. Although the state's recently enacted school tax relief (STaR) program will ease personal income tax burdens for all city residents over the next few years, IBO estimates that over 70,000 low-income households will still pay city but not state income taxes when STaR is fully implemented in 2001.

IBO's fiscal brief reviews three alternative policy options for addressing the problem: 1) indexing the city's existing household credit for inflation; 2) excluding from city tax liability low-income residents who pay no state taxes; and 3) providing a city earned income tax credit (EITC). Each of these alternatives is evaluated in conjunction with a city child care credit. Although all three options have merit, IBO's analysis suggests that an EITC would remove the vast majority of affected households from the city's tax rolls and would be particularly easy to administer and use because it would piggyback on the already-existing state credit. A non-refundable EITC equal to three-quarters of the state EITC credit would cost the city roughly $30 million in tax year 1998. Although making the EITC refundable would increase incentives for labor market participation, it would increase the cost of the option fourfold to $125 million.

Cost of the Program. Using a 1995 sample of New York personal income tax returns and IBO's micro-simulation model to project tax liabilities for the forecast period, we estimate that, if enacted, the proposed child care credit would reduce city PIT revenues by $23 million in 1999. In subsequent years the cost of the program is expected to gradually decline, reaching $19 million in 2002. The cost of the child care credit declines over time because the underlying federal credit is not indexed for inflation. For tax year 1998, an estimated 180,000 households would benefit, receiving an average credit of $127.

The estimates of the cost of the child care credit contained in the Mayor's budget are somewhat higher than IBO's. The preliminary budget projects that the program would cost $27 million in 1999 ($4 million more than forecast by IBO) and expects costs to increase by $1 million a year over the forecast period. The discrepancies between the two forecasts are due to technical differences in producing the estimates which lead the Mayor's budget office to forecast that more city households will benefit and the average value of the credit will be slightly higher than projected by IBO.

Two important assumptions underlie IBO's estimates of the cost of the child care credit program. First, the estimates are premised on the continuation of current federal law. Several proposals have recently been advanced to enhance the federal child care credit, however, including a proposal by President Clinton that would significantly increase the share of eligible expenses taxpayers are allowed to claim as a credit. If the federal child care credit is made more generous, the cost of any city credit pegged to the federal credit would be greater than we have estimated.

Second, in IBO's simulation model, households are assumed to take advantage of a new city child care credit if they are already using the existing state credit. The latest tax year for which sample data is available is 1995. If the share of households taking the state credit has increased over time or if more households are encouraged to take advantage of the program due to the introduction of a city credit, the cost of the current proposal would be greater than we have estimated.

Evaluation of the Child Care Credit. Because it piggybacks on existing state and federal credits, the new proposal for a city child care credit would be simple to administer and easy for taxpayers to utilize. Moreover, making the credit refundable would provide cash assistance to some near-poor New Yorkers who take the credit and whose incomes are just large enough to incur some tax liability.[13]

The relatively modest cost of the proposed child care credit, roughly $20 million per year, makes it an attractive policy option. Yet the low cost also suggests that its effectiveness in providing tax relief to families with child care expenses is limited. Many families purchasing child care cannot take advantage of the current federal and state credits, in part because expenses associated with informal child care are not eligible for the credit. In addition, the cap on allowable expenses in the federal credit is well below the annual cost of child care for many families. Therefore, only a relatively small portion of a family's annual expenses are offset by the credit.

Subchapter S Tax Credit

The Mayor's tax reduction program includes a proposal to allow resident shareholders of subchapter S corporations (S corps) a credit against their personal income tax (PIT) liability for their share of corporation taxes paid. Although the proposal is still under development, if enacted it is expected to reduce the city's PIT collections by less than 1 percent per year.

The Model for the Current Proposal. Subchapter S corporations are a special type of small business eligible for certain tax benefits at the federal and state levels. In order to organize as an S corp, a firm must meet several qualifications, including: the number of shareholders is limited to 75 or fewer, and the firm's shares may not be publicly traded.

Under federal law, the earnings of an S corp are exempt from corporate income tax. Of course, earnings distributed to individual shareholders as dividends are subject to the federal personal income tax.[14] Under state law, firms that choose to organize as New York State S Corps also benefit from a tax preference; firms that elect New York State S Corp status agree to have all shareholders treated as New York State residents, even those who live out of state. Although the firm's earnings are subject to the state's corporate franchise tax, they pay a lower rate-in most cases it is 1.125 percent rather than the regular 9 percent state rate.

Under city tax law, S corps are treated like all other corporations and are subject to the general corporation tax (GCT) with no preferential treatment. The current proposal would not alter the corporate taxation of S corps on the city level, but it would benefit city residents who are shareholders in S corps subject to the GCT. Specifically, these taxpayers would be permitted a credit against their PIT liability for the portion of GCT payments attributable to the taxpayer's stake in the S corp.

The current proposal is patterned after the PIT credit enacted last year for resident taxpayers who are sole proprietors or partners in businesses subject to the city's unincorporated business tax (UBT). The new credit would be structured similarly, with the percent of business tax liability that could be claimed as a PIT credit decreasing as taxable income rises. While the Mayor's proposal has not been finalized, the estimates in the financial plan assume that the credit would be identical to last year's UBT-related credit. Resident taxpayers with taxable income up to $42,000 would get a credit equal to 65 percent of their share of S corp GCT liability. The value of the credit would fall as shareholder income rises from $42,000 to $142,000. For shareholders with taxable incomes over $142,000, the credit is worth 15 percent of their share of firms' GCT liability.

Fiscal Impact. With this initial specification of the S corp proposal, the Department of Finance calculates that the credit, if enacted, would reduce the City's PIT revenues by $34 million in 1999-roughly 0.7 percent of projected PIT revenues-with slightly greater reductions in subsequent years. Finance derived these fiscal impact estimates by matching information reported on S corps' federal tax forms with information from local GCT and PIT returns, a rigorous method not available to IBO because of the confidentiality of tax returns.[15]

The Dual Nature of the Tax Cut. The proposal to give city residents a PIT credit for their share of S corp-related GCT payments serves goals related to both business and personal income taxation.

Whether or not the proposed reform, when finalized, would compute the credit in exactly the same manner as the UBT-related PIT credit, the new credit would make the treatment of city residents who are shareholders in local S corps similar to the treatment of city resident business proprietors and partners paying the UBT. Both the proposed and the already enacted credit would benefit owners of New York City based small businesses, because S corps, like most unincorporated businesses, are relatively small entities. Many view tax relief to small firms as desirable because they believe such businesses have accounted for much of the national and local job growth in recent years, though this premise has been the subject of debate.

By providing a credit against the city's personal income tax, the new PIT proposal (like its predecessor) would specifically target tax benefits to city residents, as opposed to small business owners in general.[16] As with the recent UBT reform, focusing benefits on city residents is seen as desirable, since residents are subject to a considerably higher income tax rate than commuters. Moreover, the proposal would reduce what some have regarded as unfair double taxation of business income on the population that is most burdened by the high local taxes.

Clothing Sales Tax Exemption

Starting December 1, 1999, apparel items priced under $100 (except footwear) will be exempt from city and state sales taxes and surcharges. The estimated cost of the city sales tax exemption is now included in the baseline forecast of total city sales tax revenues. The city will also bear an additional cost for reimbursing the Metropolitan Transit Authority (MTA) for half of its losses from exempting city clothing sales from the 0.25 percent Metropolitan Commuter Transportation District (MCTD) surcharge.

A major element of the Mayor's new 1999 tax program is a proposal to accelerate the starting date of the $100 exemption by one year (to December 1, 1998) and at the same time expand the exemption to cover all apparel sales, including footwear.[17] The original clothing tax cut was motivated by the argument that it would disproportionately benefit lower-income New Yorkers and stimulate the city economy, in part by recapturing apparel sales now being lost to New Jersey. The combined effects of extending the clothing exemption and providing a footwear exemption would still be progressive, and enlarging the tax cut would also strengthen the economic stimulus. However, the size of the total stimulus to the city's economy will depend on several factors, including whether the city eliminates its exemption threshold on its own or in conjunction with the state and other New York localities.

Direct Costs. As shown above, there are substantial differences between the Administration's estimate of the direct cost of the new clothing tax cut and IBO's repricing. IBO's $202 million cost estimate for 1999 is $26 million higher, while our $167 million cost estimate for 2000 is $35 million lower. (Less than $10 million separate the respective cost estimates for 2001 and 2002.)

There are two major reasons for these differences. First, IBO's baseline sales tax revenue forecast, exclusive of clothing tax cut impacts, shows collections growth gradually declining through 2000 and then slightly increasing. IBO forecasts baseline sales tax revenue growth rates of 4.7 percent in 1998, 4.1 percent in 1999, 3.4 percent in 2000, and 3.7 percent in 2001. In contrast, the Office of Management and Budget's (OMB) baseline forecast shows an alternating pattern of sharp drops and spikes: growth seesaws from 4.9 percent in 1998 to 3.2 percent in 1999 to 4.9 percent in 2000 to 3.9 percent in 2001. OMB's estimate of the cost of the clothing tax cut is thus somewhat dampened by the forecast growth deceleration in 1999 and boosted by the forecast growth acceleration in 2000.

Second, IBO's estimate anticipates substantial shifting of apparel sales that would normally occur in the weeks leading up to the December 1st start dates of both the enacted and proposed clothing tax cuts; consumers will postpone their purchases to take maximum advantage of the exemptions.[18] This means that IBO assumes considerably larger costs than OMB for the baselined $100 clothing exemption in 2000 ($132 million versus $110 million). This reduces the amount of apparel sales that will still be taxable in 2000 and that would be subject to the proposed full clothing exemption Both IBO and OMB estimate smaller costs in 2001 and 2002 for the proposed full exemption than in 2000. This is because throughout 2001 and 2002, only clothing sales of $100 or more would be impacted by the proposed exemption; sales of under $100 will already be exempt. In 2000, however, there would be five months (July - November 1999) when all clothing sales would be affected by the new exemption.

Secondary Impacts. IBO addressed the issue of secondary economic and revenue impacts from a clothing tax cut in a fiscal brief issued last year (IBO, *Would Clothing Sales Tax Cuts Pay for Themselves?* June 1997). In that report, IBO's estimate of a clothing tax cut's total impact on city apparel sales (including the recapture of sales currently shifted to New Jersey) was not far below the estimate produced by the city's Economic Development Corporation (EDC). However, we found that these additional sales translated into much smaller overall growth in city output and jobs, and hence into much smaller offsetting increases in other city tax revenues. While EDC found that secondary revenue increases could offset fully 40 percent of the direct cost of a clothing sales tax cut, IBO estimates a secondary revenue offset of just 16 percent to 17 percent of direct sales tax losses-and this much only if both city *and* state sales taxes are cut.[19]

The main reason for the difference with EDC is that IBO recognizes that when a $100 clothing item is sold in New York City, typically no more than $53 pays for work performed or output ("value added") produced in the city itself. The rest pays for value produced outside New York City-where, in most cases, the articles of clothing and footwear sold here are manufactured.

That does not mean that new sales generated by a city clothing tax cut have a weak overall impact on jobs and other tax revenues-just that the city itself captures only a little more than half of that overall impact, sharing the rest with other localities.

While focusing mainly on proposals to cut state as well as local sales taxes statewide, IBO's clothing tax fiscal brief also analyzed alternative tax cut scenarios, including one in which only New York City cut its sales tax. From the fact that financial plan documentation does not specify additional MCTD surcharge reimbursement costs for the proposed full exemption (as it does for the enacted $100 exemption), it appears that the city may be contemplating a go-it-alone scenario for the new exemption. This would mean that if the proposed full exemption were enacted, shoppers in New York City would pay no sales tax on clothing items costing under $100 and a 4 percent state tax and 0.25 percent MCTD surcharge on clothing costing $100 or more and on footwear.

Figure 2-4.
Estimated Direct and Secondary Revenue Impacts of Clothing Tax Cuts (In millions of dollars)

	1998	1999	2000	2001	2002
Direct City Cost of Tax Cuts					
Clothing items under $100 (baselined)[1]	---	---	(132)	(193)	(199)
All other clothing and footwear (proposed)[2]	---	(202)	(167)	(117)	(120)
Total	---	(202)	(299)	(310)	(320)
Secondary City Revenue Impacts					
City-funded tax cuts					
Clothing items under $100 (baselined)[1]	---	---	5	8	10
All other clothing and footwear (proposed)[2]	---	8	8	8	9
Total	---	8	14	16	19
Total City and State tax cuts					
Clothing items under $100 (baselined)	---	---	11	17	20
All other clothing and footwear (proposed)[2]	---	8	8	8	9
Total	---	8	19	25	28
Percent Secondary Offsets of Direct Costs[1]					
City-funded tax cuts					
Clothing items under $100 (baselined)[1]			4.1%	4.4%	4.9%
All other clothing and footwear (proposed)[2]		4.0%	5.0%	6.6%	7.2%
Total		4.0%	4.6%	5.2%	5.8%
Total City and State tax cuts					
Clothing items under $100 (baselined)	---	---	11	17	20
All other clothing and footwear (proposed)[2]	---	8	8	8	9
Total	---	8	19	25	28
Percent Secondary Offsets of Direct Costs[1]					
City-funded tax cuts					
Clothing items under $100 (baselined)[1]			4.1%	4.4%	4.9%
All other clothing and footwear (proposed)[2]		4.0%	5.0%	6.6%	7.2%
Total		4.0%	4.6%	5.2%	5.8%
Total City and State tax cuts					
Clothing items under $100 (baselined)			8.1%	8.7%	9.8%
All other clothing and footwear (proposed)[2]		4.0%	5.0%	6.6%	7.2%
Total		4.0%	6.4%	7.9%	8.8%
Net City Cost of Clothing Tax Cuts[3]					
Clothing items under $100 (baselined)	---	---	(122)	(176)	(180)
All other clothing and footwear (proposed)[2]	---	(194)	(158)	(109)	(112)
Total	---	(194)	(280)	(285)	(291)
Memo: Total Impact on Jobs[3]					
Clothing items under $100 (baselined)	---	---	*3,500*	*5,450*	*5,450*
All other clothing and footwear (proposed)[2]	---	*2,610*	*2,770*	*1,880*	*1,880*
Total	---	*2,610*	*6,260*	*7,330*	*7,320*

Source: Independent Budget Office.

