Statement by James A. Parrott, Ph.D.
Deputy Director and Chief Economist
Fiscal Policy Institute

before the New York City Charter Revision Commission

Fiscal Stability

Brooklyn Public Library
March 23, 2005

The New York State Financial Emergency Act for the City of New York (FEA) has been very beneficial to the city over the past 30 years in achieving fiscal balance, discipline, accountability, transparency, and a measure of stability. New York City taxpayers have benefited, as have bondholders, and state taxpayers. Its conception, as well as that of Municipal Assistance Corporation Act, reflected enlightened leadership and a rare joining of city and state interests and responsibilities.

The FEA established the Financial Control Board (FCB), comprised of the Governor, the Mayor, the State Comptroller, the City Comptroller, and three private members appointed by the Governor. In its "sunset" phase since 1986, the FCB's authority to re-assume control for NYC finances should the City end the year with an operating deficit of more than $100 million has exerted a powerful discipline over city fiscal matters.

The Commission is grappling with the question: With the FEA expiring on July 1, 2008, what, if anything, should replace the FEA?

The main financial management provisions of the FEA could be incorporated into the City Charter, including:

- Detailed four-year financial planning process
- Ongoing balanced budget requirement
- Restrictions on short-term debt
- Establishment of a general debt service fund

Continuing the FCB, or some variation of the Board, and the accompanying fiscal monitoring by the State, can not be accomplished through a Charter change but would require State legislative action. It is important to continue a New York City FCB, or "Financial Review Board", comprised of the executives and the comptrollers of the city and the state for two basic reasons:

1. Such a board gives the Governor a direct interest and role in the city budget and an ongoing capacity to understand the key elements of the city budget. In the

absence of an ongoing board, the Governor would be far less well-prepared should the city experience a financial emergency; and

2. Involving the State Comptroller through the board provides an important component of the multi-pronged budget monitoring process.[1] For all their positive attributes, neither the FEA nor the budget monitors can prevent ill-advised budget actions that can contribute significantly to budget crises. For example, during the late 1990s period when the Wall Street financial bubble temporarily boosted city tax collections, the City adopted several tax cuts that in the aggregate just about matched the magnitude of the tax increases the city was forced to adopt in 2003 as the economy faltered.[2] Rigid statutory constraints that try to avert bad fiscal practices often amount to medicine that is worse than the illness. Perhaps the best approach is to maintain a vigorous independent budget monitoring apparatus that increases the chances that such ill-timed and unwise fiscal practices are identified and their risks spelled out in a public manner as is done now with the publication of the monitors' reports on the city's four-year financial plan.

Separate from the FEA, there is another important issue that I think this Commission should consider that relates to fiscal stability and to the Charter's handling of the separation of powers between the Mayor and the City Council. This is the issue of the Council's involvement in the consideration of large-scale economic development projects. Such projects have substantial fiscal implications for the city and should not be under the sole control of the Mayor, or of entities such as the city Industrial Development Agency whose board is comprised solely of Mayoral appointees. Our experience over the last several years has been that accountability and transparency have suffered greatly in such large economic projects and that the fiscal stability of the city has been put at risk.

For example, under the previous Mayor, the city Industrial Development Agency was considering a cash subsidy and financing subsidy to the New York Stock Exchange the value of which was several hundred million dollars.

When one reviews the process that has been followed over the past two years as the Far West Side proposals have been considered, it becomes clear that the public review process has been very flawed. The Council's role has been peripheral regarding important aspects that carry substantial fiscal implications for the city, and generally, there has been insufficient public information made available to carry on an informed debate. This fundamentally flawed process has been overshadowed in the media and in the public eye by the polarization of public opinion on the question of the proposed West Side stadium.

---

[1] The budget monitoring apparatus for the city includes: the City Comptroller, the State Comptroller, and the staff of the Financial Control Board. The Independent Budget Office is also concerned with budget balance but their role stretches beyond that and deals with a broad range of budgeting issues.

