Note: City Budget Committee

There is no file for 1985. (File is missing.)

April 8, 2002
Date: 5 December 1989
To: Felix G. Rohatyn
From: Stephen J. Weinstein
Re: City Budget Figures

Current 1990 Budget -- $26.48 Billion
Planned 1991 Budget -- $28.13 Billion

Proposed 1990-1991 Increase -- $1.65 Billion (+6.2%)

<table>
<thead>
<tr>
<th>Revenue Risks:</th>
<th>City Gap Projection</th>
<th>$400 Million</th>
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<td>Coliseum Sale Proceeds</td>
<td>$300 Million</td>
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<tr>
<td>Potential Tax Shortfalls</td>
<td>$200 Million</td>
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<td>State Aid Additions</td>
<td>$300 Million</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>$1.2 Billion</strong></td>
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<tr>
<th>Spending Risks:</th>
<th>Labor Settlement at 5%</th>
<th>$400 Million</th>
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<td>Potential Cost Overruns</td>
<td>$200 Million</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>$600 Million</strong></td>
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Combined Revenue and Spending Risks -- $1.8 Billion

1990 Payroll Expenses -- $14.3 Billion

1990 Headcount Total -- 246,500 City Employees [Exclusive of 114,000 Covered Organization Employees (Transit, Hospitals, Housing, Betting)]

1990 Headcount Increase -- 8,200 City Employees

Real Estate Tax Revenues:
- 1990 -- $6.57 Billion
- 1991 -- $6.93 Billion
- Projected Increase -- $360 Million (+5.5%)

Other City Tax Revenues:
- Income, Sales, Business and Property Transfers
- 1990 -- $8.66 Billion
- 1991 -- $9.34 Billion
- Projected Increase -- $680 Million (+7.9%)

City's 1990 operating budget adopted last July was increased over previous year by approximately same amount as now proposed for next year's rise, but required City to take actions in October to close gap projected at $530 million, with FCB and OSDC identifying possible additional revenue shortfalls of $130-$170 million.
Date: 29 November 1989
To: Board of Directors
From: Felix G. Rohatyn
Re: City Budget

The daunting fiscal situation now facing the City of New York calls for this unusual mid-year memorandum. Local revenue growth continues to deteriorate. Consequently, the City must prepare an austere budget for the fiscal year beginning next July, while maintaining budget balance for the remaining half of the current fiscal year. Next year's operating budget should be kept at the level of this year's revenues, and spending controlled in all possible areas to fit within such an overall limit. A renewed emphasis has to be placed on allocation of available financial resources and management of municipal operations. Such actions are more critical today than at any time in the past ten years, in light of the ongoing economic erosion.

An assessment of the City's fiscal prospects must begin with an appreciation of the hard reality of economic performance, which is the ultimate driving force of local government revenues. There has been nothing less than a sea change from the robust and unbroken expansion that characterized the New York City economy for six straight years earlier in the 1980's to virtual stagnation today. For the past 12 to 24 months, there has been almost no private sector job growth within the City, and a broad spectrum of economic
indicators are pointing downward for the coming 12 to 24 months. Inevitably, revenue growth to support City budgetary expansion continues to decline and threatens to stall.

The local situation reflects a regional economic trend, although particularly acute in the City, that also poses serious consequences on a statewide basis, with potential concerns for the State's own fiscal prospects. The consensus of economic forecasters in both public and private sectors is that the upcoming year will be weaker for the State than the nation and weaker for the City than the State, and that economic performance in 1990 will lag behind the lackluster patterns of 1989. This unenthusiastic local view posits a national growth rate of 2.0 to 2.5 percent in 1990, forecasting a slowdown without a recession in the country as a whole, but only about half of that increment for the New York State economy, and near zero growth within New York City.

Even this bleak assessment, however, is fraught with assumptions that pose numerous negative risks without counterbalancing positive possibilities. All projections of job growth within the State and City hover under one percent. Yet, this economic perspective of merely treading
water assumes the addition of thousands of government jobs, no new contractions in financial firms' employment or defense spending, and continuing modest growth in the service sector to offset an ongoing decline in manufacturing activities. Each of these assumptions may be more optimistic than warranted by current economic events, and therefore poses real risks for public budgets predicated on revenues generated by economic growth. The unemployment and inflation rates in the City have been running above the national rates, and are expected to continue to do so. And if the economic slowdown for the nation is something less than gradual, the City and State will not be particularly well positioned to buck the trend, in which event the local treasuries would be even more vulnerable to additional revenue risks.

While the relation of economic performance to local revenues is not strictly one to one, and the effect on tax collections may lag, clearly the impact is direct and unavoidable, whether on corporate profits (already down substantially), retail sales (flat so far, with trepidations about this holiday season), or personal income (still showing an increase at this time). Only by postulating substantial rises in wages in the coming year can State and City revenues be counted on to increase at all, and such a
hypothesis may be running counter to developments across the business spectrum, but particularly pronounced at the high-wage end of the employment scale.

In examining the City's prospects and devising a local budgetary strategy, the State's evolving fiscal situation cannot be ignored. Driven by economic slowdown, the State of New York may face a budgetary shortfall this year of $300 million, and a potential budget gap for its fiscal year starting next April that could be in the $1.5 to $2 billion range. It would be an unfortunate confluence of budgetary strain next Spring if the City were to look for real new revenues from a strapped State and the State were to propose relieving its spending pressures by reducing aid to the City. Such an eventuality would send strong signals that would be highly negative and inevitably lingering.

The fiscal picture for the City of New York comes clearer into focus with each month of budget statistics. After the first quarter, City revenues were not meeting the modest growth projections for the current year. Due principally to business tax receipts, the shortfall was approximately $250 million. Another $250 million in the form of a non-recurring payment for sale of the Coliseum site did not materialize due to litigation. In addition to posing a
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budget problem, the lack of Coliseum proceeds has created a
cash crunch requiring the City to go to market to borrow
$250 million or more this month by selling additional short-
term notes to augment its regular seasonal financing of last
summer.

The City's budget problem was addressed in actions in
October, putting into effect $200 million in spending cuts,
raising $100 million in water and sewer charges, and
obtaining the balance from refinancing principal payments on
outstanding debt. The latter element also required the City
to utilize more of its valuable credit market access for a
substantial amount of unanticipated additional long-term
debt. Further, it is a measure that produces non-recurring
benefits and cannot be replicated with another similar
financing next year.

With these changes put in place by executive action based on
collections through September, October figures have created
additional concern, causing the Financial Control Board and
the State Deputy Comptroller to project more revenue erosion
of $130 to $170 million for this year. Some believe that
City and State revenue shortfalls of previous months will be
offset by rising collections in coming months. However,
empirical evidence abounds that the current quarter, which
includes both the bellwether Christmas shopping season and the year-end reporting period for most corporations, is unlikely to produce windfall retail sales or business income tax receipts for either the City or State. At the same time, the still increasing but unexplained personal income tax collections may not continue to hold up.

For fiscal 1990, the City's projected budget gap now stands at about $400 million. To this must be added the possibilities of additional local revenue shortfalls, and further delay in receipt of the $300 million from the Coliseum sale now scheduled for next year, for an aggregate risk of more than $700 million. Labor contract settlements next summer could push the figure substantially higher, to well over $1 billion. Also, the projected gap assumes the receipt of additional aid from the Federal and State governments, which may not be forthcoming.

The City's financial plan for next year calls for increasing its spending by $1.6 billion, more than the increase for the current year, in the face of a weaker economy. This assumes new agreements with the municipal unions next summer raising compensation by 1.5%, considerably below the settlements of the 1980's in the range of 5% to 6% annually. In addition, it continues the enormous expansion of the City's workforce.
The City has added almost 60,000 employees over the past eight years, including 8,000 scheduled for hiring during the current year. If all positions are filled as scheduled, there will be approximately 250,000 City employees in 1990, more than the City employed in 1975.

The combination of a growing workforce and upcoming collective bargaining poses the largest single budgetary concern facing the incoming City administration. More than half of City spending is for payroll -- some $14 billion in the current year. Settlements next summer along the lines of previous contracts would produce expenditure numbers that the City would be hard pressed to sustain.

Over a three-year contract period, an average of $1 billion a year would be added to the City budget, bringing City labor expenses to $17 billion annually by 1993, double the level of 1983. Such an increase may simply be beyond the City's ability to pay without substantially undercutting its ability to deliver essential public services.

These economic and fiscal realities counsel extreme caution for the incoming City administration in constructing next year's budget. The City must hold the line in its January financial plan modification to preserve the $500 million
program of revenue additions and spending reductions put in place by the outgoing City administration. It must also be prepared to pare spending even more should such actions be required by developments during the six months remaining in the current fiscal year. Any waiver from a clear commitment to maintaining budget balance would be a devastating step backwards for a City that has become a model of municipal fiscal prudence during the last decade.

The new administration will have four months to prepare its first and pivotal budget, in the context of a reorganized City government under the new charter. Even assuming that developments over the remainder of this year are carefully monitored and responded to effectively, the possibility of a substantial budget gap for the next fiscal year now looms.

The next City budget for the fiscal year beginning in July should be balanced based on revenue assumptions that err on the conservative side, given the fragility of the local economy and the fiscal situation facing the State. The underlying economic and fiscal forecasts call for the new budget to be prepared at the same spending level as the current year, after a decade which has seen City spending double. City revenues are unlikely to increase through natural growth in the coming year. The imposition of new
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taxes, particularly on local business activity, are likely to prove counterproductive, undermining the City's competitiveness in an already fragile environment. Preparing next year's spending plan at this year's level would effectively eliminate the projected budget gaps and identified revenue risks. This would put the City in a significantly strengthened position to withstand the uncertainties of revenue collections in a continuing sluggish economy.