Notes: 1. Includes city reimbursement of MTA for exemption of clothing items under $100 from MCTD surcharge.
2. Combines city proposals to raise exemption threshold from $100 to $500 and include footwear, and then to exempt all items over $500. Assumed to apply to city sales tax only (not to state or other local sales taxes and surcharges).
3. Net city cost and total impact on jobs include impact of state tax cuts where applicable.

This would have several offsetting consequences for the proposed full exemption. On the plus side (from the city's perspective), New York City would enjoy a tax advantage over Long Island and upstate New York for higher-priced clothing and for footwear, allowing city retailers to recapture apparel sales from the surrounding New York counties as well as from New Jersey and Connecticut. On the minus side, the additional direct local stimulus from further cutting the state tax in New York City would be lost. This would also result in a smaller recapture of high-end sales from New Jersey.

On balance, the overall increase in New York City sales, jobs, and secondary tax revenues would be smaller without a matching full exemption of clothing sales from state taxes. The differences can be seen in Figure 2-4 by comparing the impacts of the baselined $100 city exemption (which is accompanied by a state exemption) with the estimated impacts of the proposed full exemption (which is modeled as a stand-alone city tax exemption).[20]

Thus in 2000, secondary revenue increases would offset 5.0 percent of the direct city cost of a stand-alone full city clothing tax exemption. This is larger than the 4.1 percent secondary revenue offset attributable to the city-funded share of the $100 clothing exemption, but smaller than the 8.1 percent secondary city offset from the combined city, state, and MCTD surcharge exemptions.

Figure 2-4 shows that a stand-alone full city clothing tax exemption would generate about 2,770 new jobs in the city in 2000, raising the total city employment impact of the enacted and proposed sales tax cuts to over 6,250. However, if the city and state both eliminated all their remaining sales taxes on clothing, 5,000 new jobs would be generated in the city, and the total city employment impact (including the impact of the enacted $100 exemption) would rise to 8,500. As noted earlier, these sales tax cuts would also generate thousands of new jobs outside the city.

Total Impacts. IBO estimates that the costs of the proposed full city clothing tax exemption would be offset by secondary revenue increases of about $8 million per year over the financial plan period. (When the property tax revenue impacts of the full exemption are completely phased in, secondary revenue increases would rise to over $13 million per year.) This would reduce the net costs of the exemption to $194 million in 1999, $158 million in 2000, and $112 million in 2002 (see Figure 2-4). At the same time, secondary city revenue increases associated with the enacted $100 clothing exemption are estimated to rise from about $11 million in 2000 to $20 million in 2002. (When all secondary tax impacts are phased in, secondary revenue increases will reach $40 million.)

Here it may be noted that the difference between the overall budgetary impacts of the stand-alone city tax cut scenario and city-plus-state cut scenario turns out to be rather small. This is because while the city would have stronger secondary revenue gains from the added economic stimulus provided by a state tax cut, it would also have higher direct costs from having to reimburse MCTD surcharge losses.

Thus under the stand-alone scenario assumed here for the proposed full clothing exemption, estimated direct costs in 2000 would be almost $167 million, secondary revenue increases would be $8 million, and net costs would be $158 million. Were the state to also provide a full-clothing tax exemption, direct city costs (now including a

$5 million MCTD reimbursement) would be $172 million, secondary city revenue increases would be $15 million, and net city costs would come to $156 million.

Miscellaneous Revenues

About 10 percent of the city's own-source revenues (revenues excluding state and federal categorical grants) comes from so-called miscellaneous revenues, which consists of nearly 300 different types of non-tax receipts. There are two basic categories of miscellaneous revenues: the recurring and larger portion from sources such as licenses, fines, fees, and water and sewer charges; and a non-recurring portion that includes the sales of city assets and airport back rent from the Port Authority. While recurring revenue can be forecast with reasonable accuracy, there is much greater uncertainty surrounding the non-recurring portion of miscellaneous revenues.

IBO Reestimate. Based on a review of the largest miscellaneous revenue sources, two items currently planned to provide significant revenues-airport rent and the sale of the coliseum-pose considerable risk both as to the size and the timing of their receipt.

The city receives rental income from the Port Authority for LaGuardia and Kennedy airports. The city has long questioned several aspects of how the Port Authority computes the airport revenues which serve as the basis for the Authority's rental payments to the city. In particular, the city contends that the $3 per airline ticket surcharge should be included in the Authority's rent calculation. In addition to seeking a portion of future surcharge proceeds, the city asserts that it is entitled to a retroactive adjustment covering the years since the surcharge was first imposed. Although the issue is still under arbitration, the Federal Aviation Administration has advised the arbitrators that the surcharge, which was intended to fund airport improvements, should not be considered part of the general revenue stream generated by the airports. There is little evidence at this time to suggest that this issue will be resolved in the near future or that it will be resolved in the city's favor. Therefore, IBO expects airport rent payments to total $35 million in 1999 and in subsequent years.

In addition to reestimating expected airport rents, IBO questions the Administration's assumption that the sale of the Coliseum by the Metropolitan Transportation Authority (MTA) will be completed in 1998. Because the sale has been subject to repeated delays and there is little time remaining to complete the transaction during the current fiscal year, IBO has shifted the $200 million the city expects from the sale into 1999.[21]

With these reestimates, IBO estimates that miscellaneous revenues will equal $2.7 billion in both 1998 and in 1999, falling to $2.4 billion in 2000 with little change thereafter. Much of the decline after 1999 is directly attributable to the non-recurring nature of the receipts generated from the larger items in this revenue category. Based on past experience, however, it is likely that additional assets will be identified for sale in future years, bringing miscellaneous revenues closer to their recent levels.

Other Revenues

The Mayor assumes additional revenues from the state and federal governments as a result of certain legislative initiatives intended to benefit the city budget. IBO projects much lower revenues from these initiatives than does the Administration¾$358 million less each year through 2002.

We estimate the city will receive only $32 million of the $200 million anticipated by the Mayor from various state actions. Increased revenue sharing with localities and increased reimbursement for state prisoners held in city jails are expected to generate some additional revenues, though not as much as forecast by the Mayor. Moreover, the budget includes a number of state initiatives unlikely to be enacted, including a funding shift to the state for the Fashion Institute of Technology and the Office of the State Deputy Comptroller for New York City, elimination of funding for the Independent Budget Office, and a proposal to increase Article VI public health funds.

The budget also assumes an additional $190 million in revenues from the federal government, although IBO does not project any additional unrestricted revenues from federal initiatives. Of the $190 million anticipated by the Mayor, $60 million would be from a new initiative to increase federal revenue sharing with urban areas. Such an initiative is neither part of the President's budget nor Congressional budget resolutions, making enactment over the next year unlikely. The remaining $130 million is anticipated from a national tobacco settlement. However, there is significant uncertainty as to when and in what form the tobacco settlement will be approved by Congress. Because potential settlement funds are likely to reach the city in the form of new programs and categorical aid, IBO has estimated no tobacco settlement proceeds for the city as unrestricted aid.

Categorical Aid

The largest revenue item in the Mayor's preliminary budget is state and federal categorical grants, which IBO forecasts will total $11.4 billion in 1999. These estimates are significantly higher over the 1998-2002 period than are forecasts in the preliminary budget. For some types of intergovernmental categorical aid, such as education and welfare, IBO has developed forecasts based on programmatic changes and caseload projections that affect the level of aid received from the state and federal governments. IBO's forecast of such aid in other parts of the budget are based on a methodology that takes the grant level in the current year and applies growth factors developed form recent historical trends on an agency-by-agency basis.

For 1999, IBO's forecast for state categorical grants is $349 million higher than the Mayor's. By 2002 this difference grows to $921 million. IBO's forecasts of education aid account for over two-thirds of our higher 1999 aid estimate. Similarly, IBO's forecast of federal categorical grants is $742 million higher than the Mayor's in 1999, a difference that increases to $1.1 billion in 2002. IBO's forecasts of education and health care account for nearly half of the 1999 difference, while forecasts for housing and police comprise a third.

Unrestricted Aid

IBO's estimate of unrestricted intergovernmental aid is identical to the preliminary budget's forecast with one exception: state reimbursement for the STaR tax relief program. IBO's estimates are $19 million higher than the Mayor's in 1999, slightly lower in 2000-2001, and $50 million higher in 2002. The differences are attributable to IBO's forecast that more homeowners will qualify for the property tax exemption and differing economic assumptions that affect our estimates of the personal income tax reduction and property tax exemption under STaR.

Chapter 3
Expenditure Estimates

Overview

IBO estimates that total spending under the policies proposed in the Mayor's preliminary budget would increase from $35.2 billion in 1998 to $35.4 billion in 1999. Under the five-year financial plan proposed by the Mayor, spending would rise to $40.3 billion in 2002.

The portion funded with city-generated revenues would be $23.9 billion in 1998 and $24.0 billion in 1999, rising to $28.0 billion in 2002. As discussed in Chapter 1, the rate of growth of city-funded expenditures exceeds that of city-generated revenues resulting in significant budget gaps in the out-years of the financial plan period.

Spending from state and federal categorical grants would be $11.3 billion in 1998 and $11.4 billion in 1999, increasing to $12.3 billion in 2002. IBO's estimate of categorical aid, while similar to current year levels, is substantially higher than the levels forecast in the Mayor's budget. Although some of this additional aid may be anticipated by the Mayor, it will not be reflected in the financial plan until received.

Figures 3-1 and 3-2 provide details of our reestimate of the spending proposed by the Mayor. (Agency expenditures have been adjusted to reflect an allocation of the labor reserve.)

A discussion of our reestimates, major initiatives in the Mayor's budget, and other program issues is provided throughout this chapter.

Health/Social Services

Public Assistance

Background. Over the last three years, caseloads for both Family Assistance (FA, formerly Aid to Families with Dependent Children) and Safety Net Assistance (SNA, formerly Home Relief) have declined significantly. City welfare policy changes have combined with favorable economic conditions to bring about this decline. The city's financial plan assumes that these factors will continue to generate caseload declines through fiscal year 2000 and prevent any increases after that point.

Mayor's Projections. The Mayor's budget projects that the number of persons on FA will decrease from 653,000 in December 1997 to 623,000 in June 1998, and eventually reach 578,000 in June 1999, and 548,000 in June 2000 and the remaining years of the financial plan. Similarly, the budget projects that the number of SNA recipients will fall from 164,000 in December 1997 to 155,000 in June 1998, and continue heading downward to 140,000 in June 1999 and 130,000 in June 2000 and the subsequent years of the financial plan.

As a result of these expected caseload reductions, the Mayor's budget projects that total expenditures for FA will decrease from $1.4 billion in 1998 to $1.2 billion in 1999, $1.1 billion in 2000, and $1.1 billion annually in 2001 and 2002. Similarly, total spending for SNA will decline from $476 million in 1998 to $417 million in 1999, $381 million in 2000, and $370 million in 2001 and 2002.

Figure 3-1.
IBO Expenditure Estimates Under the Mayor's Proposals (In millions of dollars)

	1998	1999	2000	2001	2002
Health/Social Services:					
Social Services	5,380	5,291	5,316	5,400	5,508
Admin. for Children Services	1,991	1,958	1,988	2,002	2,017
Health	1,562	1,627	1,693	1,747	1,804
Homeless	393	393	408	412	417
All Other	435	443	446	448	451
Subtotal	9,761	9,712	9,851	10,009	10,197
Education:					
Board of Education	9,079	9,653	10,144	10,536	10,937
CUNY	395	402	411	417	424
Subtotal	9,474	10,055	10,555	10,953	11,361
Uniformed Services:					
Police	2,672	2,798	2,977	3,021	3,031
Fire	985	1,000	1,031	1,033	1,035
Correction	849	863	947	964	966
Sanitation	685	692	757	783	783
Subtotal	5,191	5,353	5,712	5,801	5,815
Debt Service	3,207	2,360	3,615	4,035	4,301
All Other	7,593	7,896	8,271	8,437	8,581
Total Spending as Estimated by IBO	35,226	35,376	38,004	39,235	40,255

SOURCE: Independent Budget Office.
NOTE: Excludes intra-city expenditures.

IBO Projections. Our caseload projections for the Family Assistance and Safety Net Assistance programs as compared to the Mayor's can be seen in Figure 3-3 and Figure 3-4.

IBO projections for the Family Assistance program indicate a slower but more extended pattern of caseload decline. The downward trend is expected to slow as federal, state and local welfare reform efforts ultimately result in a caseload that is smaller but increasingly needy and difficult to place in private employment. On the other hand, a federal prohibition against using Temporary Assistance for Needy Families (TANF) funds for assistance to persons arriving in this country after August 22, 1996, will continue to shrink the base of eligible families as the city continues to experience heavy immigration. In 2002, implementation of the five-year limit will make 62,000 FA recipients ineligible, even if the state exempts the maximum number of households from the time limit based on hardship. If the state chooses not to do so, the number of recipients cut off from FA could total as many as 175,000.