[2] Faced with substantial excess returns on its pension fund investments in the late 1990s the City elected to do a pension "re-start" that allowed it to dramatically reduce its pension contributions. The resulting "savings" were then used to fund expenses that would recur in future years.

The scale and the scope of the development of the Far West Side directly affects the city budget and the future demand for city services, the Mayor has proposed the widespread use of property tax breaks with implications for the commercial property tax base for all of Manhattan, it involves considerable public borrowing by the city and by a newly created Hudson Yards Infrastructure Corporation (HYIC), and calls into play the credit of the Transitional Finance Authority. Yet, despite all this, the Council's role has been marginal, and because the Council role has been peripheral, there has been a lack of essential information regarding the financial aspects. When the city operated under the Board of Estimate, all important aspects of such proposals, including the proposed financing, would have been subject to approval by the full Board. The essential details of the proposed financing and the proposed use of tax breaks would have been made public.

While State law and the City Charter give the IDA the authority to negotiate economic development projects, I do not think very large-scale projects were envisioned at the time of the last major Charter revision in 1989. With respect to the Hudson Yards redevelopment proposal -- a complex project involving the re-zoning of 60 acres and the financing for the $3 billion in public financing necessary to pay for the extension of the #7 subway line, the mid-block boulevard between 10th and 11th Avenues, and parks and other public amenities -- the Charter gave the Council a role in approving the land use changes but no formal role regarding the financing. On an ad hoc basis, the Council was able to negotiate some changes in the financing proposal at the last minute before it approved the re-zoning in mid-January, but public discussion of the financing aspects during the several months leading up to that was limited and key aspects of the financing details were not made public.

When first formally proposed, the Hudson Yards project was billed as "self-financing", i.e., that it would not come at the expense of the city budget, that the massive borrowing by the HYIC would not in any way jeopardize the city's credit standing, and that revenues generated by the project, e.g., through the sale of development bonuses and from payments in lieu of taxes (PILOTS) received from commercial developers would be more than sufficient to repay the sizable up-front public investment. The PILOT mechanism built in substantial property tax subsidies to office building developers and promised to insulate them from property tax rate increases.

The PILOT arrangement was needed, it was argued, to provide a revenue stream negotiated by the city's economic development corporation outside of the city budget process that could be dedicated to debt repayment.

In its agreement with the Mayor to modify the financing, the City Council significantly increased the amount of affordable housing and agreed to the use of $1B from the city operating budget as a way to keep down the overall borrowing costs. The project is now clearly not "self-financing". The Council’s financing resolution did not address the issue of the PILOT mechanism or whether property tax breaks would be provided to commercial developments.

However, several Hudson Yards documents from the City have described the City's intent to provide steep property tax subsidies to developers of commercial sites. It is not clear if the subsidy component is still part of the financing plan. For a project that entails the construction of 24 million square feet of office space, building in property tax breaks from the start would permanently institutionalize property tax breaks for Manhattan commercial projects. This would likely seriously compromise the city's property tax base. Homeowners and other commercial property owners would then be forced to bear the property tax burden that will be lessened for office buildings on the West Side.

It is troubling that this project has proceeded this far, and is close to the point at which HYIC bonds could be sold, and there is still uncertainty as to the role of widespread tax breaks in the Hudson Yards redevelopment area. On a related issue, the Hudson Yards redevelopment has been touted as one that will generate $60+ billion in city tax revenues over the next several decades, yet the city has not made public the basis for this projection and there has been no review of such projections by the Council or any of the budget monitors.

I do not have a specific proposal in mind at this point, but I urge the Commission to consider this issue and explore whether or not there is a better procedure for the city to follow in developing, reviewing and approving such large-scale economic development projects that have such significant fiscal implications. One suggestion would be to have a more structured, transparent and accountable process for projects involving a combined total city investment (including cash, land, borrowing and tax expenditures) exceeding $10 million. Part of the solution might also be to have a city IDA whose board members reflect a better balance of appointments by city officials. (In the rest of the state the local legislature appoints the members of the IDA.) We would be happy to work further with the Commission on this should you desire.

Thank you for the opportunity to share our views with you this afternoon.

# # #