The key to City budget balance for fiscal 1991 will be its provisions for labor, both in the size of the workforce and the nature of next summer's contract settlements. Unless the City can get a firm and early handle on containing its burgeoning personnel costs, there is little hope that the City can successfully control its overall spending. The workforce has increased substantially each and every year since 1983, despite periodic partial hiring freezes. The incoming administration must hold the line in absolute terms on total payroll expenses for fiscal 1991, at the current $14 billion. This critical objective could be achieved by deferring the consideration of increases in compensation for another year. It could alternatively be accomplished by negotiating modest increases below the local rate of inflation, but finding the funds to finance them by genuine
reductions in workforce, starting with a hiring freeze and developing into a meaningful attrition program.

The City must then take steps to strategically allocate relatively scarce resources within the $26.5 billion level of this year's budget for next year's spending. In addition to establishing clear priorities for limited funding, the City must begin immediately to establish and implement a program of large-scale management reforms, in which nothing is sacrosanct. One place to consider starting such a program is the work recently completed by the Mayor's Private Sector Survey, which may offer the incoming administration the opportunity to begin to realize substantial operating savings. The savings to be generated by such a program could approach $200 million the first year, and grow to $1 to $2 billion over the next four years.

It is through management improvements and allocation priorities that funds must be found to meet the City's pressing social and economic needs in the coming years. Counting instead on continuing real budget growth fueled by swelling revenue collections would be placing unfounded confidence in a healthy local economy that appears elusive in New York City for some time to come.

vsj#202
REVIEW OF 1990 CITY BUDGET

Overview

The operating budget of the City of New York for its fiscal year ending June 30, 1990, sets revenues and expenditures at $26.6 billion. The 1990 City Budget is once again balanced in accordance with generally accepted accounting principles, as it has been for ten straight years. The budget increases spending for the new fiscal year by approximately 6 percent, a moderate growth rate reasonably related to the regional rate of inflation. The City appears positioned to balance its income and expenses during fiscal 1990 at the budgeted levels, absent unforeseen developments, although the overall spending plan cannot tolerate much downward fluctuation in projected revenues over the coming twelve months.

However, far more unsettling challenges to City budgetary stability may lie in the years ahead. Next year's budget, for fiscal 1991, will be pivotal. The marked slowdown in revenue growth of the past two years may well persist. Current contracts between the City and the municipal unions expire next June. New labor settlements must be negotiated next year for virtually the City's entire workforce. Operating expenses will be driven upward substantially over the period of the next labor agreement. Operating revenues cannot be anticipated to rise significantly in real terms. Nevertheless, the City needs to make major improvements in its physical facilities and enhance a broad range of municipal services to relieve social problems. These
pressures are likely to continue through the 1990's, straining fiscal resources to the limit.

During the past year, the City periodically reported shortfalls in revenues from projected levels. In response, it instituted a number of management initiatives reducing expenditures to ensure that budget balance was maintained. These actions demonstrated the City's commitment and capability to adjust to unexpected budgetary events as they unfolded within the course of the year.

But the real budget challenge facing the City in the 1990's is more fundamental. It must adapt to an environment in which revenue growth is no longer likely to outpace expenditure levels, as a result of a considerably softened local economy. It is therefore essential to do more than conservatively project revenues and meet each new fiscal development on an ad hoc basis. The City must now focus efforts on stabilizing its budgetary outlook by exerting the greatest possible discipline on year-to-year expenditure growth, particularly its payroll outlays. Labor costs must be contained.

It is once again time to stress that the City of New York simply must live within its means. This underlying precept of the 1970's remains paramount today. The pronounced revenue expansion of the 1980's diverted public attention to issues of accommodating additional income in the City's
spending plans. But the local economy has flattened, and the boom times are over for now in New York City. Questions of priority and productivity are once again of primary concern.

With claims on its resources enormous, the City must, first, make difficult public policy choices on where to spend its money. Inevitably, the allocation of available revenues will produce funding for some programs at the expense of others, and some spending levels that may be considered less than optimal. Without far more rapid local economic growth than is likely, the City cannot do everything on everyone's agenda and still balance its operating budget. Second, the City must succeed in making its dollars go as far as possible by examining and improving its efficiency in delivering services across the board. The discipline necessitated by non-expansionary times must be brought to bear afresh on City operations.

The overriding importance of these two concepts of allocation and management must once again be recognized. Only these fundamental notions can help make the City's resources go as far as possible in meeting today's needs. These resources are considerable, even in slow economic times. The City's income has doubled during the decade. Yet, the principal fiscal lesson of the 1970's must become the guiding fiscal principle of the 1990's.
The 1990 Fiscal Year

The 1990 City Budget plans spending of $26.6 billion, a $1.4 billion increase over the preceding year. The City expects total tax revenues to rise by 9.5 percent, but with only a 6.2 percent increase in the economically sensitive taxes. While these projections are supportable, the volatility in collections experienced over the past twelve months dictates that the City vigilantly monitor its revenues on a continual basis during the coming year.

The 1990 City Budget includes approximately $630 million of non-recurring revenues, constituting about 2.4 percent of its budget. The estimated fiscal 1989 surplus of $283 million is to be applied to fiscal 1990, as has been the pattern in each of the previous nine years. The City expects to receive the initial $246 million from the sale of the New York Coliseum in fiscal 1990 and the $93 million balance in fiscal 1991, under a new agreement renegotiated and approved by the Board of Estimate in 1988. The 1990 City Budget also includes $100 million for operations to be provided by the Municipal Assistance Corporation as part of an agreement with the Governor and Mayor signed in May 1989. Together with two earlier agreements, the Corporation is committed to making available a total of $3.425 billion during the years through fiscal 1996, including $925 million for capital improvements to the New York City transit system and $600 million to the new building program for the New York City public schools.
In addition, the City proposed $190 million in a variety of additional taxes starting in fiscal 1990. The State Legislature authorized the City to impose approximately $150 million of its requested tax package. The new revenues will be derived primarily from new or increased impositions on certain types of real estate transactions in the City.

The City reports that tax receipts for fiscal 1989 are expected to show annual growth of nearly 9 percent when the annual audit is completed. Among the City's economically sensitive taxes, only the personal income tax is expected to exceed projections for that year made at the outset. Among the business collections, general corporation tax revenues are reported to have been $176 million below initial projections for fiscal 1989.

In submitting last year's budget for adoption in June of 1988, City officials commented on declining economic trends, and during the year most tax collections were lower than anticipated. In September, the City Budget Director announced that business and income tax receipts were $71 million below projections made three months earlier, and this figure rose to $105 million in November. As recently as April, the City budget office indicated that the revenue shortfall had risen to $150 million. Over the course of the last three months, the City revised its calculations, and now projects a surplus for fiscal 1989 of $283 million.
Later Years
As the 1980's come to a close, the City can look back upon a decade of significant fiscal accomplishments. On the whole, the City has projected revenues prudently, planned operating budgets properly, and responded to an evolving local economy in a timely fashion. But it was the rapidly expanding municipal revenue base of the 1980's, fueled by an enormous and extended expansion of local business activity, that essentially enabled the City to absorb significant and recurring increases in spending. Swelling collections permitted the City to expand its spending year after year. The decade has seen the City budget double in size, with fiscal 1990 spending of $26 billion at twice the 1980 level of $13 billion. In most years, the City actually accumulated sizeable budgetary surpluses, evidencing that revenues were rising at an even faster pace than spending.

The diminished growth of revenues now makes it difficult for the City to sustain such a pattern of expanded spending. The local economy is no longer growing rapidly. In particular, local employment expansion seems to have peaked in 1987, with only a 0.4 percent overall increase during the 1988 calendar year. Currently, total employment in New York City is just 0.2 percent above a year ago. Only the government sector has been showing any real growth over the past 18 months, with private sector employment stagnant or actually declining. Such a pattern does not auger well for City budgetary expansion.
The financial, banking and real estate sectors in New York City all experienced remarkable growth levels during the 1980's, generating record revenues for the City. However, employment in financial services firms declined by over 15,000 positions during calendar 1988, following a ten-year period during which they had registered a gain of almost 140,000 jobs. Their current doldrums have fundamentally impacted City tax collections.

The alternatives available to the City to ameliorate this revenue slump are also limited by economic slowdown and revenue shortfalls at the State level, along with a continuing lack of new local assistance funding at the Federal level. Federal aid as a percentage of the City operating budget has declined by more than one-third during the last ten years. Federal assistance to the City went from $2 billion in 1980 to only $2.5 billion in 1990. During that time, State aid nearly tripled, from $2 billion in 1980 to $5.8 billion in 1990. Without Federal policy changes in Washington, and with continuing State problems in Albany, the City cannot reasonably rely on increases in intergovernmental assistance to augment its revenues.

At the same time that the City faces a tighter revenue environment, it experiences pressures to increase spending on services. This tension between limited resources and expansive demands poses both budgetary and managerial challenges for the City in the 1990's. The City has no
choice but to confront the ubiquitous problems of street
crime, drug addiction, housing scarcity, crumbling schools
and deteriorated roads and bridges. While the City must act
to redress these social and physical ills, it must do so
within the constraints of prudent budgeting.

The rising level of capital spending could impose still
another burden on the City's operating budget during the
next several years. The City has expanded its ambitious
capital program to $57 billion over the next ten years, or
almost $6 billion each year. However, an expanded capital
program based on borrowing also has a major impact on the
City's expense budget to service the debt. Within five
years, the City's debt service is projected to grow by about
half over current levels, to nearly 18 percent of City
revenues, or 12 percent of the entire City budget, by 1994.
Adding the costs of significant amounts of additional
borrowing to this would hobble the City's ability to address
its real service delivery needs.

Beyond the immediate trends in the City's revenues and
expenditures, the changing nature of the local economy may
ultimately weaken the City's competitive position and erode
its income. During the 1980's, the City has lost 28 percent
of its manufacturing jobs, five times the decline for the
nation as a whole. The local job base has become more
skewed toward information oriented businesses requiring a
more skilled workforce. At present, the City's public
education system does not effectively prepare its students for the demands of the local job market. The mismatch between the employment base and the labor force is an important factor in the geography of business investment decisions. Improved communications and data processing technologies broaden the choices. Quality of life issues, including adequate housing, good education and public safety, are other overriding locational considerations for both individuals and institutions.