Figure 3-2.
IBO's Reestimate of the Mayor's Expenditure Proposals (In millions of dollars)

	1998	1999	2000	2001	2002
Total Spending as Estimated by the Mayor	34,868	34,324	36,386	37,287	37,885
IBO Reestimates:					
City Funded:					
Public Assistance	(5)	8	35	50	86
Medicaid	---	9	26	27	28
Education	(91)	6	50	37	80
Overtime:					
Police (uniformed personnel)	10	12	12	12	40
Correction (uniformed personnel)	---	20	20	20	20
Admin. for Children's Services	12	5	5	5	5
Social Services	1	5	5	5	5
Debt Service Prepayments	164	(164)	---	---	---
All Other	---	60	60	63	63
City Funded	91	(39)	213	219	327
State Funded	115	349	517	709	921
Federally Funded	152	742	888	1,020	1,122
Total Spending as Estimated by IBO	35,226	35,376	38,004	39,235	40,255

SOURCE: Independent Budget Office.
NOTE: Excludes intra-city expenditures.

Unlike the Mayor's budget, the IBO projects that the Safety Net Assistance caseload will soon bottom out and gradually start to rise again. We expect the caseload to reach 156,000 persons in June 1998 and decline slightly to 150,000 in June 1999. After this, however, the number of SNA recipients will begin to increase, reaching 155,000 in June 2000, 160,000 in June 2001, and 227,000 in June 2002.

As with Family Assistance, we expect the SNA caseload to become increasingly made up of very needy and hard to employ individuals. Upward pressure on the SNA caseload is expected to result from federal SSI and TANF eligibility restrictions on new immigrants, which would leave thousands of needy individuals and families eligible only for the state- and city-funded program. In addition, the five-year rule on FA eligibility is expected to lead to a shift of 62,000 recipients from the FA to the SNA program in 2002.

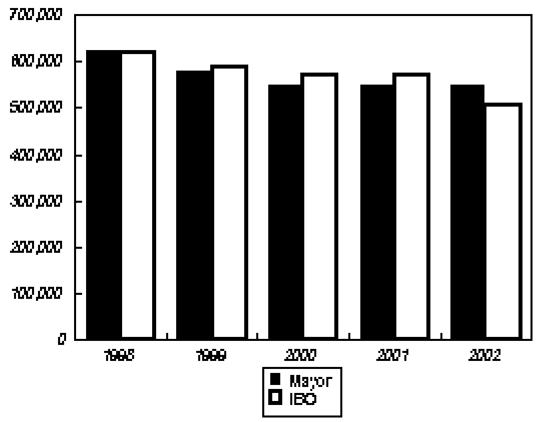
Higher projected caseload results in total expenditures for public assistance which are expected to exceed the Mayor's projections by $24 million in 1999, $88 million in 2000, $125 million in 2001, and $159 million in 2002.

Medicaid

Background. Recent changes in federal policy will have a major impact on city expenditures under its Medicaid program. The primary catalyst of these changes is the implementation of mandatory Medicaid managed care in New York State. In July

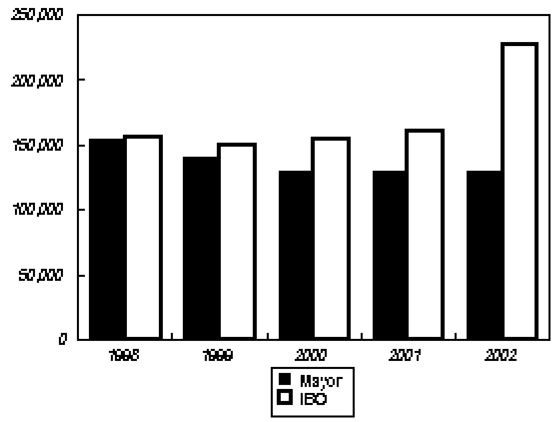
1997, the federal Health Care Financing Administration (HCFA) permitted the state to enroll Medicaid recipients into managed care plans. This decision triggered changes which will ultimately produce Medicaid savings for the city. These developments and the impact on the Mayor's budget are discussed below.

Figure 3-3.
Family Assistance Caseload



SOURCE: Independent Budget Office.
NOTE: Prior to 1998, Family Assistance was known as Aid to Families with Dependent Children.

Figure 3-4.
Safety Net Assistance Caseload



SOURCE: Independent Budget Office.
NOTE: Prior to 1998, Safety Net Assistance was known as Home Relief.

Federal Approval of State Waiver Request. Section 1115 of the Social Security Act authorizes the Secretary for Health and Human Services, through HCFA, to permit states to test new methods of administering their Medicaid programs. Participating programs remain eligible for federal funding, even though such experiments may conflict with existing law. Currently, states cannot mandate enrollment of Medicaid recipients into managed care without HCFA's approval of a Section 1115 waiver request.

Federal approval of the state's application, the largest that HCFA has ever approved, dramatically altered the state-federal relationship under New York State's Medicaid program. Before the waiver, the state and the city subsidized the health care of eligible Safety Net Assistance (SNA, formerly Home Relief or HR) recipients. Each paid 50 percent of Medicaid costs because this population was not eligible for federal funding. Instead, federal assistance to the state for the health care of this population was disbursed through the Disproportionate Share Hospital (DSH) program which mandated states to make supplemental payments and provided matching funds for hospitals serving low-income people. After waiver approval, the federal government will now pay 50 percent of the Medicaid costs of SNA/HR recipients, thereby eliminating the state's participation in the DSH program. The city and state will now each pay only 25 percent for the Medicaid costs of this population, whose caseload is also decreasing due to welfare reform.

Implementation of Managed Care. The transition to managed care, however, is the main factor that will produce Medicaid savings for the city. Under the traditional Medicaid system (also known as fee-for-service), health care providers individually billed the government for services delivered. Although Medicaid generally pays less than the market rate for medical services, the fee-for-service system imposed few limitations on how many times a beneficiary accessed covered services. In contrast, a managed care system establishes contractual arrangements with numerous providers who provide an array of medical services for a flat monthly payment for each patient enrolled in the plan.

Managed care saves money because, unlike fee-for-service, it imposes caps on expenditures regardless of how much the services delivered actually cost. Since managed care forces the providers to assume more financial risk than the traditional system, it compels more emphasis on outpatient care (which is less expensive than inpatient care) and a greater focus on preventive care. These practices largely generate the cost savings under managed care.[22] The move to managed care, however, has significantly changed the fiscal outlook of the Health and Hospitals Corporation (HHC). For an assessment of the impact of managed care on HHC, see discussion below.

IBO's Projections. The Mayor's budget projects that Medicaid expenditures at the New York City Human Resources Administration (HRA) would increase by 2.5 percent in 1999, 2.3 percent in 2000, 2.5 percent in 2001, and 3.1 percent in 2002. In previous fiscal years, the January Plan has anticipated major savings that depended on improbable state actions. Significantly, there is an absence of such contingent entitlement reductions in this year's plan.

IBO estimates that Medicaid expenditures at HRA would slightly exceed those contained in the Mayor's preliminary budget. The modest differences result from differences in expected growth rates for particular Medicaid services. IBO projects that the cost of various services will exceed the growth rates reflected in the Mayor's plan even under the full implementation of managed care. These services include expenditures related to intermediate care facilities, home nursing, and prescription drugs. In addition, the Mayor anticipates no growth for home attendant and house keeper services while we project 1.0 percent annual cost increases. IBO estimates overall Medicaid expenditures will rise by 3.0 percent in 1999, 3.0 percent in 2000, 2.5 percent in 2001 and 3.1 percent in 2002.

Health and Hospitals Corporation

HHC Finances Uncertain

The Mayor's budget would reduce New York City's total contribution to the Health and Hospitals Corporation ("HHC" or "the Corporation") from $682 million provided in 1997 to $662 million in 1998, a decrease of $20 million, or 3 percent. In 1999, HHC would receive $677 million from the city. These relatively small adjustments, however, belie the more significant changes contained in this budget which are discussed below.

HHC Deficits Projected. In 1997, the Corporation appeared to stabilize its financial condition, ending the year with a $100 million surplus. Successful rate appeals challenging the reimbursements received from the federal government bolstered both Medicaid and Medicare revenues. Meanwhile, HHC's continued headcount reduction and revisions to the contracts the Corporation signs with its affiliates further decreased expenses (For a discussion of the Corporation's affiliation contracts, see *IBO's Analysis of the Mayor's 1998 Executive Budget*.)

According to the Mayor's budget, the Corporation will face substantial and increasing deficits over the next several years. Though the $100 million surplus has been rolled over into this fiscal year, the budget projects that before gap closing actions, the Corporation's expenses will exceed its revenues by $73 million in 1998. As can be seen in Figure 3-5, the Corporation's deficits are projected to grow to $378 million in 1999, $618 million in 2000, $642 million in 2001, and $650 million in 2002.

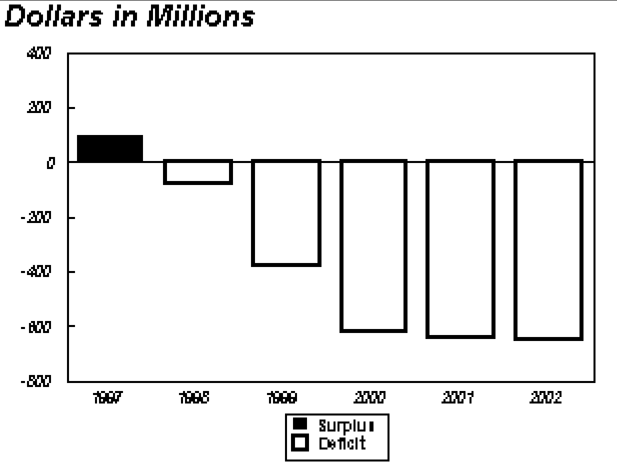
Impact of Managed Care. The state will begin mandatory enrollment of Medicaid beneficiaries into managed care plans at the start of 1999. Medicaid is the Corporation's principal revenue source: about 63 percent of 1998 revenues are projected to come from care provided to beneficiaries of this program. However, the move to managed care will likely reduce the Corporation's Medicaid revenues because, unlike traditional reimbursement methods, managed care plans pay providers a negotiated fee for care regardless of actual costs.

Projections contained in the Mayor's budget for HHC's Medicaid revenues for 1998 are $22 million lower than earlier projections, indicating that revenues from Medicaid have already fallen. Our review indicates that a couple of factors largely explain this decline. First, HHC has already begun to enroll its patients in managed care, which favors less expensive outpatient care. Second, HHC has lost Medicaid market share as private health care facilities have intensified competition for the Medicaid population. Given that managed care is in the early stages of implementation, it is too early to gauge the full impact of the changes underway. It is clear though that the impact of enrolling the majority of the Medicaid population in managed care on the Corporation's revenues will need to be closely tracked in the years to come.

In order to reduce costs to meet falling revenues, the Corporation will undertake a series of gap closing actions. These initiatives include savings from the early retirement of several hundred HHC staff, continued reductions in payments to affiliates, and further appeals on reimbursements received that are likely to counteract some of the decreases in Medicaid receipts. For the current year and 1999, we expect these actions to eliminate HHC's deficits. However, because the deficits increase dramatically in 2000 and 2001, these actions will only begin to close these gaps.

Prognosis for the Future. The Corporation has already demonstrated that it can successfully adapt to meet the challenges that have been imposed by a changing health care marketplace. Among other things, HHC's leadership has implemented innovative strategies to enhance efficiency. Foremost among these is the institution of performance-based contracts with the Corporation's affiliates which has resulted in lower costs. In addition, with Corporation-wide headcount falling by over 7,000 since 1995 alone[23] , personnel at the city's public hospitals are being retrained for different or greater responsibilities. This consolidation of tasks or "broad banding" has further limited the growth of the Corporation's expenses.[24]

Figure 3-5.
After a Surplus, HHC Deficits are Projected



SOURCE: Independent Budget Office.
NOTE: Deficits before HHC's gap closing actions.

Other actions will further assist the Corporation in its efforts to equip for managed care. Due to its lobbying of the state, a share of those Medicaid beneficiaries that do not choose a managed care plan will be assigned to HHC's health maintenance organization, MetroPlus. Preliminary indications are that this number could reach about 25 percent. In addition, at least for the short term, the city will alleviate pressure on HHC's finances by covering the debt service costs for HHC on capital projects to upgrade Kings County Hospital Center and Queens Hospital Center (see discussion below). These actions should provide some stability to HHC's finances.

Overall, while the Corporation has weathered declines that have already occurred in Medicaid revenues, its financial condition remains uncertain in the years to come. On the one hand, the Corporation appears to have preserved the quality of care provided at its facilities while the number of uninsured receiving health care at the city's public hospitals has been increasing. On the other hand, further cost-saving initiatives will be necessary to allow the public hospitals to continue to provide quality health care, meet the health care needs of the city's poorest residents, and preserve its finances.

Capital Projects at Kings County and Queens Hospital Centers

The mayor's preliminary budget highlights the plans of the Health and Hospitals Corporation to undertake two significant capital projects: a major reconstruction of facilities at the Queens Hospital Center (QHC) and the renovation of facilities at the Kings County Hospital Center (KCHC). These two projects, expected to cost a combined $238 million, would assist the Corporation in preparing for the forthcoming expansion of managed care.

