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## On Reconciling Finances and Democracy in New York City

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# BOOK REVIEW

THE STREETS WERE PAVED WITH GOLD. THE DECLINE OF NEW YORK — AN AMERICAN TRAGEDY. By Ken Auletta. New York: Random House. 1979. Pp. xvii, 330, index. Hardbound \$12.95; Softbound \$4.95.

## ON RECONCILING FINANCES AND DEMOCRACY IN NEW YORK CITY

*Jerome R. Bidinger\**

### I. Introduction

During much of the five years I have resided in Manhattan, the media have reported on New York City's financial crisis and have warned that the spectre of bankruptcy haunts the City. Those reports and warnings notwithstanding, I have not found a complete, coherent exposition of the factors underlying New York City's financial difficulties. Although the media generally have ceased to make those dire announcements, the fear lingers that the financial crisis still exists and that bankruptcy remains a possibility. Now, in *The Streets Were Paved with Gold*,<sup>1</sup> Ken Auletta provides us with a description of the underlying factors and tells us, much as Tocqueville told the French, that the *Ancien Regime*, with its financial crisis and potential bankruptcy, still exists.

Mr. Auletta is best when presenting statistics and other information to document the excessive public expenditures, massive municipal borrowings and illicit budgetary manipulations practiced by successive City administrations that together created the New York City financial crisis. Some of the facts and information presented are largely irrelevant, not being related to the City's financial crisis, statistics sometimes are set forth in a confusing manner, sources frequently are not given, and the presentation at times is repetitious. Nonetheless, the author does present a plethora of information scattered throughout the book supporting his argument

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1. K. AULETTA, *THE STREETS WERE PAVED WITH GOLD* (1979) [hereinafter cited as AULETTA].

that New York City annually expended sums in excess of its ability to fund legitimately and greater than the amounts spent by other major cities. As a consequence, New York City has financed its budgetary excesses through a variety of fiscally unsound techniques that could lead only to a financial crisis and possible bankruptcy.

## II. The Facts of City Finances

New York City's 1978 budget of \$14 billion surpassed all states except California. In 1974, New York spent \$1,382 per capita for local governmental expenses, while the average per capita expenditure in the next twenty-six largest cities was \$726, only 52.5 percent as large.<sup>2</sup> According to Mr. Auletta, New York City's expenditures are higher partly because New York state and county governments assume proportionately less of the City's costs than is the case in other states.<sup>3</sup>

New York City's generosity is documented easily. For example, only New York, among American cities, has its own vast city university system which, in the past, was open at no cost to all of its students. To support that system, New York has spent for higher education three times the per capita average of the next twenty-five major cities in the United States. Similarly, New York has the most extensive municipal hospital system in the United States; as a result, it spends on the average twice as much per capita for health and hospitals as any other city. No other city has provided housing subsidies as large as those provided in New York City. Finally, through 1975, New York City's per capita welfare costs, then the most generous in the United States, "were \$338 — five times the \$67 averaged by local governments in major metropolitan areas."<sup>4</sup>

New York State's generosity towards its largest city has not been nearly so great. In June 1977, New York State ranked first in the nation in "aid to families with dependent children." New York City was required to contribute twenty-five percent of that cost; the only city approaching New York's burden was Newark, New Jersey, which was required to pay twelve percent. During fiscal 1976, New York State, one of only thirteen states requiring local

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2. *Id.* at 203.

3. *Id.*

4. *Id.*

contributions for Medicaid, had the highest average Medicaid payment in the nation, more than twice the national average and thirty-six percent higher than the second ranking state. In line with that largess, New York City, as part of its local contribution, paid by far the highest supplementary Medicaid benefits of any city in America.<sup>5</sup> If New York City's costs for public assistance and Medicaid had been paid by New York State, the City would have saved \$1 billion in fiscal 1978, almost enough, Mr. Auletta points out, to balance the City's budget in that year.<sup>6</sup>

Like New York City's social welfare expenditures, common wisdom holds that the City's personnel and labor costs, including wages and benefits, are excessively high. However, according to Mr. Auletta, there never has been a comprehensive evaluation of the compensation New York City provides to its employees as compared to the compensation provided to similar job categories in other major American cities and in private industry. Consequently, at each contract negotiation, union representatives contend that municipal salaries in New York City trail or at most are in line with other cities, while City officials counter that City salaries are far greater than those paid for comparable public and private jobs. Basically, the amount of the City's personnel and labor costs are confusing and Mr. Auletta's analysis does little to clarify the matter.