Labor Costs
Renewed emphasis must be placed on controlling spending. A prime target is the payroll, which has grown substantially in recent years. For fiscal 1990, personal service spending will be $14.4 billion, 68 percent more than the level just six years ago. Personal service spending by the City today comprises more than half of its operating budget.

The major sources of this growth have been the rapid increase in the City's labor force and the contract settlements over the years. This year, the municipal workforce is planned to total nearly 250,000 employees, with as many persons employed by the City as in 1975. This represents a six-year addition to the City's payroll of approximately 50,000 persons.

The continuing expansion of the workforce will exert increasing pressures on future City budgets, beginning in
the coming 1991 fiscal year. Labor agreements between the City and its principal unions will expire next June, at the end of fiscal 1990. Considering the burgeoning size of the City's workforce, wage increases at any realistic level would pose a greater drain on expenditures than ever before. The City cannot afford to negotiate settlements at more than the local rate of inflation, currently projected at about 5 to 6 percent. Yet, even such increases on a $14 billion payroll would be difficult for the City to sustain absent real efforts to control the size of its workforce. Wage settlements at forecasted inflation levels could cost the City another $3 billion during a three-year term under new agreements. Such salary increments could create annual budget gaps of $1 billion or more. The need to fund such gaps could force the City to divert resources away from much needed services.

If the City is to continue to achieve budget balance and fund needed programs, it must control future growth in labor costs above all others. The pattern of the recent past cannot be sustained in the long run. The size of the labor force and the magnitude of wage increases must be viewed together. One or both must be reined in from unsustainable levels of growth that have seen the City's labor expenditures double in eight years.
Outlook

The demand for municipal services and the necessity for infrastructure revitalization, in a period of relatively static revenues, presents the City with its greatest governance challenge in fifteen years.

The key to the City's future is addressing high levels of needs without threatening the budgetary stability of the municipal government. Implementation of such a long-term strategy is all the more formidable given impending changes in the shape of local government here from the pending revision of the City Charter. The current legislative proposal to establish a procedure for the possible secession of Staten Island from the City of New York poses further fiscal concerns.

In the recent past, the City has responded to projected budget gaps by imposing new taxes and applying one-time revenues, as was the case in fiscal 1989 and 1990. In preparing its 1991 operating budget next year, the City must shift its focus from non-recurring resources and new tax sources. More taxes imposed at the local level related to business or personal income would be counterproductive, as the City experienced in the 1970's. Funding ongoing spending items with non-recurring revenues would be sowing the seeds of future budgetary strain.
Rather than seeking to expand its revenue base, the City must put more emphasis on managing its budget on the spending side. It will have to sharpen its priorities in allocating available funds and renew its efforts to get more output for each dollar spent. The City's resources at present are enormous, with a $26 billion budget and 250,000 workers. Increasing either one significantly should not be a substitute for more effective management of City operations.

Absent an unforeseen economic calamity, the City will likely progress through fiscal 1990 satisfactorily. But it should use that year to position itself for the requirements of the following years for a leaner and more responsive local government. The City's energies must not be confined to budget balancing. Its efforts must be geared toward nourishing the social and physical health of New York City as it strives to remain economically competitive throughout the coming decade.
October 11, 1988

Dear Felix:

Thank you for submitting your staff review of the City's 1988-89 operating budget.

Recent events have served to confirm the appropriateness of the basic policy advice to the City contained in the report -- the need for budgetary caution. The Mayor announced that City tax revenues were $71 million below estimates for the first two months of the current fiscal year. He has indicated he will be prepared to act if a review of the City's revenue estimates for the first quarter of the fiscal year evidences further serious deterioration.

Regarding your comments on the capital needs of the City's public school buildings, as you know, the Senate has failed to pass Assembly-approved legislation. However, I believe it is important that we press forward and I will be discussing this issue with the Senate upon its return to Albany.

Again, thank you and your staff for the report.

Sincerely,

Mario

Honorable Felix G. Rohatyn
Chairman
Municipal Assistance Corporation
One World Trade Center, Suite 8901
New York, New York 10048
Date: 28 July 1988
To: Board of Directors
From: Steve Weinstein
Re: Budget Review

Enclosed is a copy of the Corporation's report on the City's 1989 operating budget, as discussed at today's Board meeting, in final form, along with copies of the Chairman's transmittal letters to the Governor and Mayor.

Enclosures (3)
28 July 1988

REVIEW OF 1989 CITY BUDGET

Overview

The newly adopted operating budget of the City of New York for the fiscal year that began on July 1, 1988 comes at a time when local economic patterns appear to be undergoing significant changes. Over a six-year period extending through fiscal 1987, the expansion of business activity in New York City was exceptionally strong. This continuously contributed to robust City revenue collections exceeding expectations in each of those years. Over that same period, the City was able to enlarge its operating expenditures while maintaining properly balanced budgets and reporting favorable operating results annually. The City funded enhanced municipal government services, with its budget growing by over 50 percent, or more than $7 billion, during those six years.

However, the fiscal year just ended on June 30, 1988, was different in two respects. First, the rate of City tax revenue expansion was less than half that of the prior year. Second, the actual growth of City tax collections was below the initial projections for the year, in contrast to the
previous years' experiences. For the fiscal year just begun, City revenue growth is projected to be more in line with the moderate level of the past year than with the much more expansive collection experiences of the previous years. Thus, budgetary and management caution are appropriate for fiscal 1989.

The 1989 operating budget represents an important opportunity for the City to examine its spending patterns. In contrast to recent years, the 1989 operating budget anticipates a slowdown in the rapid economic growth of the past several years. This view is consistent with a wide range of public and private projections indicating that in the near-term City revenues are likely to increase only moderately. The October 1987 stock market crash and the workforce reduction in the financial industry have caused the City to scale back its revenue collection estimates for fiscal 1989. In addition, recent tax collection information shows a further decline in the growth of economically sensitive taxes during the 1988 fiscal year. The City now estimates a cumulative surplus in fiscal 1988 of $210 million, down substantially from the previous year's $567 million, which means that during the year just ended the City spent $357 million more than it took in.
The new City operating budget calls for spending significantly above last year's level. Expenditures for fiscal 1989 are budgeted at 9.3 percent more than fiscal 1988 expenditures, an increase that is approximately twice the rise in the local consumer price index over the last twelve months of about 4.5 percent. This is also about twice the 4.4 percent budget increase from 1987 to 1988, in a healthier economic context.

For 1989, larger amounts than last year are budgeted for major City services, including education, sanitation, fire and police, and most of the increases are in excess of the local rate of inflation. While the City reduced its planned 1989 expenditures below the levels it had projected six months ago, virtually no City departments are suffering absolute budgetary cutbacks. The City's 1989 operating budget provides for hiring increases in most areas; there are cutbacks in the workforce levels previously anticipated for the coming year, but not reductions from the actual workforce levels of fiscal 1988.

This continued expansion of City spending comes at a time when the nature and extent of the eventual impact of recent developments in the City's economy remain unclear. Revenues may not be available in the future to continue to expand the range of service enhancements the City has funded
over the past six years. As a result, the City may find itself facing more difficult choices relating to spending priorities.

Taxing and Spending Policy

Over the next several years, the City may find itself straddling potentially growing budget gaps, with rising expenditures being supported by an increasingly unpredictable revenue base. Already, the City's ambitious spending plans for fiscal 1989 have challenged its ability to balance its budget for the current fiscal year. The City has financed its higher expenditures for this year through a combination of user fees, taxes, and one-time transfers, as well as moderate growth in its existing collection base. If the City hopes to remain competitive with other areas, however, it cannot over the long term balance its yearly operating budgets by resorting to increased taxes and other revenue measures which negatively impact economic activities.

The evolving economic environment also makes it important for the City to regularly review revenue developments and be prepared to take appropriate management actions. With monthly information available on trends in City collections, it would be advisable for the City to
review its budgetary position on at least a quarterly basis
and implement cost reduction measures as needed to ensure
that spending remains in line with current revenue. The
City demonstrated its ability to adopt such a flexible
posture last Fall when the Mayor instituted hiring
constraints in response to potential adverse cash
consequences for the City attributable to the October stock
market crash. Today, such a posture is even more important,
as signals of a soft local economy intensify and actual
receipts move closer to a no-growth situation.

Revenues

During the last decade, the City experienced a dramatic
turnaround in its economic fortunes. As recently as 1980,
the City completed its fiscal year with a budget deficit of
$356 million. Since that time, however, the City has
demonstrated the ability to adopt balanced budgets on a
regular recurring basis. The 1989 City budget is the City's
ninth consecutive operating budget balanced in accordance
with generally accepted accounting principals, with revenues
and expenditures of $25.2 billion -- a $2.1 billion increase
over the expected results for fiscal 1988.

The City's fiscal accomplishments are attributable not
only to improved administrative practices but also in large
part to robust expansion of the local economy and the receipts it has generated. Over the six years from 1981 to 1987, total City revenues rose by an average of above 7 percent a year. This substantial and sustained revenue growth, significantly in excess of annual projections, combined with effective management, enabled the City to achieve sizeable annual surpluses.

At the same time, the City has shown the ability to recognize potential income shortfalls on a timely basis and to respond to fiscal and economic uncertainty with appropriate flexibility and restraint. Conscientiously conservative City tax revenue projections for fiscal 1988 have helped the City to confine its collection shortfalls due to taxpayer behavior driven by changes in Federal tax law to a manageable level estimated at about $50 million. Other governmental units around the country, including the State of New York, are by contrast experiencing substantial revenue shortfalls because of less conservative estimation of the effects of the 1986 Federal Tax Act.

The City reports that revenue results for fiscal 1988 show the annual growth in its total tax collections to date declining from 13.2 percent in 1987 to 4.7 percent in 1988. Collections of the City's economically sensitive taxes are continuing to decline. Currently, the City reports that its
receipts of these income and business related taxes for fiscal 1988 have grown by only 2.7 percent.