Background. The Corporation has contemplated major reconstruction of these two facilities in the past. However, a number of factors, one of which was shifts in utilization, postponed major capital spending at both these facilities. In the meantime, the Corporation has used the bond proceeds to improve its other facilities and operations, although no significant portion was used at either QHC or KCHC. For example, in 1993, the Corporation issued a $550 million bond to refund bonds issued in 1985 and to pay for equipment and construction for ongoing capital projects at Elmhurst Hospital Center and Harlem Hospital Center. Similarly, a $320 million bond issued in 1997 is financing additional facility upgrades.

More generally, in pursuing these two projects, the Corporation is following nationwide trends in health care. Both public and private hospitals around the country are investing hundreds of millions of dollars to make their operations more efficient, downsizing inpatient facilities and consolidating related services. Concern for maintaining or expanding market share has motivated hospitals to make their facilities more attractive to prospective patients.

Plans for QHC and KCHC. The Corporation's plans for the QHC, which has not undergone major renovation since 1958, address a variety of concerns about the facility. The QHC has recently lost market share and has multiple health and safety code compliance issues due to the age of its plant. The Corporation proposes to streamline the sprawling 22 acre QHC campus and to construct a new acute care hospital. Currently, QHC consists of 12 buildings, many of which are aging, underutilized, or inefficient. Of these 12, the Corporation would tear down four. Services in the remaining buildings would be reorganized and duplicative services would be eliminated. The new acute care hospital would contain a reduced number of inpatient beds that would, however, be state-of-the-art. The total estimated cost for this project is $148 million.

The KCHC is the Corporation's largest acute care facility and many of its 60-year-old buildings are badly in need of upgrade. The KCHC continues to use open wards and both patients and doctors have complained that its buildings are insufficiently sanitary. During past administrations, capital projects at KCHC were stalled by cost overruns and mismanagement. Plans for the redevelopment of KCHC are more ambitious than those for QHC and would be executed in four phases. These plans have similar objectives to those for QHC; in particular, a leaner, more modern campus would replace the current one. The financing for only one phase of this plan has been determined: a new $90 million tower to house a variety of specialized services would be erected. The remaining phases of this plan would include the construction of a new Emergency and Diagnostic Pavilion, the consolidation of a variety of inpatient beds into an existing building that will be renovated, and the demolition of eight buildings that remain.

How Will the Projects be Financed? At the request of the city and HHC, the Dormitory Authority for the State of New York (DASNY) proposes to issue tax-exempt bonds to finance the construction of these two projects. The city would pay debt service on DASNY's bonds and HHC would use operating revenues to reimburse the city.[25] No schedule of payments has as yet been determined. For the design and construction management of the projects to renew QHC and KCHC, DASNY would receive fees-that are included in the total cost of each project-of $4.1 million and $3.8 million, respectively.

The Corporation's debt service payments have remained about 5 percent of its total expenditures since 1993. Before 1993, through the issuance of general obligation and other bonds, the city provided funding for a majority of the Corporation's capital projects. However, since the Memorandum of Agreement signed in 1992, the Corporation has issued its own bonds, pays the debt service on these bonds, and has also begun to repay the city for all debt service costs the city is obligated to pay on its behalf.

The city's proposed payment of debt service on the bonds to finance the Corporation's new plans for QHC and KCHC would mitigate pressures on the Corporation's uncertain financial condition (see discussion above). In the absence of the city's undertaking to pay debt service, it is not clear that the Corporation would be able to pay for these projects on its own. With deficits projected and Medicaid revenues likely to fall in the years to come, the Corporation is currently ill-prepared to take on major new costs and would have to find additional revenues or savings to incur such additional obligations.

Homeless Services

Background. The Mayor's budget for the Department of Homeless Services proposes spending of $393.1 million for 1999, an increase of about $197,000 over 1998 expenditures based on our projections. This increase includes proposed new spending to address a rise in the nightly adult shelter population.

According to the Preliminary Mayor's Management Report (PMMR), the number of people lodged per night in the city's adult shelter system has increased from 6,219 in 1995 to 7,119 in 1997. In response to this increase, the preliminary budget proposes to expand by 248 the number of beds made available by the department for homeless adults.

The increase in the adult shelter census stems, in part, from a decline in the number of homeless adults placed in publicly supported permanent housing. According to the PMMR, placements made to permanent housing dropped from 1,530 in 1996 to 1,407 in 1997. Our review indicates that this situation could worsen as a result of the expiration last fall of the New York/New York Initiative.

New Housing and Services for Mentally Ill. The New York/New York Initiative began in 1990 as a city-state partnership to provide housing for homeless mentally ill individuals. It was a multi-year agreement to build supportive housing for persons not in need of hospitalization, but unable to live independently. Its expiration last fall followed the completion of a planned 3,314 units of supportive housing developed with a combination of city and state financing. The city's Department of Housing Preservation and Development produced 1,426 units of new Single Room Occupancy (SRO) housing. The state Department of Mental Health contributed another 1,888 newly developed SRO units for the initiative. The state agreed to fund on-site support services for the New York/New York units. Over the life of the program, the New York/New York agreement placed over 5,000 individuals in newly constructed supportive housing.

The initiative proved to be beneficial to the clients and cost effective for the respective governments. Mentally ill individuals were placed in assisted living settings and received needed supportive services. The retention rate for individuals housed was nearly 80 percent, with about 10 percent of these residents moving to independent living. In 1995, city and state officials estimated that while it cost $113,000 annually to house a person in a state psychiatric hospital, $60,000 annually in jail, and $20,000 annually in a municipal shelter, the supportive SRO housing cost $12,500 per unit in annual operating costs.

Need for Additional Housing and Services. The high retention rate of the housing, however, contributed to a shortage of space in the supportive SRO housing program. A recent study estimated that the vacancy rate in the system was under 3 percent. At the same time, the eligible population continues to grow. City officials have estimated that long-term residents of city shelters-most of whom are mentally ill-now represent 9 percent of the total shelter population, up almost 2 percentage points from three years ago. This percentage is likely to increase as the state continues to reduce the number of beds in its mental hospital system. The reduction of mental hospital beds has led the city to request that the state pay for much of the new housing and treatment programs because the downsizing of inpatient psychiatric facilities has increased the number of mentally ill homeless in the city. Currently, estimates of the number of homeless mentally ill individuals in the city run as high as 12,000.

The city's capital budget has committed about $85 million over 5 years for constructing 1,000 units of SRO housing. Of these units, about 600 could be earmarked for supportive housing for the homeless mentally ill if the state provides funding for the necessary supportive programs. Although the state budget is still pending in Albany, the Assembly has included about $85 million for the city's New York/New York program in its budget bill. If the state appropriation matches the city's commitment, the total number of SRO units to be constructed would increase to about 2,000 of which 1,200 would be earmarked for the homeless mentally ill.

At present, it is not clear whether or to what extent the city would proceed on homeless housing development without additional state funding because the creation of the projected units are conditional on the state match. Even if construction proceeds, those needing assistance would still outstrip the supply of available housing units. However, to the extent additional funds are not provided for construction of SRO housing for homeless mentally ill individuals, the city's adult homeless shelter system and other programs would have to serve the needs of this population.

Education

Board of Education

Overview. IBO estimates that the Mayor's proposed budget for the Board would result in total spending of $9.6 billion in 1999, an increase of about $500 million from the estimated 1998 level of $9.1 billion. We estimate that city funding would increase by $390 million, from $3.7 billion to $4.1 billion. By comparison, the Mayor projects total spending in 1999 of $9.0 billion.

Our projected funding increase reflects the net impact of various mayoral initiatives, collective bargaining increases, and IBO reestimates of BOE spending. In particular, IBO estimates significantly higher intergovernmental aid than projected by the Mayor. As with most city agencies receiving aid from the state and federal governments, the Mayor's budget provides a conservative estimate of grant levels.

Over the last year, state funding for education has increased significantly. An in-depth look at school aid added both in last year's enacted state budget and the Governor's proposals this year is presented below.

The Mayor's budget proposes increased funding for the restoration of the arts curriculum (Project ARTS), additional instruction for students unable to pass third grade, and night schools for older students. The budget also includes start-up money for cafeterias and safety officers in newly built schools. These increases are proposed over and above funding provided in 1998 for early grade literacy (Project Read), class room technology (Project Smart Schools), Administrative Period Release for Teachers, and arts curriculum restoration. All of these initiatives have been included in our reestimate of the Mayor's budget.

Finally, as was the case for 1998, BOE has been held harmless from budgetary savings targets in 1999. As a result, no gap reduction initiatives have been proposed for BOE.

Funding for Continuing Programs. Renewed funding for projects begun in 1998 has been provided in the Mayor's preliminary budget. Project Read was funded again at $125 million for 1999 only, and Project Arts was increased from $25 million to $50 million through the financial plan period. The Mayor has indicated that future Project Read funding is dependent on its demonstrated results. What follows is a more detailed look at what has been done with Project Read, and discussions of Project Arts and Administrative Release for Teachers funding in 1998 and what is planned for 1999.

Funding of $25 million was provided in 1998 for Project ARTS aimed at restoring arts curriculum throughout the schools, occurring over three years. Total funding for the program is projected to reach $75 million by the year 2000. The program is partially supported by renewable grants secured from the Annenberg Foundation.

To begin planning for Project ARTS, BOE did a survey to determine the extent to which arts education had eroded over the past few years from budget cuts. The survey found that only half of the schools had the capacity to provide arts education in any form. BOE decided to pursue arts restoration with a two-pronged approach. First, BOE would rebuild arts capacity in schools and second, it would use the program to achieve additional literacy improvements. BOE also committed to the concept that any investment would be used to promote programs which could become self-sustaining by the districts. Thus, professional development for teachers has been a major focus of the program.

For 1998, each district was provided a Project ARTS allocation of $21 per pupil which had to be used to serve one-third of its schools, less a $30,000 match to cover personnel costs associated with the hiring of a district arts coordinator required by the central board. Schools interested in the program applied for the funding, although not all schools within each district applied. The money was awarded with the understanding that the programs begun in 1998 would be the future responsibility of the district.

The models implemented under Project ARTS vary by school, but typically follow two general programs. Community School Districts focused on supporting existing capacity in the curriculum because in the early grades arts education can be more easily integrated with general studies. At the secondary level, by contrast, Project ARTS funded the sequential restoration of course work, whereby students can access additional semester-long arts classes in ninth or tenth grade. In the high schools, Project ARTS has added about 460 art and music teachers to the faculty.

Now that additional funding has been proposed, BOE has indicated that it will ask the districts who were funded in 1998 to submit reduced budget requests limited to one-half of the original allocation. Additional schools will have the opportunity to receive funds in 1999. BOE will be conducting another survey shortly to assess the status of arts curriculum at the end of the first year of Project ARTS funding.

In 1998, the city provided $50 million and BOE provided $20 million internally to fund a United Federation of Teachers (UFT) contract provision which released teachers from administrative duties. The administrative release was enacted to allow teachers more time for educational activities like planning, professional development, and student-teacher interaction. The money was allocated for the purchase of school aide services to supervise lunch, student arrival and departure, and to monitor hallways. According to the contract provision, however, a school's UFT chapter could decide to continue to cover administrative duties with pedagogical personnel with a 75 percent vote in favor of this school-based option. To fully support administrative period coverage at $70 million for 1999, BOE will once again need to find internal funds of $20 million.

To date more than half of the schools in the city have voted affirmatively to re-create administrative coverage by teachers, although the extent of the coverage varies widely. In many schools at the elementary level, UFT chapters voted to use teachers predominantly for lunch supervision. At the secondary level, chapters have most frequently voted to use teachers to cover homeroom or to recreate conflict resolution positions and re-institute school deans.

As part of the agreement to pay aides for administrative duty coverage, teachers are required to engage in activities which improve the quality of educational services offered in a school. Teachers released from administrative duties must select and participate in clearly defined duties, such as, training workshops, community outreach, parent meetings, student tutorials, or club sponsorship. At this point, it is unknown what impact the release time has had on services. BOE has not compiled data on how schools are using the money, although it indicated at the start that the outcome of release time requirements would be considered in overall school performance as a part of governance reform initiatives already underway.

Governor's Proposed Budget for Education:
No Change in the City's Share of State Aid

Overview. The Governor's budget proposes $11.5 billion in state-wide education aid for the 1998-99 school year, $518 million more than was appropriated in 1997-98. Of the proposed increase, $454 million is unrestricted aid and $64 million is categorical aid. The major elements of the increase are consistent with last year's enacted budget, and include the following increases in existing programs:

- $28 million for building aid;
- $50 million for expansion of pre-kindergarten;
- $50 million for minor maintenance on school facilities;
- $15 million in incentive money for the expansion of full-day

kindergarten; and,

- $9 million for education technology aid.

These initiatives are scheduled to expand in the out-years with total spending growing to $1.2 billion in 2001-02. The new initiatives are discussed below.

New York City's Share. The proposed budget would allocate about $4.1 billion in school aid to the city. This represents an increase of $189 million, or nearly 5 percent, from last year. However, it would still comprise about 35 percent of all state aid for education which is the same percentage of such aid the city received last year. While several of the new initiatives benefit the city, most of the proposed increase for 1998-99, about $141 million, is in operating aid. Building aid will be increased by $10 million; pre-kindergarten expansion will add $32 million to BOE's budget; $33 million of the minor maintenance fund will come to city schools; and $2 million will be realized in educational technology incentive aid. The remaining funds are spread out among various other programs.