Avoiding that confusion, Mr. Auletta reveals that during New York City's deepening financial crisis its personnel and labor costs continued to increase, more rapidly than the City could afford, just as if the City were not experiencing any financial difficulties. For example, because of increased pension benefits and reduced years in service required to collect such benefits, the City's pension costs, between 1961 and 1976, rose 469 percent — "from \$260 million to \$1.48 billion."<sup>7</sup> During the much shorter period from 1971 to 1976, New York City's budget rose sixty-six percent while "its retirement costs rose 99.7%."<sup>8</sup> As a result of these facts and the City's reduced ability to pay, by 1977 the City's unfunded pension liability exceeded \$8 billion.

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5. *Id.* at 63, 204.

6. *Id.* at 204.

7. *Id.* at 50.

8. *Id.*

Increased employee compensation costs were not restricted to the area of pensions. With the City running a budget deficit and with fiscal crisis still a very real threat, the transit union, in 1978, obtained a six percent pay increase spread over two years, a \$250 bonus for each worker, and a cost-of-living increase, bringing the entire contract increase to between nine and ten percent.<sup>9</sup> At the same time, the Patrolmen's Benevolent Association obtained a two-year eight percent pay increase, a \$1,200 annual cost-of-living adjustment, and an increase in holiday and night differential pay to match the other salary increases.<sup>10</sup> As a result of these and other salary increases, Mr. Auletta indicates that the New York City taxpayers in the late 1970's "spend three times more than they did ten years [before] to receive the *same* level of police, fire, sanitation and education services. . . ."<sup>11</sup>

To finance these and other growing expenses, New York City increased the municipal tax burden on its individual residents and businesses. As set out by Mr. Auletta, between 1971 and 1975 the corporate income tax was raised from 5.5 to 10.5 percent, the City's personal income tax more than doubled, and its real estate tax increased nearly thirty-three percent.<sup>12</sup> As New York City increased the tax burdens imposed on business, it began to lose the business infrastructure which had employed its residents. The New York City Budget Bureau estimated "that between 1966 and 1971 the city lost 44,500 factory jobs it would not have lost had the tax burden been less severe."<sup>13</sup> Fifty-five Fortune 500 companies left New York, causing a loss of 27,000 jobs, while from 1969 to 1976 more than 600,000 jobs were lost through the closing of many smaller businesses. In fact, after 1969, the City suffered "a massive employment decline, eventually losing one of every six private sector jobs."<sup>14</sup> Relying on a 1976 report, Mr. Auletta concludes that "[h]igh levels of taxation have been a major factor contributing in causing job loss."<sup>15</sup>

Mr. Auletta also reveals that the City turned to short-term bor-

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9. *Id.* at 305.

10. *Id.* at 308.

11. *Id.* at 146.

12. *Id.* at 65.

13. *Id.*

14. *Id.*

15. *Id.*

rowing to close budget gaps. In June 1965, the Local Finance Law was amended so that revenue anticipation notes (RANs) could be based on the mayor's *estimate* of the next year's revenues rather than on the prior year's actual receipts, as had previously been the case. With that change, City government, by over estimating revenues, could obtain almost any amounts through short-term borrowing. The problem with short-term borrowing, however, is that "[i]f revenues grow slowly, or if growing expenditures are not moderated, money must be borrowed again the following year to repay earlier borrowing."<sup>16</sup> And that is exactly what happened to New York City; soon the City was borrowing to repay interest rather than principal. From a short-term debt in 1965 of \$526 million (ten percent of its total debt), with annual debt service costs of \$470 million, the City by 1975 had a short-term debt of \$4.5 billion (36.9 percent of its total debt), with annual debt service charges of \$2 billion.<sup>17</sup>