The reduced growth in City revenues during fiscal 1988 has several causes. Although it is too early to assess all ramifications of the October 1987 stock market crash, the relative decline in certain sectors of the local business economy and the employment losses in the financial sector may have contributed to reduced tax collections. In addition, a substantial portion of the dramatic revenue increases of the preceding year may have been one-time events attributable to taxpayer responses to Federal tax reform.

The City has budgeted total revenues for fiscal 1989 that rise by $2.1 billion, or 9.3 percent, over the expected results for fiscal 1988, to reach a level of $25.2 billion. This is $926 million more than the City had included in its preliminary plan for fiscal 1989 six months ago. In the context of weakening growth in collections of existing local taxes, the City has added receipts to its 1989 operating budget from a variety of other sources, including water, sewer and disposal fees aggregating $156 million, and new property and energy taxes totalling $221 million.

The City has also included $150 million of non-recurring revenues attributable to a proposed one-time
transfer during this year from certain police and fire
pension funds to the City operating budget. The City has
defferred to later years the $357 million which it originally
anticipated receiving in 1988 from the sale of the New York
Coliseum. The City currently intends to include $217
million in Coliseum sale revenues in its fiscal 1990 budget,
and $140 million in the following two years.

When such one-time receipts are used to support
recurring expenditures in a given budgetary year, other one-
time receipts will be needed in subsequent years to maintain
planned service levels. When such revenues do not appear,
the City may be forced to identify new revenue sources on
relatively short notice to finance its current operating
expenses.

Expenditures

The substantial revenue growth sustained over a six
year period in the 1980's provided the City with successive
opportunities to restore and improve services that had
suffered cutbacks during the 1970's. The City's operating
budget grew from $14.2 billion in fiscal 1981 to $21.5
billion in fiscal 1987, a 51 percent increase. Additional
spending was affordable over a wide range of services.
During fiscal 1988, the City contained its operating budget growth at a level of 4.4 percent, approximating the inflation level of last year. In response to the local economic downturn and the associated slowdown in City revenue collections last Fall, the Mayor undertook administrative actions to control City spending further for the rest of fiscal 1988.

For fiscal 1989, the operating budget calls for a 9.3 percent increase in expenditures over 1988. This is approximately twice last year's increase and is double the current and projected local rate of inflation. The 1989 operating budget anticipates significant spending increases in nearly all expenditure categories, including double-digit increases in several areas. For example, 1989 spending for sanitation, correction and hospital services has been increased by 13 percent, 18 percent, and 28 percent, respectively, over the amounts budgeted for the past year. Police, fire, and education expenses for 1989 are budgeted at 6.6 percent, 9.1 percent and 11.9 percent above the respective budgeted levels for 1988.

The fiscal 1989 spending increase results, in large part, from an almost 10 percent increase in personal service expenditures, which now comprise over half of the City's operating budget. Over the past year, the City and most of
its workers have agreed on labor settlements which call for wage and fringe benefit increases of between 5 and 6 percent a year for the three years through fiscal 1990. The City has provided for these increases in the current year, and therefore such labor costs do not imperil the City's ability to achieve a balanced budget in fiscal 1989.

Nevertheless, escalating labor costs due to wage increases and additional hiring will inevitably exert pressure on the City's future budgets. During the past twelve months, the City expanded its workforce by approximately 6,000 positions, to a total of 231,000 employees. The 1989 operating budget provides for hiring an additional 10,000 workers to increase the City payroll to 241,000 persons by June 1989. This would constitute a five-year expansion adding up to 40,000 new employees, a 20 percent increase in the City's workforce from 1984 to 1989. By contrast, in the preceding five years between 1979 and 1984 the City increased its labor force by only about 3 percent.

Given the uncertainty as to revenues over the next several years, the City's spending levels may impose an increasing burden on future City budgets. Revenue increases may no longer be sufficiently large to support continual spending increases over a range of categories. It is
therefore important for the City to examine its spending priorities. The level of local economic activity requires the City to choose where and how to allocate finite resources.

**Economic Prospects**

During fiscal 1988, there were strong indications of a downward trend in local economic performance. Taking these developments into account, the 1989 City operating budget anticipates an increase in the unemployment rate and a slowdown in personal income growth during the 1988 fiscal year.

Much of the economic slowdown can be attributed to events in the area of financial services. The City estimates that there will be 10,000 fewer securities jobs in 1988 than 1987, with a total job loss of 20,000 in all sectors directly attributable to the October crash. Developments in the securities industry are crucial to the fortunes of the City's economy because of the concentration of growth in that sector over recent years. During the last ten years, the City lost jobs in over two-thirds of its industries, including a 155,000 reduction in manufacturing employment. Meanwhile, securities employment has more than doubled during the past decade. The overall financial
sector has seen jobs soar by over 30 percent in the past ten years, while factory jobs have plummeted by about the same percentage. Over one-quarter of the new private sector jobs in the City during the past ten years have come in financial services. Wall Street wages and salaries represent over 10 percent of all private sector wages and salaries in the City, about two and one-half times their share of a decade ago.

The concentration of growth in the financial sector brings increasing volatility and unpredictability, and it is unrealistic to pin hopes for continuing economic expansion on such a narrow base. Moreover, this growth has been centered largely in Manhattan.

The concentration of economic fortunes can also be seen on an individual level. While minorities comprise a growing proportion of the City's labor base, the unemployment rate for minorities during 1987 was approximately double the overall rate for the City's population. The long-term health of the City, both financially and socially, depends on economic access for all segments of its population. A major challenge for the City will be to ensure that the opportunities for all of its citizens to participate as fully as possible in the local economy will be maximized in the coming years.
At the same time, it is important for the City to continue to take actions to enhance its competitiveness with other areas for economic activity. The nature and scope of services that the City provides means that its citizens bear a tax burden that amounts to almost 18 cents per dollar of personal income generated in the City. As part of its plan to increase revenues for fiscal 1989 in order to balance its budget, the City reimposed a commercial energy tax of $67 million, an action which is in conflict with the City's laudable ongoing efforts to attract and retain businesses. Currently, the City is experiencing an office vacancy rate of approximately 13 percent, which, although lower than the 20 percent level of the mid-1970's, is significantly higher than the 10 percent level of a year ago.

In both the short run and long run, the City must balance its spending and taxing measures in ways designed to strengthen its economic base and thereby enhance future revenues, while meeting its substantial operating needs in a fiscally prudent manner.

Capital Construction

In conjunction with adoption of the operating budget for fiscal 1989, the City also prepared the biennial update of its long-range capital plan for improving and expanding
its physical facilities. The construction program for the coming ten years, already at an enormous scale to meet the City's formidable needs, was expanded to one of even greater magnitude. It now anticipates spending approximately $57 billion over the next decade, starting with $5.2 billion of capital works in fiscal 1989. This nearly doubles the capital program level of $2.7 billion for the year just ended. While such a significant increase will continue to test the City's capacity to manage its capital spending, its record of implementation has improved steadily for five straight years. Ongoing investment in a broad array of local public infrastructure projects over the long term is essential to ensure the future viability of the City as a place to live and do business. The revised capital plan provides the largest increases for fiscal 1989 in the areas of transit, housing, sanitation and education.

The Municipal Assistance Corporation continues to provide substantial funding to the City to finance important elements of the capital program. These resources are generated by the Corporation's investment earnings, its capital reserve funds and the savings from its refinancing activities. Under agreements with the Mayor and the Governor in 1984 and 1986, the Corporation is making available a total of $2.7 billion over the period through
fiscal 1995. This includes $925 million for the improvement of New York City Transit Authority facilities, $550 million for other City capital purposes and $365 million for economic development projects.

More than a year has now passed since the Corporation proposed making available an additional $600 million to be applied to the critical capital needs of the City's public school buildings between now and 1996, a proposal supported by the Mayor and the Governor. A special committee was established last Fall to examine the school construction program, which included representatives of the Governor and Mayor and officials of the Board of Education and its employee unions. More than six months ago, that committee concluded that the implementation of the capital program of the New York City public school system had to be substantially improved, and unanimously recommended that it be transferred from the Board of Education to an independent State construction agency. The committee further recommended that a new long-term capital plan for the school system be developed which would include application of the $600 million proposed by the Corporation in addition to available City and State capital funds. The recommendation was endorsed by the Governor and Mayor and embodied in statutory proposals submitted to the State Legislature in
January 1988. Regretably, this matter of overwhelming public importance and compelling urgency still remains unresolved some six months later, as the City's public school buildings continue to decay.
28 July 1988

Honorable Mario M. Cuomo
Governor
STATE OF NEW YORK
Executive Chamber
Albany, New York 12224

Dear Governor Cuomo:

The Board of Directors of the Municipal Assistance Corporation respectfully submits its review of the fiscal 1989 operating budget of the City of New York.

The new budget comes after a year of changing patterns and at a time of continuing uncertainty in the local economy. The robust revenue growth of the six preceding years receded during fiscal 1988. City receipts grew at less than half the rate of the prior year, and less than had been forecast at the outset of that year. Indications are that the expansion of City collections will continue to decelerate in fiscal 1989. Thus, budgetary caution is appropriate.

For 1989, the City has balanced its operating budget in accordance with generally accepted accounting principles for the ninth consecutive year, with revenues and expenditures of $25.2 billion. This is $2.1 billion, or 9.3 percent, over the expected results for fiscal 1988.

Such an increase is about twice the local inflation rate and about double the budget growth last year. In order to augment the expected moderate expansion of receipts from existing taxes in 1989, the City has imposed $527 million of new user fees, additional taxes and one-time transfers.

If the City is to remain competitive, it cannot over the long term balance its yearly operating budgets by resorting to increased taxes and other revenue measures which negatively impact economic activities. The evolving economic environment also makes it important for the City to regularly review revenue developments and be prepared to take appropriate cost reduction actions.