New Initiatives. In addition to supporting the programs advanced in the 1998-99 budget, the Governor also requests funding for several new initiatives beginning in 1999-00. These include a six-week summer school program for 4th graders who demonstrate substandard performance ($45 million) and an English immersion summer program for children in kindergarten through 2nd grade with limited English proficiency ($20 million). Other new initiatives include enrichment money for after school programs which starts at $1 million in 1998-99 and grows to $10 million in 1999-00.

The Governor's education budget also includes a list of proposed legislative changes to create charter schools, implement special education reforms, and empower teachers to remove disruptive students from the classroom. Mandate relief measures are also included to allow school districts greater flexibility in supply purchase and contract management, and lower the compliance standard for asbestos removal to those of the private sector.

Next Steps. The Governor's budget is only the starting point for budget negotiations. For the 1997-1998 school year, legislators provided 4 percent more unrestricted aid than was originally proposed, and in the previous year the increase was 10 percent by the time the budget was adopted. Hence, while the final figure is still unknown, it is likely that the adopted state budget will contain still greater aid for BOE.

New Initiatives. The Mayor's budget also proposes two major new initiatives related to night schools and the ending of social promotion. The largest new initiative would offer the equivalent of six additional weeks of school (30 days) for students who are not prepared to move to 4th grade. The proposal, funded at $25 million, is targeted at ending the long-standing policy of social promotion, where students are moved on to the next grade solely to continue with their peers. The Mayor has announced his intention to end social promotion throughout the school system, where on average more than 95 percent of the students are passed to the next grade, despite the fact that only 50 to 60 percent of them are at or above grade level in reading and math. Figure 3-6 presents the percentage of community school district students in general education or resource room who were at or above grade level in reading and math, compared with the percentage of students promoted at all levels since 1992.

The specific criteria by which students will be chosen for additional schooling are not yet defined, but the grade level data indicate that the initiative will affect a significant number of students. IBO estimates that at the current level of student performance in third grade reading alone, more than 45,000 students will need remedial assistance this summer.

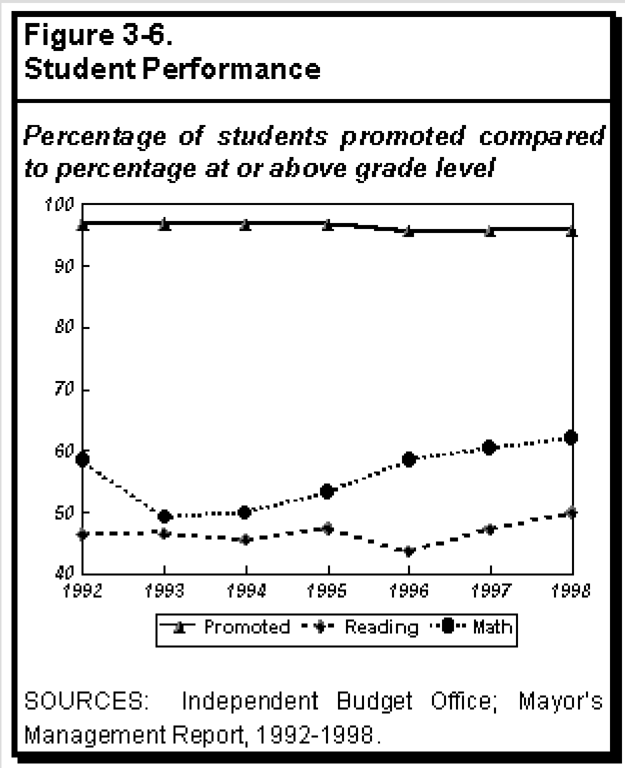
Implementation plans for the 3rd grade proposal are not yet completed, but BOE has indicated that this effort will be folded into their planning efforts for educational summer camp which is scheduled to begin this summer. However, given the scope of the Mayor's stated objective, many questions will need to be addressed in the coming year. These questions include the following:

- Whether the additional training will be offered after school or by extending the calendar into the summer.
- How decisions will be made about whether or not students will be promoted after participating in the program.
- How will BOE's already overcrowded facilities accommodate more students being held back.
- Whether BOE would be adequately funded to account for the budgetary ramifications of holding more students back each year until the problem is corrected.

If social promotion is to be addressed systematically, BOE must plan not only for this limited 3rd grade objective but also for these critical long term issues.

The Mayor's budget also funds a new initiative to reduce the number of years a student is given to graduate within a traditional high school setting. Currently a student can work toward graduation for up to seven years. This means that students in the same school can range in age from 14 to 21. Since the challenges and needs of each age group are quite different, there are implications for school environments to such an accommodation. The Mayor has proposed reducing traditional high school eligibility to six years in 1999 and then to five years in 2000. In turn, he has proposed the formation of night schools where older students can get high school diplomas and job placement assistance. For 1999, the Mayor's budget includes $7 million to begin the program, and adds $2 million per year to that amount, to reach $13 million by 2002. BOE has indicated it would develop the night school program using Manhattan Night School as a model. That school is organized to provide opportunities for older students to earn a high school diploma rather than a General Equivalency Diploma (GED) and allows flexible scheduling so students can work during the day.

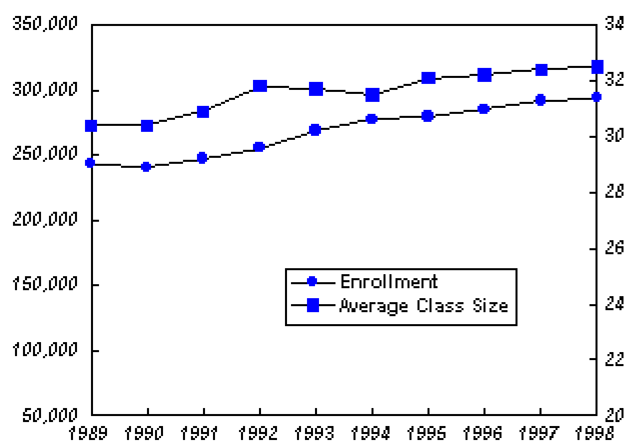
Project Read



Background. The largest commitment of new funds provided in 1998 and proposed for 1999 is for Project Read at $125 million per year. The program was added in the current 1997-1998 school year to provide intensive reading support in the early grades (1-3). The program was funded in 1998 for one year only with renewal contingent on demonstrated progress. The Mayor has proposed funding Project Read's renewal for 1999 while awaiting the results of BOE's program evaluation. Funding has not been proposed in the out-years.

What is Project Read? Project Read is intended to serve students at-risk of not achieving literacy by third grade. In the initial phase of implementation, at-risk students were identified by their classroom teachers using a four-point scale developed at the central board. On the scale, 1s and 2s were used to identify students as being at risk of illiteracy. As of its most recent district survey, BOE indicates that 60 percent of the students involved with Project Read were 1s and 2s. It is not known if all of the students identified as 1s and 2s are being served by Project Read. Within the program, there is wide latitude for local decision-making and voluntary participation on the part of students. The second major focus of Project Read was to provide additional services for Limited English Proficient (LEP) students and special education students.

Figure 3-7.
Enrollment and Average Class Size Trends in High Schools



SOURCES: Independent Budget Office; Mayor's Management Report, 1989-1998; NYC Comprehensive Annual Financial Report of the Comptroller, 1989-97.

How does it work? Project Read has been implemented to provide three types of literacy training, as well as to offer teacher training workshops. Within the program there is an after-school component, an intensive day program, and a family literacy initiative. To provide after-school reading activities for at-risk students, BOE added six hours per week of additional literacy training where students read out-loud or participate in a guided or shared read. At the half-year mark BOE served approximately 80,000 pupils in the after-school component of Project Read. The intensive day program is designed to provide literacy help where reading teachers either take six students out of the class or work in the classroom with small groups of students. In the fall semester BOE provided intensive day services to more than 50,000 students. Over four hundred schools have established family literacy programs due to Project Read. These programs, begun in schools without any other family literacy funding, were given $25,000 per school in 1998.

What has happened? About 104,000 students, or 38 percent of students in 1st through 3rd grade have been served in the after-school and the intensive day components of Project Read. In addition, about 20 percent of those served by Read are participating in both the after-school and the intensive day components of the program. In total, BOE has hired more than 800 new teachers. Many of these new hires have filled other vacancies, since BOE has encouraged districts to move the most experienced teachers into Project Read. The family literacy initiative has also utilized teacher resources by paying teachers per session to offer training workshops.

How will it be evaluated? To measure overall literacy progress, BOE is using the Terra Nova test with 25,000 students. The Terra Nova is a nationally implemented, norm referenced and standardized test of reading. It was given last May for the pre-program benchmark and it will be given again this May to the same group of students some of whom have been involved in Project Read. The second set of test scores will be compared to the first and in this way any performance improvement attributable to Project Read will be measured against the progress of the control group. BOE will use Terra Nova in the short term while it is finishing the design of a test to be used only in New York City.

The number of students affected by this proposal is yet to be determined. According to the 1997 Mayor's Management Report, BOE's four-year graduation rate was about 48 percent, and the drop-out rate was 16 percent. At the seven-year mark, 71 percent of the students who continued on after four years will graduate. At these rates, about 74 percent of the students will graduate in seven years and 26 percent will leave high school without graduating. The youth affected by the Mayor's proposal are within the 10 percent who do not graduate within four or five years. With a typical entering ninth-grade class of 65,000, as many as 11,000 students are likely to continue beyond their fifth year-of-study.

Allowing seven years to graduate has implications for all high school students. Average class sizes at the high school level have been increasing in recent years, and facilities are overcrowded. Figure 3-7 below demonstrate class size and high school enrollment trends over the past few years. Moving students into night school after their fifth year is likely to relieve some facility and class size pressures for BOE.

CUNY Community Colleges

The Mayor's Proposal. The Mayor's preliminary budget proposes major changes to the operation of the City University of New York (CUNY) community colleges. According to CUNY data cited by the Administration, about 87 percent of entering freshman fail at least one of the three basic skills (reading, writing, and math) exams and the two-year graduation rate for community colleges decreased from 3.6 percent for the 1980 freshman class to 1.0 percent in 1994. The Mayor's proposal would outsource the basic skills classes currently taught by CUNY. Applicants to CUNY who do not pass basic skills tests would be required to achieve passing grades in remedial classes before being accepted into the community college system.

Although the Administration has not provided many details of the plan, our review indicates that it could effectively eliminate CUNY's open enrollment policy and have significant budget implications. The Mayor has indicated that a portion of the city funds currently supporting CUNY community colleges could be used to fund the outsourcing of remedial classes. We discuss the elements related to the proposal below.

Basic Skills Classes. The implementation of an open enrollment policy in 1970 guaranteed a place in CUNY to every high school graduate in the city. While expanding the amount of opportunity available for students, it also created the need for CUNY to establish a basic skills program to help some entrants better prepare for college-level work. The cost of the basic skills program represents roughly 6 percent of CUNY's community college budget, or about $19 million in 1998. CUNY students pay full tuition for these classes.

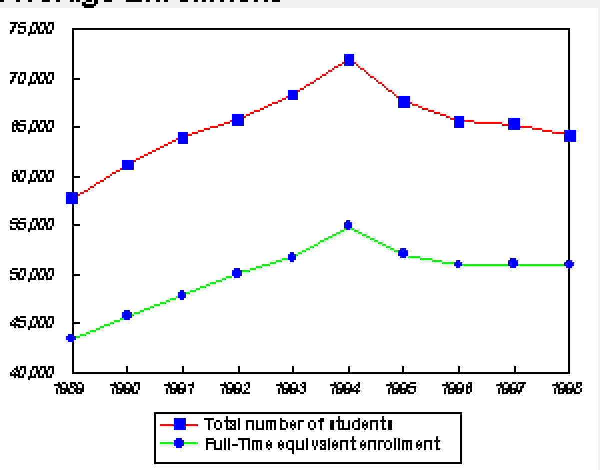
At present, all incoming CUNY students must take freshman skills assessment exams in reading, writing, and math. For those students not passing particular exams, CUNY offers basic skills classes to provide remedial instruction. Successful completion of a class satisfies the basic skills requirement and allows students to proceed to regular coursework.

The CUNY Community College System

Background. CUNY's community college system took shape during the 1950s and 1960s, a period of rapid growth for community colleges nationally. Bronx Community College opened in 1957, followed by Queensborough in 1958, Manhattan and Kingsborough in 1963, Hostos in 1968, and LaGuardia in 1971. These colleges were established to provide a post-secondary education for students who were not seeking the traditional four-year college experience. Prior to the fiscal crisis of the 1970s, CUNY community colleges were fully funded by the city. As part of a fiscal relief program in 1979, the state agreed to share the cost of supporting the community colleges.

Figure 3-8.
Community College Enrollment Has Declined Slightly

Average Enrollment

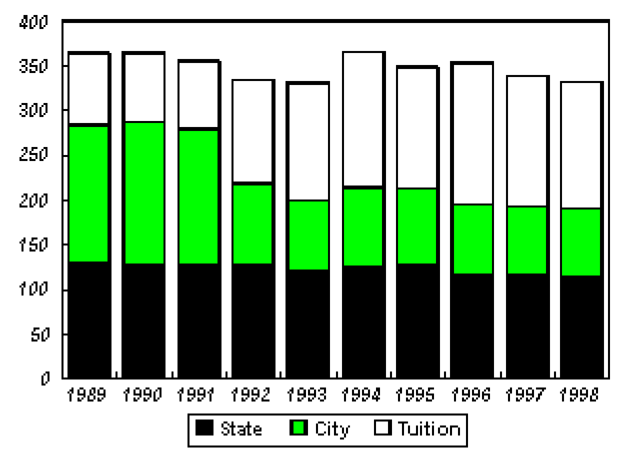


SOURCE: Independent Budget Office.