When tax increases and short-term borrowing proved insufficient to finance City budgets, City politicians used various manipulations, termed "gimmicks" by Mr. Auletta, to hide expenses or to "find" funds. After the 1964 and 1967 amendments to the Local Finance Law, City officials were able to hide expense items, such as consultants' fees and advertising costs, in the capital budget. As a result, these expense items, rather than being financed by tax revenues, were financed in the same manner as are other capital items, through the sale of bonds. According to Mr. Auletta, by 1975 more than one-half of the capital budget "was earmarked for expenses."<sup>18</sup> The result has been not only to give politicians a place to hide expenditures, but also to deprive New York City's capital structure—streets, bridges, highways—of improvements and essential maintenance.

Even more incredible are the following manipulations used by New York City to "find" monies to finance budget expenditures: (1) claim fictitious state and federal aid which is then used as collateral to borrow additional money; (2) deliberately overestimate tax and other revenues and then borrow money on such falsely inflated income estimates; (3) change billing dates on water and

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16. *Id.* at 58.

17. *Id.*

18. *Id.* at 56.

sewer charges in order to obtain eighteen months of revenue in twelve months; (4) use a 364 day year in computing payroll liability; and (5) charge employees' salaries for one year to the following year's budget.

Mr. Auletta also describes other factors—the exodus of middle class families (read taxpayers) to the suburbs, influx of numerous poor, inadequate federal aid and bank mortgage redlining—that may have contributed to New York City's financial crisis and over which the City had little control. In the main, however, Mr. Auletta describes a City which had incurred tremendous social welfare, pension and labor costs, had raised taxes, and borrowed excessively to finance those costs rather than reduce its expenditures, and, when all other methods failed to raise sufficient funds, used financially unsound budgetary manipulations to hide expenditures or to create the illusion of finding funds. Consequently, it was only a matter of time until the City faced bankruptcy when it could no longer obtain the funds necessary to pay its expenses. Mr. Auletta presents all these facts.

But the most important questions have not been answered and, in some instances, even have not been addressed. Why did New York City take those actions which inevitably led to its financial crisis? Does New York City's experience provide any insights into understanding the conflicts between democracy's social goals and its economic system and between interest groups and the public good? In fact, is the concept of a public good useful in planning social welfare and economic programs? Here Mr. Auletta's book falls short of the claims made by the publisher that such questions would be addressed and answered.

Mr. Auletta suggests three underlying reasons why New York City took those steps leading to its financial crisis: (1) City expenditures were based on the prevailing view that city government was to redistribute income and establish means of upward social mobility for its citizens; (2) special interest groups demanded and obtained more from the City than the City could afford to give; and (3) weak political leaders failed to pursue the general public interest, which ultimately required reduced City spending. All three reasons Mr. Auletta fails to analyze.

Certainly, New York's city university system and its other social welfare policies are evidence of a commitment to provide avenues of upward social mobility for its less advantaged citizens. However,

the implementation of that commitment may well conflict with the basic premises of the economic system. When New York City taxed heavily to finance its social programs, various enterprises either went out of business or left the City. Even if New York could have forced those latter businesses to remain, the City could not have compelled those former enterprises that went out of business to continue functioning. The City's experience in this regard may indicate that to achieve such social goals through increased, progressive taxation, society must be willing to accept the collapse of financially marginal enterprises. In that event, we should consider means of providing employment, not merely temporary aid, for the displaced workers.

Burdened by the progressive tax structure needed to support such social welfare programs, the private sector may not be able to generate sufficient investment capital to absorb the additional workers. As a result, the only effective source of alternative employment may be the public sector. Mr. Auletta briefly mentions the financial problems encountered by New York City when the numbers of City employees increased without similar increases in the number of jobs in the private sector. Furthermore, according to common wisdom, governmental employment does not provide the competitive drive or desire for achievement found in the market economy, particularly when the government becomes involved in manufacturing or some other form of production through state-owned enterprises. Consequently, society must confront the issue of whether new forms of government involvement in the economy must be devised in order to achieve the twin goals of greater social welfare (including more extensive upward social mobility and a more equitable distribution of wealth) and the maintenance of a viable, functioning economy.