Personnel expenditures, which have grown to comprise over half of the City's budget, were raised by nearly 10 percent for fiscal 1989. The City plans to hire 10,000 more employees this year. While the additional expenses attributable to recent wage settlements and continuing expansion of the City's work force are accommodated for fiscal 1989, these escalating labor costs will inevitably exert budgetary pressures in subsequent years.
28 July 1988
Governor Mario M. Cuomo
Page 2

Given the uncertainty as to revenues over the next several years, the City's spending levels may impose an increasing burden on future budgets. Revenue increases may no longer be sufficiently large to support continual spending increases over a range of categories. It is therefore important for the City to examine its spending priorities. The level of local economic activity requires the City to choose where and how to allocate finite resources.

The City has also substantially expanded its capital construction program, nearly doubling planned expenditures from 1988 to 1989. The Corporation is continuing to contribute funding for City capital projects under agreements with the Governor and Mayor totaling $2.7 billion.

Over a year ago, the Corporation proposed making available an additional $600 million to be applied to the critical capital needs of the City's public school buildings. That proposal was supported by the Mayor and Governor and included in the recommendation of a special committee last Fall to transfer the capital program of the Board of Education to an independent State construction agency. Regretably, this matter remains unresolved in the legislative process.

Sincerely,

Felix G. Rohatyn
Chairman
28 July 1988

Honorable Edward I. Koch
Mayor
CITY OF NEW YORK
City Hall
New York, New York 10007

Dear Mayor Koch:

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Sincerely,

[Signature]

Felix C. Rohatyn
Chairman
August 28, 1987

Mr. Felix G. Rohatyn
Chairman
Municipal Assistance Corporation
1 World Trade Center, Suite 8901
New York, New York 10048

Dear Mr. Rohatyn:

The Municipal Assistance Corporation report on the City's budget for Fiscal Year 1988 was a useful and important document. It addressed the achievements all of us have been proud to be a part of, but also highlighted some of the concerns we all share about the City's future and the directions needed to meet those concerns. I would like to elaborate on the issues discussed in the report, respond directly to some of the points made and update you and the Board on the status of our future plans.

Most importantly, earlier this month the City reached a labor settlement with local 237 (Teamsters) which provided for wage increases of 16.45 percent over three years plus $150 increase in welfare fund payments. Based on current projections of inflation this settlement established an appropriate pattern for bargaining with the other municipal unions. The Bureau of Labor Statistics recently conducted a survey of state and local settlements covering approximately 366,000 employees during the first six months of 1987. They found that the weighted average for the first year of the settlements was 5.2 percent for wages with an out year cost of 5.4 percent. The three year settlement with local 237 compares favorably with the results of the BLS survey. It is a good settlement for the City's workers and its taxpayers, and should the other agreements conclude in a like manner, one of the most important risks facing the City would have been addressed in a responsible and prudent manner.
The other key area of concern in the report deals with the effects of Federal tax reform on the City's tax receipts. You properly point out that much of the revenue received in Fiscal Year 1987 was a result of one-time adjustments by taxpayers seeking to avoid being caught up by the new tax law's effects. We have built our budget to assume exactly this; our growth rates planned for 1988 are modest, reflecting acceleration of many 1988 receipts into 1987, and growth rates in later years are based on normal historical levels. We have avoided building high inflation into our revenue modelling, a further conservative step designed to protect the City from unforeseen changes in the local economy; should inflation accelerate, our revenues would improve, offsetting some of the parallel expenditure increases. Finally, we have built a mild recession into all of our planning, based on the forecasts of most econometricians, now foreseen in 1989-90. All of these approaches address the concerns you raise about revenue forecasting in a changing tax law environment.

Given these prudent approaches to the revenue estimation side of the budget, we have had little choice but caution on the expense side. Our financial plan does include the expansion of some key services which all of us believe are very important to the long-run stability of the City: education, criminal justice, social services and housing. Our progress in these areas has been within the context of a financial plan reflecting our caution on the revenue side. It was this balance that has led the Financial Control Board to view the plan as reasonable and balanced in its growth. Together with reasonable labor settlements, our modest employment growth to support enhancement of key City services can be sustained even with conservative revenue planning. Our shared priority of productivity improvement remains in place, and this year as in the past, our budget includes approximately $200 million of savings in expenses or increases in revenues due to improved management of the City's workforce.

One area of concern I had with the report was the capital budget. The staff report leaves the impression that the City is falling far behind in its Ten Year Capital Plan. In fact, this is not the case. Overall, the growth of the capital program continues, and in some cases the expansion has been extraordinary. We have achieved over 90% of the overall goal in commitments this year, the sixth straight year we have been over 90%. Most of the major City construction agencies have continued to do well, with the basic infrastructure agencies—transportation, environmental protection, general services and sanitation—exceeding their target levels for commitments. In housing, we have a great deal to be proud of, as the City's housing commitment levels expanded from $50 million in 1986 to $150 million in 1987. Our Construction Management Program, valued at $130 million, did slip to the first quarter of Fiscal Year 1988, but we are moving ahead on this element of our
expected $450 million capital program for housing in 1988. Sustained growth of 300% annually is difficult to achieve while maintaining careful review and approval procedures, and I believe our achievements in housing are even more remarkable in this context. We share your concern about the Board of Education's capital budget, and advancement of its program must be a critical priority for the Board, as well as the City and MAC, in the months to come.

We agree that the implementation of the capital program is essential to the future of the City, but your comment that the program "merits management and oversight attention as much as does the City's ongoing operating budget" implies that there is little oversight of the capital budget. As the program has grown, so have the City's oversight mechanisms. We have enhanced our management capabilities by strengthening the Office of the Director of Construction (ODC), increasing the level and number of agency technical personnel, improving our information systems and by developing new indicators that measure agency capital performance. We would welcome an opportunity to discuss the management of the capital program with your staff in order to update them on some of these many initiatives.

Finally, your letter closes with the most important issue of all: the strength of the local economy that supports the services New Yorkers deserve. Adequate services are part of what makes New York an attractive place to live and do business, and here we have made much progress, as you acknowledge. But the local tax burden is a critical element of our future growth: my commitment in tax policy has been to move tax cuts to the top of my list of goals for the coming years. This year, we began with a full return of the personal and corporate windfalls, as well as targeted additional cuts in both areas. We have focused our cuts on making New York competitive "within the region, the nation and the world," and they are only the first steps. Our Tax Study Commission will be looking closely at the entire tax structure in the months to come, with the goal of improving the equity, the efficiency and the competitiveness of our tax system. Whatever we do, of course, will be in the context of continued budget balance and fiscal prudence, but our commitment remains firm to a balanced program of service increases and tax cuts in the years to come. MAC's support of this direction is more than welcome, it is crucial, and I am pleased to see this convergence of our policy goals.

Sincerely,

Edward I. Koch
Mayor
14 July 1987

Honorable Edward I. Koch
Mayor
THE CITY OF NEW YORK
City Hall
New York, New York 10007

Dear Mayor Koch:

The Board of Directors of the Municipal Assistance Corporation respectfully submits to you its review of the City of New York expense budget for its 1988 fiscal year.

The 1988 City budget, with revenues and expenditures of $22.9 billion, is the eighth consecutive budget to be balanced in accordance with generally accepted accounting principles. This is a significant achievement for a City that, only ten years ago, finished its fiscal year with a deficit of more than $1 billion.

Importantly, the 1988 budget also implements a general rate reduction in the City's personal income tax in order to enhance New York's competitiveness. The Mayor has also proposed a series of changes in certain other taxes in order to provide incentives for retention and expansion of business activity.

But there are some central concerns regarding both revenues and expenditures. City revenues climbed by more than 9 percent in fiscal 1987, and an additional gain of about 4.5 percent is included in the 1988 budget. However, the bulk of the 1987 increase reflects transactions driven by Federal tax law changes. In addition, the 1988 budget includes a substantial surplus carried over from fiscal 1987. Consequently, the extent of City revenue growth over the next several years may be too uncertain to finance rapid expansion of City spending.

The 1988 budget contains overall expenditure growth to a level approximating the local inflation rate. This spending policy, including retention of a portion of the 1987 budget surplus, is appropriate and realistic. However, more than half of the 1988 expenditures are for personal services. If these expenses continue to expand, they will require continued revenue growth that could be beyond the City's capacity to sustain.
The provision for 11,000 more employees on the City payroll in 1988 continues the pattern of recent years. Together with new labor contracts currently being negotiated between the City and the municipal unions, the expanded payroll will be the single largest factor in the City's ability to cover its operating expenses in future years, although the increases in fiscal 1988 may easily be met. Consequently, further increases in the City's labor costs should be contained by a combination of new agreements at or below inflation levels, restraints on employment growth and productivity improvements.

Also central to the long-term condition of New York City are its economic prospects. While the underlying local economy continues to perform strongly, certain trends toward business and geographic concentration are cause for concern, as are office relocations and regional needs. Efforts to strengthen the local economy are essential to the future financial well-being of the City, just as much as prudent fiscal management and responsible budgetary policies.

Sincerely,

[Felix G. Rohatyn's signature]

Felix G. Rohatyn
Chairman

Enclosure
14 July 1987

Honorable Mario M. Cuomo
Governor
State of New York
Executive Chamber
Albany, New York 12224

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14 July 1987
Honorable Mario Cuomo
Page 2

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Sincerely,

[Signature]

Felix G. Rohatyn
Chairman

Enclosure
14 July 1987

REVIEW OF 1988 CITY BUDGET

Overview
The newly adopted budget of the City of New York for the fiscal year ending June 30, 1988 is the eighth consecutive annual budget balanced in accordance with generally accepted accounting principles. This is a significant achievement for a City that, only ten years ago, finished its fiscal year with a deficit of more than $1 billion.