Enrollment. At present, community college students comprise about 30 percent of the CUNY system's overall enrollment, 37 percent of CUNY undergraduate students, and 45 percent of its first-time, full-time freshman. As can be seen in Figure 3-8, average enrollment at CUNY's community colleges grew significantly between 1989 and 1994, increasing from 57,817 students to 71,990. Average enrollment then decreased to 64,299 in 1998. Proportionate decreases were experienced in full-time equivalent (FTE) average enrollment measuring CUNY enrollment on the basis of a full course load (15 credits). Some of the decrease is due to Medgar Evers becoming a senior college in 1995.

Figure 3-9.
City Funding of Community Colleges Has Fallen in Real Terms

1998 Dollars in millions



SOURCE: Independent Budget Office.

Budget. CUNY's community college operating budget is funded by state aid, city funds, tuition, and fees. As shown in Figure 3-9, its budget has decreased from $364 million in 1989 to $332 million in 1998 in inflation adjusted (real) terms. While the portion of its budget funded by the state remained fairly constant over the period at about 35 percent, the city share fell from 43 percent to 23 percent. Conversely, the portion covered by tuition rose from 22 percent to 42 percent. This increased reliance on tuition caused CUNY to have the highest tuition of community colleges in major urban areas for the 1997-98 school year, according to the College Board's Chronicle of Higher Education.

Students who pass particular skills assessment tests can begin taking regular classes in that area. For example, if a student passes the math test, he could begin taking regular CUNY math courses and start working toward a degree. However, the student would have to complete basic skills courses in reading and writing before continuing with course work in those areas.

As noted by the Mayor, 87 percent of the freshmen entering CUNY community colleges in the fall of 1996 failed at least one of the three freshman skills assessment exams. On the other hand, two-thirds of these students completed all necessary remedial classes within one year. By mandating passing grades in all test areas, the practical effect of the Mayor's proposal would be to prevent some students from beginning their regular program of study.

CUNY is currently drafting a new Comprehensive Action Plan (CAP) to limit the amount of time students are permitted to continue in pre-college class work. According to the latest draft, students who do not complete basic skills classes in two of the three basic skills areas in the equivalent of one full academic year would be referred to a CUNY intensive skills program for further remedial work. They would be readmitted into the CUNY community college system after demonstrating readiness.

Such an intensive skills program would be an alternative model to traditional basic skills classes. Among other things, the programs would allow focused remedial attention on those students most at risk of not being admitted into regular CUNY classes. In addition, the CAP provides that students would not be allowed to repeat a basic skills course after receiving a failing grade twice.

Both the Mayor's proposal and the CAP would have implications for CUNY's budget, discussed below.

Graduation Rates. The Mayor cited the decline in the two-year graduation rate for community colleges from 3.6 percent for the class entering in the fall 1980 to 1 percent for the class entering in the fall of 1994. While this is one measure of performance, our review indicates that the overall picture is less clear than these figures suggest.

A more complete measure of academic success would include transfers and attainment of degrees other than CUNY associate's degrees. The graduation figures cited by the Administration only represent first-time, full-time community college freshman who graduate with a CUNY associate's degree. The figures do not take into account students who earn certificates, those who attain four-year degrees from CUNY, or those who transfer to other universities and receive degrees. To ascertain a more complete picture of incoming community college freshman who are academically successful, these factors should be taken into consideration.

According to the most recent tracking information available from CUNY, 33 percent of community college students who entered as first-time, full-time freshmen in the fall of 1990 graduated with either an associate's or bachelor's degree or received a certificate from a post-secondary institution (including CUNY) after five years. An additional 28 percent were still enrolled either at CUNY or as a transfer student at another college. The projected eight-year rates are 46 percent and 14 percent, respectively. The eight-year figures are identical to those of the freshman class entering in the fall of 1988.

By comparison, the American Association for Community Colleges tracks these trends at the national level, but only at the four-year mark. Their profile of community college students who enter as first-time, full-time freshman indicates that, nationwide, 46 percent graduate with some degree or certificate and 12 percent are still enrolled at a post-secondary school at the end of four years. These figures indicate that CUNY students take longer than the national average to achieve academic success.

Many factors can contribute to the extended period taken by some CUNY students to achieve academic success. For example, CUNY community colleges traditionally educate a large immigrant population. Although the percentage who speak a language other than English at home has remained constant at about 56 percent, the overall percentage of CUNY community college students born outside the U.S. mainland has increased from 41 percent in 1989 to 52 percent in 1995. Some of these students may take longer to achieve their academic goals due to a limited initial command of English.

CUNY community college students also tend to be more economically disadvantaged than the national average. According to 1995 data from CUNY and the Higher Education Research Institute, 44 percent of CUNY first-time community college freshman have household incomes below $15,000 as compared to 16 percent nationwide. For households with incomes of $20,000 or less, these figures are 55 percent and 22 percent, respectively.

Economically disadvantaged individuals tend to have a harder time maintaining a continuous college experience and, therefore, may take longer to complete an academic program. This can be due to the need to work, the inability to afford tuition, and the need personally to provide child care instead of being able to pay for child care services. All of these factors can limit the amount of time these students can spend pursuing a degree.

Budget Impact of the Mayor's Proposal. Our review indicates that the Mayor's proposal could have a significant negative impact on CUNY's revenue stream due to two factors. First, any student taking a remedial class would not be allowed to enroll in CUNY community colleges. This could result in the loss of tuition revenue and FTE-based state aid, depending on how CUNY's budget is altered due to the outsourcing of basic skills classes.

Second, if the implementation of outsourcing results in the elimination of the open enrollment policy, CUNY could lose its designation as a full opportunity institution. Under current law, a college is a full opportunity institution when it guarantees enrollment to all high school graduates in its sponsorship area. This designation is important because the amount of state aid is higher for full opportunity institutions ($1,900 per FTE for 1998) than for non-full opportunity institutions ($1,584 per FTE for 1998).

Assuming 11,000 CUNY community college FTEs take remedial classes, CUNY would lose about $51.3 million in state aid and tuition revenue in 1999. For the 40,000 FTEs that would still be enrolled in CUNY, reduced state aid would cost CUNY an additional $12.6 million. On the expense side, CUNY would save the $19 million that it currently spends on basic skills classes. According to CUNY, there would be no significant additional operating savings from removing basic skills students from non-remedial classes. Taken together, our preliminary estimate of the net result of these changes is a projected budget gap of about $45 million for 1999.

The projected budget impact of the pending CAP program is unclear at this time. On the one hand, since the CAP would keep all of the basic skills classes and intensive skills programs under the auspices of CUNY, the state would still consider CUNY a full opportunity institution and, hence, not reduce state aid based on removal of this classification. On the other hand, CUNY would likely have a decrease in tuition revenue since students would be charged $100 per class in lieu of full tuition for intensive skills classes. CUNY is still trying to determine the full fiscal impact of the program.

Next Steps. In order for the Mayor's proposal or the CAP to be implemented, the CUNY Board of Trustees must formally adopt one of the proposals. On March 23, 1998 the Board is scheduled to discuss the issue of remedial education.

Based on our analysis of the Mayor's proposal, we recommend that elected officials and the public consider the following:

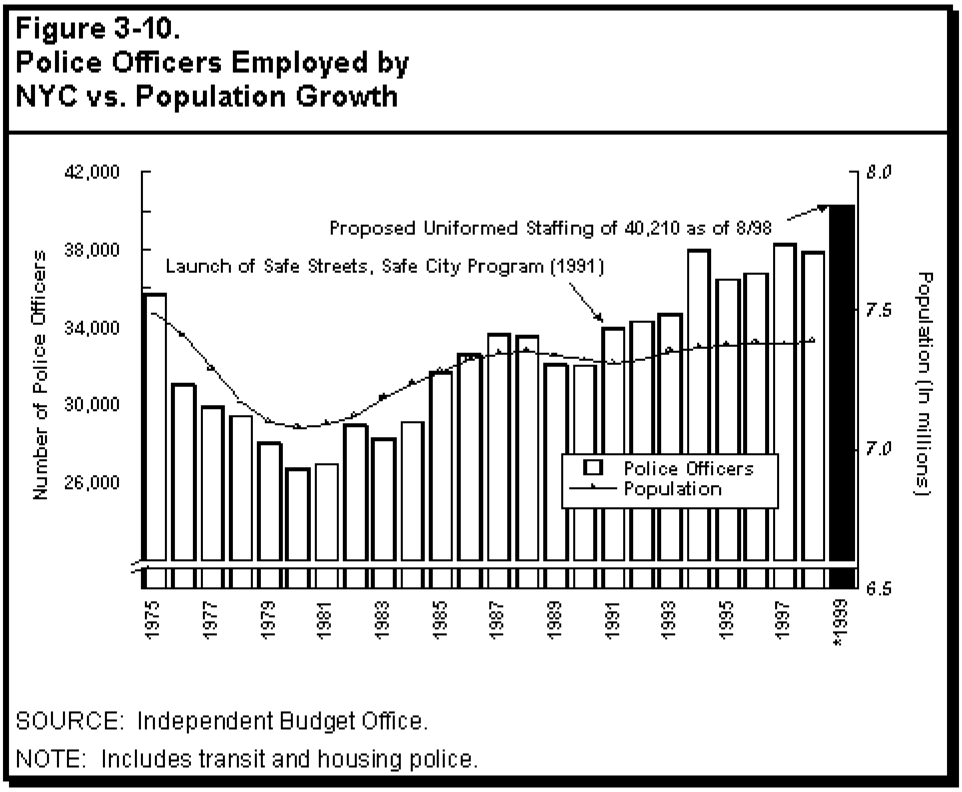
- The Administration's proposal could effectively eliminate CUNY's 28-year policy of open enrollment allowing any New York City public school graduate to enter the CUNY system.
- A more complete assessment of CUNY's academic success rate requires the consideration of transfer rates and non-CUNY degrees attained by students, and a recognition of the challenges faced by many students.
- The Administration's proposal could have significant budget ramifications if implemented.

Uniform Services

Police Department

The Mayor's preliminary budget would result in Police Department (NYPD) spending of $2.8 billion in 1999, an increase of $127 million, or 4.7 percent over 1998, based on our estimates. The NYPD budget would increase annually by an average of 3.2 percent between 1998 and 2002. Significant contributing factors to the growth in NYPD spending include rising labor costs and the proposed continuation and expansion of intensive drug enforcement efforts in several communities throughout the city.

New Hiring. Also contributing to the rise in NYPD expenditures is the proposed addition of 1,600 uniformed personnel to NYPD's hiring plan from 1999 through 2002. As can be seen in Figure 3-10, the new hiring would elevate uniformed police headcount to an all-time high of 40,210 by August 1998.



The cost of the additional police officers over the first three years would be partially covered by an annual average of $40 million in federal funding made available through the Justice Department's Community Oriented Policing Services (COPS) program. The Mayor's plan assumes expiration of the COPS program funding in 2002, thereby necessitating full city funding for the additional officers at an annual cost of about $66 million.

How Many Officers are Needed? At the request of the City Council Committee on Public Safety, IBO conducted a preliminary analysis assessing the relationship between police staffing levels and reported crime rates in the nation's largest cities. Although our analysis is preliminary, the findings point to the need for serious consideration before city taxpayer funds are appropriated to an enlargement of our police force beyond its current size.

- New York City's current staffing level of 53 police officers per 10,000 residents is second only to Washington among the nation's 25 most populous cities. If the NYPD expands to 40,210 uniformed personnel as proposed in the 1999 preliminary budget, New York City would have 55 police officers per 10,000 residents, almost double the average in America's next 24 largest cities.

- From 1990 through 1996, San Diego was the only other major city (besides New York City) to enjoy a drop in crime rate of more than 40 percent. However, San Diego accomplished its crime reduction with only a 1 percent increase in the number of police officers per capita.
- In contrast, the number of police officers per capita in New York City climbed 18 percent between 1990 and 1996, and is currently 20 percent greater than in 1990. If the NYPD expands to 40,210 uniformed personnel, the number of police officers per capita in New York City would be fully 25 percent greater than in 1990.
- Also quite striking were the trends in Dallas and Seattle. In both of those cities, significant drops in crime occurred between 1990 and 1996 despite net *decreases* in per capita police staffing.

We are continuing our research in this area and will present additional findings in future IBO reports.

Fire Department

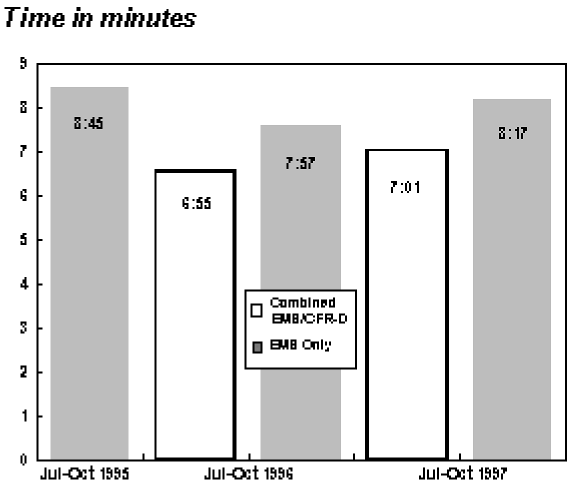
Update on the FDNY and EMS Merger

On March 17, 1996, the New York City Fire Department (Fire Department) and the New York City Emergency Medical Service (EMS) were merged. Primary goals of the merger were to decrease response time to medical emergencies--especially life-threatening incidents such as cardiac arrest--and improve the quality of medical care.