These are difficult and troubling issues, but they must be confronted and dealt with if our national society is ever to achieve the democratic social goals that New York City has pursued. At this point, however, one cannot be sure what New York City's experience can contribute to a resolution of these issues, for they were not analyzed by Mr. Auletta.

Next, the simple, unadorned statement that special interest groups demanded too much from the City explains everything and, at the same time, explains nothing. What is a special interest group; one that does not represent the common interest of all the

citizens? If so, all interest groups are special because no group has ever been universally accorded the status of representing the interests of all. Furthermore, although interest groups, such as unions and citizen organizations, did make demands upon New York City government, that circumstance is not unusual. All other governmental units also have been the object of claims and demands by interest groups, and yet the majority of those governmental units have not experienced the same financial crisis as experienced by New York City. Therefore, what, if anything, was special or different about the interest group-government relationship in New York that helped create its financial crisis?

The only answer given by Mr. Auletta is that New York did not possess strong leaders capable of representing the public interest. One can legitimately ask what democratic government in recent times has had such leaders. An even more basic question, however, is "what constitutes the public interest?" Is it the sum of all special or individual interests? Is it equivalent to the common good? Is it that result which emerges victorious from an election with an absolute majority of the votes cast?

Determining the content of the public good is not a mere academic exercise if, as Mr. Auletta maintains, it is to be the standard employed by the government to determine which of its citizens' requests will be fulfilled and which requests will be denied. How to determine the nature and content of the public good or general welfare has been debated for centuries by political philosophers without any definitive answers having been reached. Furthermore, proposing that government must be run by strong political leaders who will pursue the public interest is nothing more than asking for philosopher-kings, or perhaps philosopher-leaders. The obvious problem with this proposal is that the public interest as interpreted by a particular "strong leader" may be simply an expression of that leader's individual special interest, which may be completely inconsistent with the interests of all other citizens. Need we be reminded that near the end of his time in office, Richard Nixon pursued his interpretation of the public interest against what he termed the opposition of special interest groups?

Mr. Auletta would do well to place less reliance on the guidance of strong political leaders pursuing an undefined public interest or common good and instead explore new alternatives of increased electorate-wide involvement in the selection of specific policy alter-

natives. Such a decision-making process may not result in the pursuit of any particular leader's conception of the public good, but at least it would more probably result in policies having wide societal support and even may result in superior policy decisions.

### III. Has Democracy Failed in New York City?

For his conception of democracy Mr. Auletta looks to the past: to Joseph Schumpeter,<sup>19</sup> who argued that public participation in government must be limited merely to the selection of candidates at regularly scheduled elections to hold public office; to *The Federalist Papers*, which exhibit an elitist and antiparticipatory bias in their support of a political structure that will limit the political activity of citizens to participation in the periodic selection of political leaders; and, to that political tradition which emphasizes strong political leaders and institutional political checks that will restrain the electorate when imposing its demands upon government.

Recognizing that Mr. Auletta draws his conception of democracy from these sources, one can understand why he laments the growth of "community action centers, police precinct counsels, neighborhood health centers, . . . community planning boards [and] community task forces"<sup>20</sup> as vehicles by which the citizens can participate in making those political decisions they deem to be important. Apparently, Mr. Auletta even finds fault with the political reform movement because it removed the strong political party both as a potential check on the abuse of power and as an apparatus "through which citizen complaints could be filtered, sorted out, *disciplined*."<sup>21</sup> However, Mr. Auletta seems to forget that the reform movement itself arose to check the abuse of power—by the strong political party and its leaders—and to provide citizens with an avenue by which their demands could be heard more effectively—not just filtered, sorted and disciplined. Mr. Auletta's attitude toward democracy, as set forth in this book, is best expressed in his belief that citizens must trust their elected leaders to make decisions or the social contract will be threatened.<sup>22</sup> These beliefs

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19. *E.g., id.* at 250 (citing J. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY (3d ed. 1950)).