The 1988 City Budget provides for revenues and expenditures of $22.9 billion, an increase of approximately $970 million over the expected results for fiscal 1987. This represents a 4.4 percent increase, as compared to 4.0 percent last year. The new budget contemplates, on the revenue side, continuing substantial increases in City revenues from the continuing prosperity of the local economy, along with a significant reduction in tax rates. It also includes a substantial budgetary surplus generated in fiscal 1987 that will be available during fiscal 1988.
During the 1988 fiscal year, the City will again receive substantial funds from the Corporation for application to its operating budget, as well as funds for economic development and transit capital improvements. Fiscal 1988 represents the final year in which the Corporation will provide funds under its March 1984 Agreement with the City and the State to make available $1.1 billion over the 1985-1988 period. Fiscal 1988 is also the second year of the Corporation's April 1986 Agreement with the City and the State to provide an additional $1.6 billion from 1987 through 1995. Combined commitments under both of these agreements are scheduled to provide $325 million to the City in fiscal 1988, including $140 million for operating purposes. In addition, in June 1987 the Corporation paid to the City $335 million for application to the City's capital program, as the final portion of $2.5 billion of proceeds which the Corporation had raised previously for capital purposes.

The 1988 budget will benefit from a substantial budgetary surplus generated in fiscal 1987. The City currently estimates the 1987 surplus to be $470 million, and it may turn out to be even higher after final tabulation of year-end results. This appears to be attributable to a combination of 1987 revenues higher than projected and expenditures below budgeted levels.
The 1988 budget includes a general reduction in the rates of the New York City personal income tax, for the first time since the tax was initially imposed in 1966. This City tax cut is intended to negate the entire windfall of additional local personal income tax liability created by the major revisions in Federal income tax laws effective this year, which the City estimates at $230 million, and to provide additional tax relief of $75 million. The Mayor has also stated that he will propose changes in the City's corporate income tax structure in order to eliminate the estimated windfall of such collections after recommendations by the New York City Tax Study Commission. These are important steps designed to enhance New York City's competitiveness as a place to live and do business in the new Federal tax environment.

On the expenditure side, the fiscal 1988 budget provides for further significant increases in the number of City employees. The budget also must finance the first-year costs of the labor contracts to be negotiated with the municipal unions. Further, a bill passed by the State Legislature would, if it becomes law, require the City to pay additional pension benefits of approximately $110 million each year starting in fiscal 1988, which the City proposes to offset with other expenditure reductions. In
addition to these operating budget considerations, the Corporation is also concerned with the City's capital expenditures, particularly its ability to award contracts on schedule.

The 1988 budget provides funds for adding personnel, principally in the areas of police protection, social services and public education, with the goal of improving City services. These actions would add 11,000 employees to the City payroll, continuing the pattern of recent years, and resulting in an increase of nearly one-fourth in the City funded workforce over a four-year period.

The City must complete negotiations for labor contracts with the municipal unions. The previous agreements had covered the three years through June 1987. These new labor settlements, in combination with the City's expanded payroll, will be the single largest factor in the City's ability to cover its operating expenses in future years, although the increased labor costs in fiscal 1988 may easily be met.

The City's capital program directly and dramatically affects the quality of City services and facilities. The 1988 Capital Budget calls for commitments of City funds of $2.45
billion in fiscal 1988 out of City funds. In the City's current Ten-Year Capital Plan, covering the years 1987-1996, the City proposes to spend $45.7 billion over that period. Approximately 60 percent of this is to be funded by the City through the capital budgeting process, with the balance to continue to come from State and Federal sources. The focus of this spending is infrastructure improvement, such as $5.3 billion for streets and bridges and $8.3 billion for the water and sewer systems, and such important facilities as housing ($4.2 billion) and schools ($2.2 billion).

During fiscal 1987, the City again experienced delays in awarding capital contracts. Out of $2 billion appropriated for public works projects in fiscal 1987, it was projected that the City would finish the year some $250 million short of that mark, with almost half of the total for the entire year having been actually committed in the final month. As a result, important construction and repair projects have been delayed, particularly in housing and education. Each of these was initially scheduled for about $300 million of capital expenditures in fiscal 1987 and each target was cut approximately in half by the City during the year. Yet, the City appears not to have met even the reduced goals of $153 million for housing and $168 million for education. A mounting backlog of capital commitments, given the ambitious
scope and essential nature of this program to the future of New York City, merits management and oversight attention as much as does the City's ongoing operating budget.

Revenues

City revenue growth in fiscal 1987 exceeded all prior expectations, after disappointing collections of last summer and fall. As late as November 1986, the City had projected declining revenue growth throughout the fiscal year, including a substantial shortfall in non-property taxes. As a result, the Mayor initiated a program of reductions in agency spending during the course of the year. Today, however, it appears that total revenues for fiscal 1987 rose by 9.1 percent, more than double the original 1987 budget projections, and in excess of the increase for the previous year. Marked gains have occurred in a broad range of tax collections. A large part of the revenue growth arose from double-digit increases in non-property tax receipts, estimated by the City at 10.3 percent and by the Office of the Special Deputy Comptroller (OSDC) at 16.6 percent. Collections of the most economically sensitive local taxes, primarily on sales and income, climbed by about 14 percent during the year.
The strength of the City's revenues is also reflected in the size of the 1987 surplus, currently estimated by the City at $470 million. Although the actual 1987 surplus amount will not be known until the year-end audit is completed in the fall, there are indications that the surplus may exceed the City's estimate. For example, OSDC currently calculates it to be more than $500 million. These surplus projections reflect the transfer from fiscal 1987 to 1988 of $227 million from the scheduled sale of the New York Coliseum.

It is especially notable that the City has generated such a substantial surplus in light of previous years' experiences. In fiscal 1977, the City ran a deficit of over $1 billion, and as recently as 1980 it exceeded $300 million. Starting in 1981, however, the City has ended each fiscal year with a significant cumulative surplus available to carry forward into the next year. In addition, it realized annual surpluses in each of the years 1981 through 1985. This turned around in 1986, when actual City expenditures during that fiscal year exceeded actual revenues during the year. Consequently, the City was forced to use up over one-quarter of its previously accumulated surplus, reducing the amount available to carry forward to fiscal 1987 to $423 million. In fiscal 1987, the City again added to its surplus. Thus, the City will be able to carry a substantial budgetary
amount into 1988 and future years, re-building an important component of its conservative fiscal management practices. In order to do so, the City has kept its fiscal 1988 spending increases to modest levels.

For fiscal 1988, the City presently projects a more modest 4.4 percent growth of revenues, as non-property tax increases return to single-digit levels. The 1988 revenue projections reflect the changing distribution of City receipts. Ten years ago, the City was dependent on Federal aid for 20 percent of its total budget, but today Federal funds comprise just 10 percent. Seventy percent of the 1988 budget will be funded from revenues that the City itself generates, compared to less than 60 percent a decade ago.

The fiscal 1987 revenue results have several causes. New enforcement actions by the City were very effective in producing added receipts. The City's economy enjoyed another strong year. However, the bulk of the increased revenues reflects transactions driven by Federal tax law changes. These are by nature one-time phenomena, producing a non-recurring upsurge in local collections. OSDC describes two distinct surges of City tax revenues in the last fiscal year: (i) payments of State and local taxes before the end of calendar year 1986 to maximize the value
of those Federal deductions; and (ii) acceleration of capital gains into calendar year 1986 to take advantage of lower tax rates. Much of the 1987 revenue increase appears unrelated to real gains in local economic activity and therefore is an insecure base for future spending plans.

Although the effects of Federal tax reform on City revenues have been significant, it is still too early to estimate their full impact. Consequently, the extent of City revenue growth over the next several years is too uncertain to finance rapid expansion of City spending. In its Four-Year Financial Plan, the City appears to be properly cautious, projecting more modest growth of 14.6 percent for the three-year period starting in fiscal 1989, compared with an aggregate increase of 21.3 percent over the preceding three years ending in fiscal 1988.

Expenditures

The 1988 budget contains expenditure growth to a level approximating the local inflation rate. This spending policy, including retention of a portion of the 1987 budget surplus, is appropriate and realistic. However, more than half of the 1988 expenditures are for personal services, which presents two problems.
First, the City's three-year collective bargaining agreements with both uniformed and civilian employees expired on June 30, 1987. Those agreements provided for across-the-board cost-of-living increases in wages and benefits of about 6 percent in each of the three years of those contracts. The City has begun negotiating new labor agreements, although the process will most likely continue for an extended period, as happened with the last round of bargaining in 1984.

In the past, the settlements have exceeded local inflation rates. Over the six-year period from 1981 through 1986, cumulative City wages increased by one and one-half times the New York area inflation rate. Meanwhile, patterns of labor settlements in other sectors of the economy have remained more consistent with inflation rates. For example, annual wage increases for Federal employees declined from 9.1 percent in 1980 to 3.0 percent in 1987, and private employees nationwide experienced a decrease in yearly wage adjustments from 10.4 percent in 1980 to 1.1 percent in 1986.

In other sectors of the economy, the use and level of cost-of-living adjustments, which are in addition to merit and promotion increases, have changed considerably over the past
decade. During the double-digit inflation of the late 1970's and early 1980's, about 60 percent of workers nationally were covered by such arrangements. As inflation subsequently subsided to low levels, this number gradually came down to about 40 percent of the national workforce and is continuing to decline. The size of cost-of-living adjustments also is much smaller now. These major changes in the prevailing pattern of labor agreements should weigh heavily in the current round of collective bargaining for City employees, because comparability with the private sector is a major criterion in municipal collective bargaining.

During the past twelve months consumer prices in the New York area have risen at a higher rate than they had at this time last year. For the past four years, the local rate of inflation has been somewhat higher than the national rate, following several years when the New York area cost-of-living rose at a lower rate than the United States as a whole. Nevertheless, the inflationary environment today is fundamentally different from ten or even five years ago. The inflation rates at both national and regional levels in recent years have been quite low, ranging from 3 percent to 5 percent in the New York area, and are presently projected to be between 4 percent and 5 percent during the coming year.
A second major question is the plan for further increases in the size of the City workforce. Since 1980, the City has steadily expanded its payroll to 210,000 City-funded positions in June 1987, plus another 15,000 paid with State and Federal funds. During the three-year period covered by the expiring labor contracts alone, the City workforce has grown by approximately 30,000 employees. The City anticipates hiring another 11,000 workers during the 1988 fiscal year. Therefore, the aggregate increment in four years will be 40,000 more City employees, an increase of 23 percent. However, numbers of employees alone do not ensure enhancement of municipal services. Additions to the already large City workforce can result in service improvements only in combination with management and productivity efforts.