Response Times are Generally Lower. The most serious life-threatening incidents include situations such as cardiac arrest, choking, unconsciousness, and major trauma. Although response times are generally lower since the merger, as can be seen in Figure 3-11, they actually increased in the first quarter of 1998 as compared to the prior year.

The Preliminary Mayor's Management Report (PMMR) attributes the increase to a new dispatch protocol implemented in the last quarter of 1997. According to the PMMR, the protocol has since been revised to reduce the higher response times. Information reported by the Administration since the revision of the protocol indicates that response times have decreased from first quarter levels. To the extent this trend continues, it would support the Administration's explanation. Full year data, however, will not be available to the public until the next report on response time is provided in the Mayor's Management Report which will be released in the fall of 1998.

Figure 3-11.
Response Time to Life Threatening Medical Emergencies



SOURCES: Independent Budget Office; Preliminary Mayor's Management Report 1998.

NOTE: Life threatening medical emergencies include segment 1-3 incidents, segment 1 (cardiac arrest and choking) being the most serious.

Committee Fails to Report. The improvement of patient care quality was another reason for the merger. In the memorandum of understanding between the Mayor and City Council implementing the merger, it was agreed that a committee of medical experts and physicians would be created to issue a report on the effect of the merger on the quality of patient care. Although this report was to be completed no later than March 1997, it has not yet been issued.

Construction of Ambulance Stations Falls Short. The Fire Department has indicated that the building of new stations was integral to the goals of reducing response times for medical emergencies and improving the quality of patient care. Progress on the building of such stations, however, has been limited.

The Mayor's capital budget commitment plan allocates about $13.4 million in 1998 and $30.8 million in 1999 for the construction of ambulance sites. Before the merger, there were 16 ambulance stations in the city. Ambulance crews would report to work at one of the stations and then be assigned to a street corner within their coverage area. Under this system, crews respond to emergency calls from these street locations. Among other things, this method of deployment can result in slower response times because a crew may have to leave its assigned location to restock equipment or clean-up after a service call. The travel time to and from the station can also reduce the coverage provided to their neighborhood response area. At the time of the merger, Fire Department planned to build 60 ambulance stations by the end of 1999.

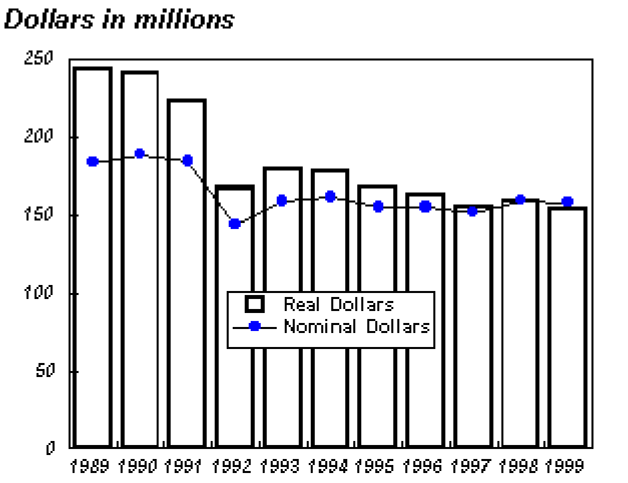
The Fire Department will not reach its goal. To date, five additional ambulance stations have been opened increasing the number of ambulance stations to 21. However, instead of the 60 stations originally planned, the department now plans to have 27 stations in operation by the end of 1999. The plan has been further modified to the point that the department now plans to have about 40 ambulance stations in operation within six years of the merger date. It is too early to tell what effect the lower number of ambulance stations will have on response times and the quality of patient care. The Administration would not provide details on the full cost and construction schedule of the revised plan, so it remains to be seen whether the new goals can be met on time and within budget.

Other Agencies

Parks and Recreation

The Mayor's budget would result in spending of about $161 million in 1999 for the Department of Parks and Recreation (Parks), based on our estimates. The budget includes a proposed reduction of $1.5 million for seasonal personnel who maintain parks, playground, and recreational centers. Other proposed reductions include the re-deployment of auto mechanics and Parks Enforcement Patrol officers ($1.8 million) and attrition ($0.8 million). These reductions are offset by an increase of $1.5 million of additional lifeguard funding and $3.2 million for collective bargaining adjustments.

Figure 3-12.
Parks Spending at Its Lowest Inflation Adjusted Level in 10 Years



SOURCE: Independent Budget Office.

As shown in Figure 3-12, total Parks expenditures decreased by 35 percent between 1989 to 1998 in real terms. The largest decrease occurred in 1992. Since then, spending has been fairly constant in nominal terms, but inflation has deteriorated the real value of the budget to the point where it is now at its lowest level in 10 years.

Although city parks do receive some private funding, a May 1997 IBO study found that it has not been nearly sufficient to offset the reduction in city spending. In 1996, private funding reached $18.6 million (1998 dollars), far less than the decrease in city spending from 1989 to 1998. In addition, the private spending has been concentrated in a few high-profile parks like Central Park, which received 57 percent of the private funding for parks operations in the 1987-96 period.

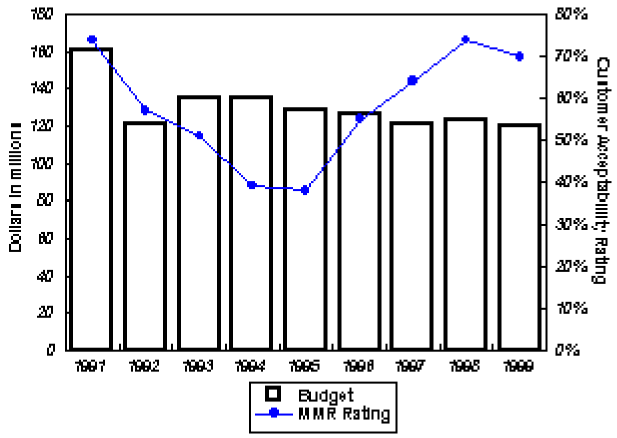
WEP Workers Improve Ratings. While the reduction in funding has effected the level of parks services, particularly in recreation, the city has found alternate resources in other cases. As shown in Figure 3-13, the acceptability rating of parks reported in the Preliminary Mayor's Management Report increased to 74 percent for the first quarter of 1998. The rating had previously been at 74 percent in 1991 but dropped as low as 38 percent in the intervening years. During this same period, Parks' maintenance and operating spending, which funds most cleaning and maintenance activity, followed the same trend seen in overall spending and decreased from $161 million in 1991 to $123 million in 1998.

The improvement in park conditions is largely due to the Work Experience Program (WEP), the city's workfare program that assigns welfare recipients to part-time city jobs like park cleaning as a condition for receiving their benefits. During 1995, the number of WEP workers assigned to Parks increased from below 1,000 to roughly 4,000. In the first quarter of 1998, Parks used an average of about 6,200 part-time WEP workers, which IBO estimates to be the equivalent of close to 3,300 full-time employees.[26]

Other Developments in Parks. With the signing of a contract in February, the city formally turned over the maintenance and operation of Central Park to the Central Park Conservancy. While this contract mostly formalizes the existing role of the Conservancy as operator of Central Park, it also requires the city to provide additional funds, contingent upon the Conservancy raising more private funds. In addition, the contract contains requirements for Parks to appropriate a portion of the revenues generated from concessions to the Conservancy.

Figure 3-13.
Trends in Parks Acceptability Ratings and Maintenance and Operating Expenses

Dollars in millions



SOURCE: Independent Budget Office.

NOTES: 1998 Rating is PMMR first quarter figure.
1999 Rating is PMMR estimate.

The Parks' capital budget includes funding for the Mayor's agreement to fund the city share of construction for Hudson River Park and the reconstruction of City Hall Park. In the Capital Commitment Plan, the Mayor commits $5 million in 2000, $20 million in 2002, $33 million in 2003, and $40 million in 2007 for the construction of Hudson River Park and $5 million in 1999 and 2000 for renovations to City Hall Park.

Debt Service

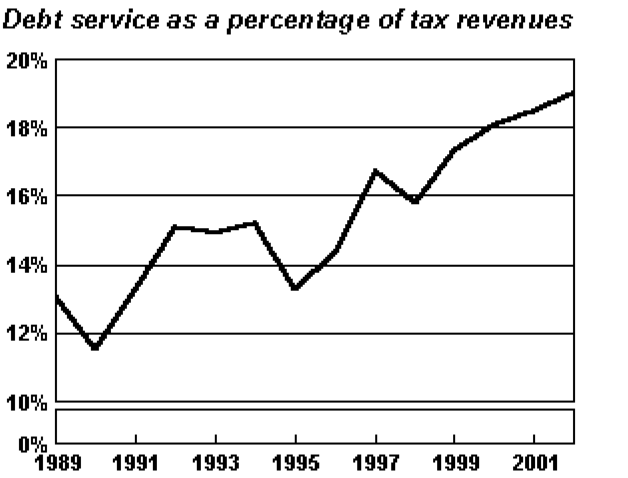
The city issues bonds to borrow funds to pay primarily for physical improvements to schools, roads, and other public facilities. Bonds are issued as general obligation (GO) debt and Transitional Finance Authority (TFA) debt. Debt, originating during the city's recovery from the financial crisis of the 1970s, which is carried through the Municipal Assistance Corporation (MAC), also constitutes debt of the city. Debt service is the repayment of these borrowed funds plus interest.

IBO projects total debt service to be $3.2 billion in 1998 and $2.4 billion in 1999. These figures reflect IBO's reestimate of the city's 1998 surplus, which we forecast to be $164 million greater than projected in the Mayor's budget. Following the city's standard practice of using surplus funds to prepay debt service (see surplus roll discussion below), we assume an additional prepayment (on top of what is already budgeted) of $164 million in 1998 of 1999 debt service. As a result, IBO's reestimate of debt service is $164 million greater in 1998 and $164 million less in 1999 than the Mayor's projections.

GO Debt Service. The Mayor's GO debt service budget shifts a large amount of spending from next year up to this year, 1998. Since the original 1998-2001 financial plan adopted this past June, budgeted GO debt service for 1998 has been increased from $1.9 billion to $2.7 billion and 1999 budgeted debt service has been decreased from $2.9 billion to $1.9 billion. IBO's corresponding reestimates are $2.8 billion and $1.7 billion, respectively. As noted above, there is an increase of $164 million in 1998 and a decrease of the same in 1999. Most of the change since the adopted budget is due to a proposed payment of $1.4 billion of 1999 debt service in 1998. Prepayment of debt service is referred to as the "surplus roll" and is a well-established mechanism for transferring surplus funds from current budget years to the next. Other budget changes affecting 1999 include a reduction of $129 million in refunding savings and some savings due to reduced interest rate assumptions.

Also included among the debt service budget changes, the Mayor's budget would allocate $210 million to the budget stabilization account for the prepayment of debt service in 2000. The budget stabilization fund is a variation on the surplus roll that is meant to act like a rainy day fund or at least a means (in effect) to spread surplus funds over more than one year. It was introduced last year when projected 1997 surplus funds were essentially pre-designated for use in 1998 for the prepayment of 1999 debt service. It is important to note that the $210 million targeted for prepayment of debt service in 2000 would be available to pay for other city expenses that arise in 1999.

Figure 3-14.
Debt Service Growth Outpaces Tax Collections



SOURCE: Independent Budget Office.
NOTE: Excludes prepayments.

MAC Debt Service. For MAC debt service, expenditures would increase $151 million from the currently budgeted level of $360 million in 1998 to $511 million in 1999. The increase is largely due to a refunding of MAC bonds that greatly reduced 1998 debt service. The savings were used to fund the first year of a reading program (Project Read) at the Board of Education and a Police Department anti-drug initiative. MAC debt service expenditures are projected to remain in the $500 million range through 2001 and beyond. Some relatively small changes, generally decreases, are expected as a result of interest earnings and future refundings.

TFA Debt Service. TFA debt service is projected to become more of a factor in the budget in the next few years. The TFA was set up to enable the city to borrow beyond its statutory debt limit. As more bonds are being issued, TFA debt service is rising, from the currently budgeted level of $18 million in 1998 to $154 million in 1999. By 2001, TFA debt service is projected to be $453 million.

Overall Debt Service Trend. The total debt service budget is projected to be $3.2 billion in 1998, $2.4 billion in 1999, and $3.6 billion in 2000. Without prepayment of GO debt service, 1999 debt service would also be in the $3 billion to $4 billion range. In the years beyond 2000, debt service is projected to exceed $4 billion. As a measure of the overall affordability of debt service, Figure 3-14 presents debt service (adjusted to remove the effects of the surplus roll) as a percentage of city tax revenue. Debt service is clearly becoming much more of a burden to the city, leaving less funds available for other uses.

Labor

Labor Reserve. The labor reserve provides funds for the costs associated with collective bargaining agreements for city employees and employees of the city's covered organizations. It also provides funds for the costs of collective bargaining agreements negotiated by organizations whose employees provide services to the city on a contractual basis.

About 86 percent of the city's workforce have contracts that end in 2000 or 2001. Those contracts are the result of recent settlements and arbitration awards and provide for a wage freeze in the first two years and salary increases over the last three years of a five-year contract. The wage increases provided by the contracts and arbitration awards together with benefit increases for the contract period are expected to increase the city's cumulative net salary cost by about 13.3 percent.

During the current year, funds are transferred from the labor reserve to the budgets of various agencies to fund scheduled wage increases. The Mayor's budget transfers $33 million in 1998, $269 million in 1999, $433 million in 2000, $445 million in 2001 and $446 million in 2002. In addition to these transfers, there was a reestimate of spending resulting in a projected savings of $36 million in 1998 and $7 million in 1999.