20. AULETTA, *supra* note 1, at 226.

21. *Id.* at 230 (emphasis added).

22. *Id.* at 238.

certainly parrot an antiquated, static interpretation of the political system, but they fail to recognize the whole process of social change and the potential for political change inherent in that process.

Some years ago Sir Julian Huxley wrote, in an essay entitled "Evolution, Cultural and Biological," that "the whole of phenomenal reality is a single process, which properly may be called evolution."<sup>23</sup> Commentators, such as Mr. Auletta, do not heed the truth expressed by Huxley when they evaluate social and economic change in terms of new and innovative programs and policies, but, at the same time, look only to the past for a understanding of society's political institutions and processes. Apparently, Mr. Auletta believes, incorrectly, that social relationships and economic conditions can change, while the institutional forms of democratic participation will remain unaltered.

Social and economic programs established to increase opportunities for upward mobility, to provide higher education to ever-increasing segments of society, and to redistribute wealth and break down or at least greatly reduce the other vestiges of class privilege, have a profound affect on all social, economic, and political institutions and processes. For example, those persons, experiencing the societal changes listed above, have the opportunity, and in fact are required, in all facets of their lives to make decisions much more frequently and with respect to a far wider range of social and economic issues, than does a person from a more socially and economically restricted environment, who has not experienced the effects of such changes. Furthermore, studies have demonstrated that the vast majority of those individuals given the opportunity to participate in decision-making with respect to significant issues, come to value such participation and desire to maintain and even increase such participatory opportunities.<sup>24</sup>

If Huxley's insight, that all reality is a single evolutionary process, is applied to this analysis, then expanded decision-making opportunities in the social and economic spheres (two aspects of phe-

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23. J. HUXLEY, *Evolution, Cultural and Biological*, in *NEW BOTTLES FOR NEW WINE* 61 (1957).

24. See, e.g., P. BLUMBERG, *INDUSTRIAL DEMOCRACY: THE SOCIOLOGY OF PARTICIPATION* (1968); T. WALL & J. LISCHERON, *WORKER PARTICIPATION* (1977); Cooper & Wood, *Effects of Member Participation and Commitment in Group Decision-Making on Influence, Satisfaction and Decision Riskiness*, 59 *J. APPLIED PSYCH.* 127, 134 (1974).

nomenal reality) not only should be valued by the participating individuals, but also should stimulate increased demands for such decision-making opportunities in the political sphere (another aspect of phenomenal reality). Consequently, one must expect that persons experiencing such societal changes, and the accompanying increased opportunities to participate in social and economic decision-making processes, will refuse to relinquish to political leaders the sole decision-making authority on those political issues such persons perceive to be important.

#### IV. Conclusion

Perhaps the most important and interesting lesson to be derived from recent New York City experiences is the apparent verification of the corollary to Huxley's insight: that changes in those aspects of social welfare and economic conditions discussed above, are accompanied by citizen demands for ever-increasing opportunities to participate in making those political, social, and economic decisions they deem to be important. These demands to participate certainly do not indicate that democracy has failed, as Mr. Auletta concludes;<sup>25</sup> rather, these demands indicate that democratic political institutions must be adapted to give expression to new forms of political participation. The challenge then is not to repress those demands or to write fondly of a previous era when the public was content with only limited political participation, and when strong political parties were controlled by a few powerful leaders who determined the public good, usually in concert with their own private interests. Rather, the challenge is to establish new institutional forms of citizen participation in decision making in a more decentralized political system, while maintaining a viable economy. On this issue the New York experience must be analyzed to determine what lessons, if any, it can yield.

*The Streets Were Paved with Gold* presents the complete facts surrounding the New York City financial crisis. As such, it is a unique and useful book. However, in some important aspects, the book fails to go beyond the facts and analyze issues presented by the crisis. Hopefully such an analysis will be forthcoming, for New York City deserves such an effort.

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25. See generally AULETTA, *supra* note 1, ch. vii.