The ongoing expansion of the City's workforce creates a large and continuing addition to City expenditures. When combined with higher wages, it will drive City spending continually upward. For the three years covered by the expiring labor contracts, aggregate labor costs rose by 33 percent, or $2.8 billion, to an estimated level of $11.4 billion in fiscal 1987. As a result of the planned expansion of the labor force in fiscal 1988, these personal service costs are projected to climb past the $12 billion level. Personal service expenses are projected to comprise
53 percent of all expenditures in fiscal 1988, compared with a figure of 46 percent in fiscal 1981. Further increases in the City's labor costs should be contained by a combination of new labor agreements at or below inflation levels, restraints on employment growth and productivity improvements.

Given the City's unexpectedly strong revenue performance over the past year, its ability to pay 1988 labor costs may not be of concern either in terms of contract settlements or staffing levels. If these expenses continue to expand, however, they will require continued revenue growth that could be beyond the City's capacity to sustain. In future years, they could generate numbers that imperil the maintenance of balanced budgets.

Economic Prospects
The uncertain revenue environment facing the City is complicated by several trends which could have significant impacts on the New York City economy, and on the City budget, in the future. New York City is not now experiencing the kind of economic exodus it faced in the 1970's. Business activity has remained robust for several successive years, with the addition of approximately 180,000 jobs over the last four years, three-fourths of them in the
private sector, and 40 consecutive months of employment expansion. Nevertheless, not all the economic evidence is positive.

Recently, there has been a flurry of announcements of plans by major companies to move their offices or operations elsewhere. Clearly, this is cause for concern in terms of both perceptions and dollars. Efforts have been made and should continue to be made to retain as many of those jobs and tax revenues as possible. New York City must remain economically competitive within the region, the nation and the world.

Another reason for concern is the changing composition of the local employment base. In recent years, private sector job growth has become ever more concentrated in the service and financial sectors of the economy. More concentration in these areas brings increasing volatility and unpredictability. Moreover, it seems hazardous to found hopes for continued economic expansion over the long term on so narrow a base. While services and finance continue to expand, manufacturing continues to decline, and at a surprisingly rapid rate. Within the last three years, a period of great prosperity for the city as a whole, manufacturing employment declined by more than 51,000, or 12
percent. In addition, job growth continues to be heavily concentrated geographically, mainly in the Manhattan central business district. However, in contrast to the first few years of the post-1977 economic recovery, there has been some growth recently in other parts of the city.

It is important for New York City to become more competitive with other areas and to have more balance in the growth rates of its various sectors. Recently, the City has proposed a series of tax incentives for companies that relocate north of 96th Street in Manhattan or to the other boroughs. Previously, the Mayor had proposed to eliminate business taxes on energy use. Together, these measures could lower business, rent and energy taxes to a level that will help preserve important components of the city's job base and thus enhance the tax base and tax revenue over time.

Recognition of the economic and social interdependence of this vast metropolitan region, in the face of a highly balkanized governmental structure encompassing local jurisdictions in three separate states, is essential. Innovative regional solutions to the problems of providing public services and facilities important to the entire region are required, not infighting among the localities and states.
Within New York City, infrastructure and services need to be improved, to support the local economy and its changing workforce. Already, the City, the State and the Corporation have combined their efforts to provide a new funding program for the transit system. Such efforts need to be matched by public and private sources to improve housing and education in the city. The use of future surplus funds of the Corporation, plus funds from other sources, may be a start toward developing a comprehensive program addressing the school system's pedagogical and physical needs. The local system of public education must be brought up to a level where it can educate its citizens adequately to contribute to and participate in a changing local economy.

As the experience of the first half of the 1970s -- the collapse of the New York City economy and the fiscal crisis -- have taught, efforts to strengthen the long-term viability of the local economy are essential to the financial well-being of the City of New York, along with prudent fiscal management and responsible budgetary policies.

aa:212
August 11, 1987

Dear Felix:

Thank you for submitting your review of the 1987-88 expense budget for the City of New York.

The City's eighth consecutive Generally Accepted Accounting Principles balanced budget along with the general rate reductions in the personal income tax are, as you note, significant accomplishments. Under your leadership, the Municipal Assistance Corporation has played a major role in helping the City achieve these milestones.

Again, thank you and the Board of Directors of the Corporation for your efforts.

Sincerely,

[Signature]

Mr. Felix G. Rohatyn
Chairman
Municipal Assistance Corporation
One World Trade Center, Suite 8901
New York, New York 10048
August 11, 1986

Hon. Felix Rohatyn
Chairman
Municipal Assistance Corporation
for the City of New York
One World Trade Center
New York, New York

Dear Mr. Rohatyn:

Thank you for sending me a copy of the MAC report on the City's 1987 budget. I would like to comment on a number of the points contained in the report.

I am in agreement with the report's conclusion (although properly qualified about possible future difficulties) that "Clearly, the City has the means to keep its finances in order". I am also in agreement that the slower rate of revenue growth both in comparison to preceding years and our projections is a source of concern and requires attention. As you know, I have publicly acknowledged this and the Budget Director has issued a directive to all agency heads informing them of our concerns and placing some restrictions on the management of expenses.

It is a fact, as you point out, that the City has significantly expanded its workforce. This expansion began in 1984 and was a product both of the need to improve services, growth in mandated functions and our ability to afford both. The recent approval of the Financial Control Board of the new four year Financial Plan, which incorporates the 1987 budget, suggests a consensus on the City's ability to afford the build-up which substantially ended in 1986. Regardless, therefore, of any future problems, substantially all of the increase in workforce that the report mentions will have been paid for and maintained for at least two years.
Similarly I believe that our collective bargaining agreements in the past have been reasonable and again affordable, as approved by the Financial Control Board. This is not to say that our future collective bargaining agreements are not going to be an important element in the City's fiscal stability and its ability to provide services.

Lastly, with respect to Federal tax reform, I believe most, and possibly all, of the provisions that would disproportionately affect New York will be eliminated.

In conclusion, looking toward 1988, the consequences of the federal budget reductions, potential softening in the national economy and a possible change in the historical relationship of the City's economic activity and revenue receipts, warrants the caution both that you call for in your letter and that I have called for publicly.

Sincerely,

Edward I. Koch
Mayor
2 July 1986

Honorable Mario M. Cuomo
Governor
State of New York
Executive Chamber
Albany, New York 12224

Dear Governor Cuomo:

The Board of Directors of the Municipal Assistance Corporation respectfully submits to you its review of the City of New York expense budget for its 1987 fiscal year.

The 1987 City budget, with revenues and expenditures of $21.360 billion, is the seventh consecutive budget to be balanced in accordance with generally accepted accounting principles, a major achievement for the City.

However, certain concerns are raised on both the revenue and expenditure sides. Patterns of reduced growth of City revenues experienced in 1986 and projected for 1987 and beyond, as well as declining Federal aid, may indicate that the City's revenue base may no longer generate automatic growth that can match or exceed rising expenditures, as it has in prior years.

During the past several years, the City has significantly expanded its workforce and increased wages substantially in excess of inflation rates. With changes in the New York area consumer price index now at the lowest levels in decades, and current labor contracts expiring at the end of the fiscal year, it is important for the City at this juncture to contain additional growth in its personal service expenditures, which are more than half of its total budget.

In addition, impending changes in Federal tax law will put pressure on the City and the State to lower their taxes rather than raise them to make up for decreasing money from Washington. This will be necessary in order for New York to remain competitive with other areas of the nation and the region, including the neighboring states of Connecticut and New Jersey.

We conclude that, provided the City negotiates prudent new labor agreements and does not increase local taxes, it has the means to keep its budget in balance and maintain a strong financial position in future years.

Sincerely,

Felix G. Robatyn
Chairman
2 July 1986

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Mayor
City of New York
City Hall
New York, New York 10007

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Sincerely,

Felix G. Rohatyn
Chairman
Overview

The Expense Budget of the City of New York for its 1987 fiscal year, as adopted on June 29, 1986, provides for revenues and expenditures of $21.360 billion, an increase of $819 million, 4.0% over the forecasted results for fiscal year 1986 (or an increase of 6.5% if certain previous City expense items picked up by the State beginning in 1987 are included).

The 1987 Expense Budget stresses the maintenance of existing City services. Unlike the 1986 budget, it does not provide for substantial service improvements, despite a decreasing rate of inflation and an increase in spending. The higher 1987 expenditures are financed in part by a combination of new recurring City tax revenues and certain cash resources available only for the 1987 fiscal year. Nearly two-thirds of the 1987 addition is for personal service expenditures.

The 1987 Expense Budget is the seventh consecutive City budget to be balanced in accordance with generally accepted accounting principles. This is a major achievement. However, the 1987 fiscal year could prove to be a difficult one, from the standpoint of achieving budget balance in future years. The 1987 Expense Budget projects that the rate of growth in City revenues will be slower in 1987 than in 1986 -- which has been below the
robust revenue growth rate of recent years -- and the Four-Year Financial Plan for fiscal years 1987-1990 forecasts still lower growth in future years.

In addition, Federal aid is expected to decline still further over time. Also at the national level, the impending changes in Federal tax law will put pressure on the City and the State to lower their taxes rather than raise them to make up for decreasing money from Washington. This will be necessary in order for New York to remain competitive with other areas of the nation and the region, including the neighboring states of Connecticut and New Jersey. Consequently, it will be difficult to sustain continuing increases, at recent rates, in City expenditures.

Significantly, current labor contracts expire at the end of the 1987 fiscal year and new agreements must be negotiated during the next twelve months to be effective July 1987. The results will strongly affect future budgets, since the contracts cover more than half of the City's expenditures. It would be imprudent at this juncture for the City to continue to add employees and award labor settlements above inflation rates while not realizing substantial productivity savings. The revenue environment facing the City in fiscal 1987 encompasses falling Federal aid and decreasing growth of local sources. These factors make it imperative for the City to reach labor agreements at or below inflation levels, to hold employment constant or to obtain
productivity improvements, in some combination, so that net labor costs do not increase any further.