After transfers and other adjustments, the Mayor's budget projects a labor reserve of $203 million in 1998, $437 million in 1999, $824 million in 2000, $895 million in 2001 and $895 million in 2002. The Administration has not provided funds for collective bargaining increases effective after the expiration of the current five-year contracts. Depending on whether the contracts to be negotiated in the future contain a similar wage freeze at the beginning of the contract period, the size of the city's budget gap could increase significantly in 2000 and 2001.

Overtime. The Mayor's budget projects total citywide overtime spending of $430 million in 1998, an increase of $46 million, or 12 percent, over the adopted budget. Based on our review of overtime spending trends, IBO estimates that overtime costs will reach $453 million by the end of 1998, an increase of $23 million over the Administration's projection. Overtime savings currently being generated in agencies such as the Department of Sanitation, could offset some of the increased costs in 1998. However, we expect spending will grow to $472 million from 1999 through 2001 and reach about $500 million by 2002. The higher level of estimated expenditures is largely attributable to anticipated overtime associated with implementation of the Mayor's drug initiative by the Police Department and Corrections, and other initiatives related to social services.

Appendix A
Gap Sheets

IBO's Reestimate of the Mayor's Budget (In millions of dollars)

	1998	1999	2000	2001	2002
Revenue:					
Taxes:					
Property	7,277	7,391	7,753	7,999	8,265
Personal Income	4,755	4,814	4,934	5,000	5,140
General Sales	3,044	3,178	3,164	3,228	3,354
Business Income	2,594	2,647	2,606	2,624	2,618
Real-estate Related	843	859	884	935	989
Other Taxes (with Audits)	1,521	1,516	1,521	1,526	1,534
Total Taxes	20,034	20,405	20,862	21,312	21,900
Tax Reduction Program	-	(259)	(504)	(604)	(765)
Miscellaneous Revenues (net of intra-city revenue)	2,738	2,707	2,471	2,398	2,460
All Other Revenue:					
Unrestricted Intergovernmental Aid	587	606	789	1,012	1,267
Anticipated Revenue	-	32	32	32	32
Other Categorical Grants	334	299	296	297	297
Inter-Fund Revenues	259	271	274	274	274
Disallowances	(15)	(15)	(15)	(15)	(15)
Total Other Revenue	1,165	1,193	1,376	1,600	1,855
Total City Funds	23,937	24,046	24,205	24,706	25,450
Categorical Grants:					
State	6,626	6,737	6,905	7,124	7,386
Federal	4,663	4,668	4,724	4,839	4,903
Total Revenue	35,226	35,451	35,834	36,669	37,739
Expenditures:					
City Funded (net of intra-city sales)	23,937	23,971	26,375	27,272	27,966
Categorical Grants:					
State	6,626	6,737	6,905	7,124	7,386
Federal	4,663	4,668	4,724	4,839	4,903
Total Expenditures	35,226	35,376	38,004	39,235	40,255
Surplus / (Gap)	-	75	(2,170)	(2,566)	(2,516)

SOURCE: Independent Budget Office.

Current Services Projections (In millions of dollars)

	1998	1999	2000	2001	2002
Revenue:					
Taxes:					
Property	7,277	7,391	7,753	7,999	8,265
Personal Income	4,755	4,814	4,934	5,000	5,140
General Sales	3,044	3,178	3,164	3,228	3,354
Business Income	2,594	2,647	2,606	2,624	2,618
Real-estate Related	843	859	884	935	989
Other Taxes (with Audits)	1,521	1,516	1,521	1,526	1,534
Total Taxes	20,034	20,405	20,862	21,312	21,900
Tax Reduction Program	-	-	-	-	-
Miscellaneous Revenues	2,738	2,507	2,471	2,398	2,460
(net of intra-city revenue)					
All Other Revenue:					
Unrestricted Intergovernmental Aid	587	606	789	1,012	1,267
Anticipated Revenue	-	-	-	-	-
Other Categorical Grants	334	299	296	297	297
Inter-Fund Revenues	259	271	274	274	274
Disallowances	(15)	(15)	(15)	(15)	(15)
Total Other Revenue	1,165	1,161	1,344	1,568	1,823
Total City Funds	23,937	24,073	24,677	25,278	26,183
Categorical Grants:					
State	6,626	6,759	6,932	7,161	7,431
Federal	4,624	4,776	4,879	5,045	5,165
Total Revenue	35,187	35,608	36,488	37,484	38,779
Expenditures:					
City Funded (net of intra-city sales)	23,937	24,145	26,515	27,412	28,098
Categorical Grants:					
State	6,626	6,759	6,932	7,161	7,431
Federal	4,624	4,776	4,879	5,045	5,165
Total Expenditures	35,187	35,680	38,326	39,618	40,694
Surplus / (Gap)	-	**(72)**	**(1,838)**	**(2,134)**	**(1,915)**

SOURCE: Independent Budget Office.

Appendix B
Economic Forecasts: IBO and OMB

	Calendar Year					
	1997	1998	1999	2000	2001	2002
United States						
Real GDP						
IBO	3.7	2.5	2.0	2.6	2.5	2.6
OMB	3.8	2.3	2.0	2.5	2.5	2.2
Payroll Employment						
IBO	**2.2**	1.5	0.8	1.4	1.4	1.4
OMB	2.3	1.8	1.4	1.3	1.3	1.2
Consumer Price Index						
IBO	**2.4**	2.5	3.1	3.2	3.2	3.4
OMB	**2.4**	2.5	2.3	2.6	2.7	2.8
Thirty Year Treasury Bond Rate (%)						
IBO	**6.6**	6.5	6.5	6.5	6.3	6.3
OMB	**6.6**	6.4	6.1	5.9	5.8	5.8
New York City						
Personal Income						
IBO	8.7	6.4	4.2	4.7	4.8	4.9
OMB	5.7	5.1	3.8	4.2	4.2	4.1
Payroll Employment						
IBO	**1.7**	1.3	0.7	0.7	0.7	0.8
OMB	**1.5**	1.3	0.9	0.8	0.8	0.8
Consumer Price Index						
IBO	**2.3**	2.6	3.2	3.2	3.2	3.3
OMB	**2.3**	2.4	2.2	2.5	2.6	2.7
Manhattan Office Rents ($/sq.ft)						
IBO	36.42	38.37	39.93	41.44	42.72	43.88
OMB	34.83	35.87	38.52	41.13	42.48	43.82

SOURCE: Independent Budget Office.

NOTES: Actual values for 1997 are denoted by bold type.
With the exception of bond rates and office rents, all figures reflect year-over-year percentage increases.
The local consumer price index covers the New York/Northern New Jersey region.

Appendix C
Major Contributors to the Revenue and Expenditure Projections

The following Independent Budget Office staff prepared the revenue and expenditure projections in this report:

Office of the Director

Terri Matthews	Debt Service
Tim Mulligan	State and Federal Categorical Aid

Economic Analysis Division

Michael Jacobs	Business Taxes, Personal Income Taxes
George Sweeting	Property Taxes
Luan Lubuele	Econometric Modeling, Education Finance
David Belkin	Sales Taxes
Stephen Mark	Business Taxes

Budget Analysis Division

Frank Posillico	Budget Projections
Richard Greene	Overtime, Labor Reserve

Health and Social Services

Paul Lopatto	Medicaid and Public Assistance
Michelle Billies	Health and Social Services
Jonathan Cottell	Health and Social Services
Sofia Quintero	Medicaid

Housing, Education, and Infrastructure

Patrick Killackey	Education, Debt Service
Bill Kramer	Housing and Buildings, Parks, CUNY
Elizabeth Lynam	Education
Joyce Sun	Economic Development, Debt Service

Uniformed Services

Mark Schreiner	Sanitation, Finance
Paul Greaves	Fire, District Attorneys
Jenell Horton	Environmental Protection, Juvenile Justice
Bernard O'Brien	Police, Corrections

The following Independent Budget Office staff also assisted with the production of this report:

Herbert Block	Press/Intergovernmental Affairs
Vanessa Richards	Intergovernmental Affairs
Kevin Koshar	Administrative/Executive Support
Elizabeth Boghossian	Computer Support
Betheum Moodie	General Support
Indera Segobind	General Support
Deanice Jenkins	General Support

Footnotes

1 Please note that economic data in this chapter are presented on a calendar year basis.

2 All effective tax rates reported are from New York City Real Property Tax Reform Commission *Final Report*, December 31, 1993, see Appendix C, Table E-3.

3 The effective tax rates for coops and condos are limited by state law that require assessors to value these buildings as if they were rental buildings, even though many rental buildings are still under rent regulation. Moreover, the degree of under-assessment varies significantly, with the widest differences occurring the prime cooperative and condominium neighborhoods of Manhattan. See IBO, New York City's *Fiscal Outlook,* February 1997.

4 For apartments in buildings with average assessed values of $15,000 or less per apartment, the percentages are higher: 2 percent, 16 percent, and 25 percent, respectively. Only apartments sold by the sponsor or developer qualify and buildings with J-51 or 421-a benefits are excluded.

5 In 1991, before the full effect of the last recession hit the commercial leasing markets, CRT revenues reached their all-time high of $666 million.

6 Revenue impacts associated with past policy changes are OMB estimates.

7 Since 1997, liability has been phased in for tenants with rent between $100,000 and $140,000.

8 This assumes that lower base rent is correlated with smaller businesses and these smaller businesses in turn pay a higher share of their income in commercial rent tax.

9 The estimated cost in 2001 and 2002 include $21 million and $44 million, respectively, for audit revenues foregone.

10 The New York State Constitution limits the amount of the city's operating budget funded from the property tax to 2.5 percent of the full value of the property tax base. In 1963, when the city did not have a personal income tax and the gross receipts tax on businesses accounted for a smaller share of revenues than do the current business income taxes that replaced it, the property tax accounted for a much greater share of the city's operating budget than it has in more recent decades.

11 In economic terms, the market value of income-producing properties depends on the discounted value of current and future rents the property will earn. Because the CRT is based on rent

levels, it can be viewed as an alternative means of subjecting market values to taxation.

12 See Independent Budget Office, *New York City's Fiscal Outlook,* February 1997, for a discussion of this and other features of the property tax law which have constrained the growth in property tax revenues to a rate well below the growth in local personal income and economic output.

13 As reported in *New York City's Tax on the Working Poor* (see box), IBO found that the institution of a city child care credit, even if non-refundable, in conjunction with several low-income tax relief options, such as an earned income tax credit, successfully eliminated PIT liability for many of the city's working poor.

14 The federal tax treatment of S corps is thus similar to the treatment of partnerships. Earnings are exempt for the business as a whole, with the income taxed only after it has been distributed either to the partners or the shareholders. While receiving similar tax benefits, partnerships and S corps differ significantly in terms of structure and liability.

15 Unlike IBO and other city agencies, the Department of Finance has legal access to individual tax returns.

16 This is because state law authorizing the resident PIT is statutorily distinct from that allowing the nonresident earnings tax.

17 The Financial Plan separately itemizes proposals to raise the exemption threshold to $500 (including footwear) and then to exempt all sales over $500. But these are to go into effect concurrently and may be treated as a single proposal to exempt all apparel sales not covered by the enacted $100 exemption.

18 A study of the January 1997 one-week clothing tax exemption by the State Office of Tax Policy *(The Temporary Clothing Exemption: Analysis of the Effects of the Exemption on Clothing Sales in New York State*, November, 1997) provides evidence that the timing of clothing purchases is sensitive to changes in sales tax rates.

19 In last year's fiscal brief, the estimated secondary revenue offset was 14 percent of direct city clothing tax losses. Our estimate is now slightly higher because the strong economy is yielding more overall tax revenues per dollar of city economic output.

20 Because of the long lags between changes in output and changes in property tax revenues, the full secondary revenue impact of clothing

tax cuts introduced in 1999 and 2000 would not be felt until about 2007. It should also be noted that the analysis holds the level of government outlays (and the positive economic impact of those outlays) constant while the level of taxes (and the negative economic impact of taxes) falls.

21 The sale of the Coliseum is particularly problematic-even if it does finally occur-because it commits the city to additional MTA-related debt service spending in future years.

22 The savings from managed care are contingent upon the continued incentives for HMOs to participate at a level where the city's managed care program covers all recipients. The environment, however, is still somewhat unsettled and there is evidence that some HMOs are reassessing their participation in such programs.

23 The 7,000 figure includes the over 3,000 EMS employees that were transferred to the Fire Department in 1996.

24 City Hospital Visiting Committee. United Hospital Fund. "The State of New York City's Municipal Hospital System, FY 1997."

25 To permit DASNY to design and manage the construction of these projects, it is proposed that HHC would sublease the projects to the city which would subsequently sublease the projects to DASNY. The city owns the real property on which all HHC facilities are located as well as all HHC facilities. The city leases the facilities, however, to HHC, under memoranda of agreement which also provide for the financial inter-relationship between the city and HHC. To support the financings, it is proposed that DASNY would then sublease the projects back to the city and the city's rental payments under the sublease (which would be subject to annual legislative appropriation), equal to debt service on DASNY's bonds, would pay debt service on the bonds. The city would finally sublease the projects back to HHC to permit HHC to operate the facilities and provide for HHC's reimbursement, out of HHC operating revenues, to the city, for the city's lease payments to DASNY.

26 Preliminary Mayor's Management Report, Volume I, p. 126. The full-time position equivalent estimate assumes that a full-time worker works 1,700 hours per year and a WEP worker works about 900 hours per year (18 hours per week for 50 weeks).