In 1987, the City will realize substantial revenues from the Corporation for operating purposes. During the year, the Corporation will provide the first of the additional funds under its April 1986 agreement with the City and the State to make available $1.6 billion from 1987 through 1995. In addition, the Corporation will continue to provide funds under its March 1984 agreement with the City and the State to make available $1.1 billion over the 1985-1988 period. Commitments under both of these agreements combined are scheduled to furnish $200 million to the City in its 1987 fiscal year.

On June 30, 1986, because the City had balanced its budget for six years, terminated all of its Federal guarantees and enjoyed adequate access to the marketplace to meet its ongoing financing needs, the Financial Control Board (FCB) "sunset" in accordance with State statute. The FCB will no longer have the active daily oversight powers it has exercised since 1975, including the authority to approve or disapprove City contracts, long-term and short-term City debt issuance and the City's four-year financial plans. However, the FCB will remain in existence, ready to resume active oversight if certain specified fiscal problems occur. In addition, the Corporation and the Office of the Special Deputy Comptroller (OSDC) will maintain their
fiscal monitoring functions.

The 1987 Executive Budget proposal for $160 million of new taxes on real estate gains and cooperative conveyances, or alternatively an increase in the City property tax, and the responses to it by the State Legislature and City Council required the schedule for adoption of the budget to be delayed for more than two weeks. Because the full $160 million of new taxing authority was not forthcoming, the City had to apply $57 million of cash available on a one-time basis, trim 1987 expenditures by approximately $50 million, and increase certain of its taxes and charges by $96 million in order to balance the 1987 budget. In addition, the temporary City taxes authorized by State law enacted in 1975 were scheduled to expire at various dates after termination of the last of the Federal guarantees of City bonds, which would have reduced City revenue by $108 million in 1987 and $364 million in 1988. However, on July 1, 1986, the State Legislature voted to extend them for two years.

Revenues

The City and its monitors must maintain a close watch on changing revenue trends in the coming years. The rate of growth in total
City revenue peaked in fiscal 1985 and is projected to decline further. The new City budget includes revenues from all sources for 1987 which are 4.0% over 1986, down from the projected 1986 growth of 8.6%, and from actual growth of 10.4% in 1985 and 8.4% in 1984. Overall revenue increases for the following three years are estimated in the City's Four-Year Financial Plan to be 3.5% in 1988, 4.9% in 1989 and 4.3% in 1990. These figures project a cumulative revenue growth of 13.2% for the three-year period 1988, 1989 and 1990, only about half of the aggregate increase of 24.6% in the preceding three years 1985, 1986 and 1987.

Tax collections alone, which comprise more than 50% of all City revenues, surpassed projected levels in several previous years, but reversed that pattern during 1986. City non-property tax revenue was expected to grow by 11% during fiscal 1986 at the outset of the year, but actual 1986 growth in tax collections appears to have been between 6.2% (according to OSDC) and 7.1% (according to the City), exclusive of the proceeds of the one-time tax amnesty program, compared with 11.3% in 1985 and 13% in 1984. The City anticipates future growth in its total tax revenues to increase somewhat over the next four years to 8.9% in 1987, 7.9% in 1988, 7.4% in 1989 and 6.9% in 1990.

This experience in a prolonged period of low inflation may evidence a greater sensitivity of the City's tax base to local
economic factors than has been previously assumed. It may also be due in part to larger than recognized but non-recurring impacts of administrative improvements in the tax collection system in prior years.

Aggravating the impact of these revenue trends is the decline in Federal aid to the City. Total Federal aid to the City is projected to fall from 14.6% of the City's budget in 1986 to 11.9% in 1987, compared with a level of 19.7% in 1980. The predicted decrease in the City's Federal aid receipts -- $336 million in 1986 and 1987 combined -- places a greater burden on City revenues.

The City has already begun to feel the impact due to cuts in the general revenue sharing and community development block grant programs, and the across-the-board spending reductions mandated by the Balanced Budget and Deficit Control Act of 1985 (Gramm-Rudman). In preparing its 1987 budget, the City assumed the continued effect of Gramm-Rudman and a 50% reduction in revenue sharing. However, this is necessarily only an estimate and actual Federal reductions are impossible to predict. If revenue sharing were entirely eliminated, the City would lose another $88 million in 1987 and $118 in each of the following fiscal years. Although the numbers may be difficult to foretell, the direction is clear -- Federal receipts will continue to decrease as a percentage of the City's budget. The City must prepare for such
a continuing decline while not raising taxes which would undermine its future economic competitiveness.

Significantly, the 1986 revenue experience has required the City to dip into cash available from previous surpluses. According to OSDC, the City began the 1986 fiscal year with an accumulated surplus of approximately $560 million but expects to end the year with only about $380 million to carry forward to fiscal 1987. This indicates that the City's expenditures have actually exceeded revenues for fiscal 1986 by approximately 32% of the accumulated surpluses of prior years ($180 million).

Moreover, by reaching into the surplus to pay for service improvements, the City has financed recurring expenditures with one-time revenues. And all of the remainder of the prior year surpluses is included as a source of revenue to balance the 1987 City budget.

These results indicate that the City's revenue base may no longer generate automatic growth that can match rising expenditures, or more than match them, which was the case between 1977 and 1985. If the revenue trend continues, it will be even more difficult to balance the City's budget in the future than it has been in the past.
Labor

The City's current three-year collective bargaining agreements with both uniformed and civilian employees will expire on June 30, 1987. Those agreements provided for general increases in wages and benefits (exclusive of promotions and merit raises) of 5% to 6% in fiscal 1985, 5% to 6% in fiscal 1986 and 6% in fiscal 1987. During the period covered by those contracts, the City has also increased its workforce substantially. The City expanded its budgeted payroll by nearly 26,000 employees in 1985 and 1986 to an employment level of approximately 205,000, an addition of about 14.5% in City agencies over the last two years. In the 1987 Expense Budget, the City anticipates adding another 6,000 employees to its payroll during the next twelve months. The increases in wages and workforce are both substantial and simultaneous. In combination, they are a large and continuing addition to the City's labor costs. For the three years covered by the current contracts, aggregate labor costs rise by 31.8%, or $2.73 billion.

The labor figures in the 1987 City budget indicate no more than small productivity savings, while payroll expenditures constitute most of the substantial increase in the overall budget. In the later years of the Four-Year Financial Plan, the City cannot responsibly continue to expand its work force and raise its wages unless it also obtains significant real productivity savings to offset such increases in labor costs.
Whether a given rate of increase in pay and benefits is appropriate for budgeting purposes depends on the trends during the same period on the income side of the budget and on trends in the rate of inflation in New York City. On both of these grounds, there is reason for concern. In the past several years, the rate of increase in the local cost of living has slowed substantially, from 9.0% in 1981 to 2.6% in 1986, a five-year cumulative 24% rise in the New York area Consumer Price Index (CPI). Over the same five-year period, City workers received cumulative annual wage increases of 39% -- more than one and a half times the inflation level, as their annual raises in salaries and benefits have only declined from 8% in 1981 to 6% in 1986.

At the same time, other public and private sectors of the economy have exhibited wage patterns more consistent with CPI changes. For example, Federal employees received average wage increases of 9.1% in 1980, but by 1984 their annual increase had fallen to 3.5%. Similarly, over the last five years private employees nationwide experienced a decrease in yearly adjustments from 10.5% in 1980 to 2.3% in 1985.

While fairness may argue that future labor contracts continue to take account of local cost-of-living changes, pay raises substantially in excess of inflation rates would generate recurring expenditure expansion of an enormous magnitude that could strain the City budget for years to come. Inflation in the New York City region has been at a rate of only 2.6% for the twelve months through May 1986 (the lowest in 20 years), and
the area CPI actually has declined by 0.8% during the past four months (the sharpest drop in 30 years). To achieve a situation that is best for City workers and taxpayers alike, wage increases in the coming collective bargaining agreements should not exceed a maximum of projected CPI increases.

The gravity of this concern over wage policy is underscored by some critical facts and figures. Over the last five years, from 1982 to 1986, the City's personal service expenditures experienced a 61.5% increase, rising by nearly $4 billion, at an average of $795 million a year. The City's increase in aggregate labor costs is projected to be $893 million in 1987, when personal service expenditures are expected to cost $11.3 billion. Personnel costs now constitute the largest single component of the City's Expense Budget -- 53% in 1987, up from 46% in 1981.

Such rapid increases in personnel costs are in large part the result of recent settlements above inflation rates and budget provisions. In 1984 and 1985, the City provided a 2% reserve for collective bargaining agreements, but the base wage increases were approximately three times that in each of the years covered by the subsequent labor contracts -- 5% to 6% in 1985, 5% to 6% in 1986, and 6% in 1987. The previous two-year contracts agreed to in 1982 provided annual increases of 8% in 1983, and 7% to 8% in 1984, following a similar pattern.
The 1987-1990 Financial Plan provides a somewhat reduced 1.5% reserve for collective bargaining. Each percentage point above that would cost the City approximately an additional $88 million annually. If the previous pattern of settlements at three times the reserve rate is repeated, it would cost the City $264 million more in fiscal 1988, twice that amount ($528 million) in fiscal 1989, and three times that amount ($791 million) in fiscal 1990. The budget gaps currently forecast for those years in the City's Four-Year Financial Plan are $505 million, $249 million and $53 million, respectively. Cumulatively, these figures would produce budget gaps of $769 million in 1988, $777 million in 1989 and $844 million in 1990.

Conclusion

Clearly, the City has the means to keep its finances in order. It must, however, anticipate coming changes in Federal tax law and competition for economic activity, and balance its budget in future years without increasing local taxes. If the City negotiates prudent labor agreements and continues to prepare for reductions in Federal aid and declining revenue growth, it will continue to meet its statutory and contractual budget requirements. Moreover, such fiscally sound practices will secure for the City a strong financial position well into the future.