

Mayor Bloomberg & The Limits of Pragmatism

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EXECUTIVE SUMMARY

Four years ago, Michael R. Bloomberg ran for the mayoralty of New York based on his experience as a successful entrepreneur and as the manager of his own company. Since he assumed office, the mayor has effectively managed the fiscal status-quo: He has navigated New York through successive multi-billion-dollar budget deficits, including a significant post-9/11 deficit, without cutting back extensively on basic services. But as a strategy for the city's continued long-term success, pragmatic management, even when executed by an expert pragmatic manager, has its limits. Even with his managerial skills, abetted by record tax hikes, the mayor has failed to remedy the city's persistent budget deficits – and no projection shows the persistent gaps closing in the future.

The city can no longer afford a purely managerial approach to its finances. Out-of-control spending has become the city's most pressing problem in need of a radical fix since former mayor Rudolph W. Giuliani controlled crime. Competent management of the city's day-to-day finances only masks the problem, and postpones an inevitably necessary resolution.

The mayor argues that the persistent deficit is caused by growth in four areas: Pension & benefits for city workers, Medicaid for low-income New Yorkers, and debt service on capital spending. He has labeled these costs “uncontrollable” because they are directed or influenced by parties outside of direct city control, including the governor and the State Legislature (pensions and Medicaid), city labor unions (benefits for city workers), and decisions made by past mayors (debt levels).

But these costs are uncontrollable only because the city has chosen not to control them. To assert control over these costs would require re-thinking the size, scope and functions of New York's government.

If New York does not start to think differently during the next mayoral term, its fiscal woes threaten to erode much of the progress achieved in other aspects of New York's governance over the past 12 years.

ABOUT THE AUTHOR

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MAYOR BLOOMBERG & THE LIMITS OF PRAGMATISM

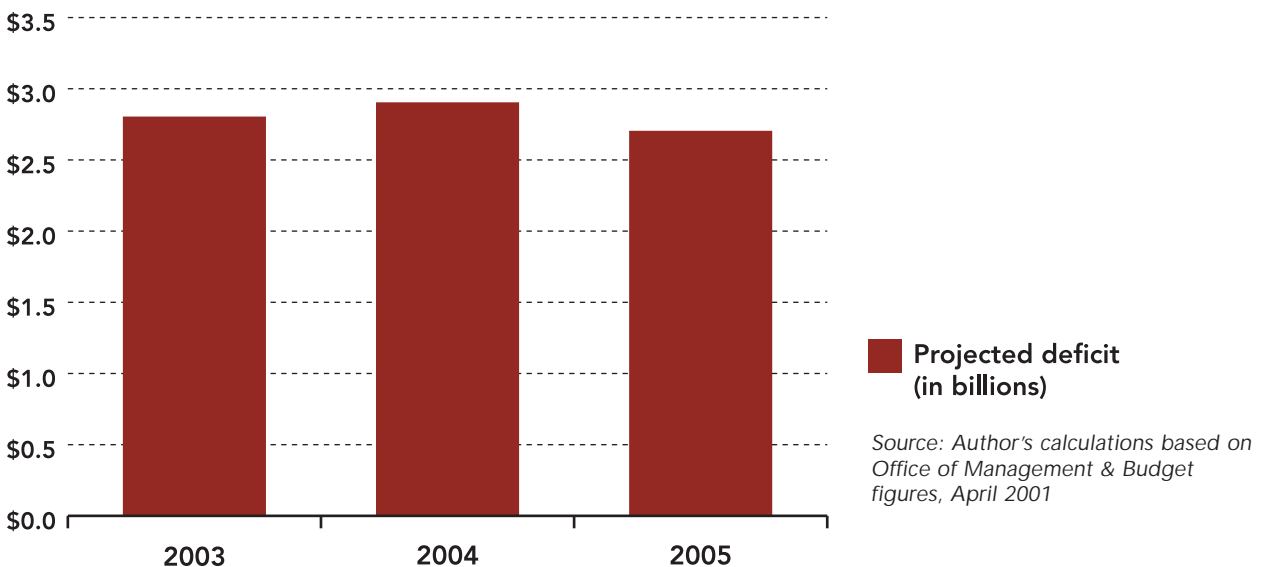
Four years ago: A private-sector approach?

Bloomberg presented himself to New Yorkers four years ago as the more experienced and competent candidate for the job of managing New York City through the post-9/11 fiscal crisis. “My opponent [Mark Green, then the city’s public advocate] has not had any experience in ... setting large budgets,” Bloomberg said in a 2001 debate. “[W]hen it comes to leading this city, he does not have the experience for a quarter of a million employees and a \$40 billion budget.”¹

But even before he was elected to office, Bloomberg emphasized an outlook on the city’s finances that was to prove prescient for his current term in office. “Mr. Bloomberg says that there is not very much that can be easily cut from the city’s budget,” the *New York Times* reported of an interview with the then-candidate. “He emphasizes the need to set priorities and to work with the city’s employees to find efficiencies if they are to make more money.”² It was Green who warned repeatedly that the fiscal crisis then emerging was akin to the one faced by the city in the mid-1970s; Bloomberg, conversely, spoke of a “manageable” deficit.

New York’s post-9/11 deficit reached \$6 billion after the attack³, but the underlying fiscal problems Bloomberg faced four years ago long preceded 9/11. Indeed, nearly six months *before* 9/11, New York projected future budget gaps between 2003 and 2005 that would have averaged more than nine percent annually of projected city-funded revenues.⁴ New York’s chronic fiscal problems, evidenced by recurring, and growing, structural annual budget deficits, were exacerbated by 9/11, but 9/11 was not the root of the problem; the problem was, and still is, a city government structured to become increasingly unaffordable.

Figure 1. Before 9/11, New York already faced successive annual budget deficits that would have represented more than 9 percent of annual city revenues.



The past four years:

Why managing the *status-quo* hasn't fixed the city's long-term fiscal woes

Bloomberg, with some caveats, has done what he said he would do. He plugged the post-9/11 deficit, and has plugged the deficits that persisted throughout the rest of his term (although the mayor, contrary to his pre-election plans, increased taxes to do so). He has kept growth in most operational costs at or below inflationary growth (except in education), and has wrung modest work efficiencies from labor unions (although these work efficiencies do not cover the cost of recently negotiated raises). But the mayor has not systematically addressed the city's chronic fiscal woes.

The mayor does acknowledge the problem. In his budget address this past January, the mayor clearly outlined the city's situation: Expenses the mayor called "nondiscretionary" (those on public-employee pensions & benefits, Medicaid, and debt service) have eclipsed operational expenses on basic services.

The city has balanced its budgets not by cutting spending, but by reaping higher-than-expected tax revenues over the past three fiscal years, due to tax hikes and to robust economic activity (including real-estate transactions). This year's budget is balanced due only to an infusion of \$4.6 billion in one-shot revenues, including higher-than-expected tax revenues from last year.

Figure 2. Since 2002, growth in city-funded spending on Medicaid, debt service, and employee pensions and healthcare has far outstripped growth in spending on other services.

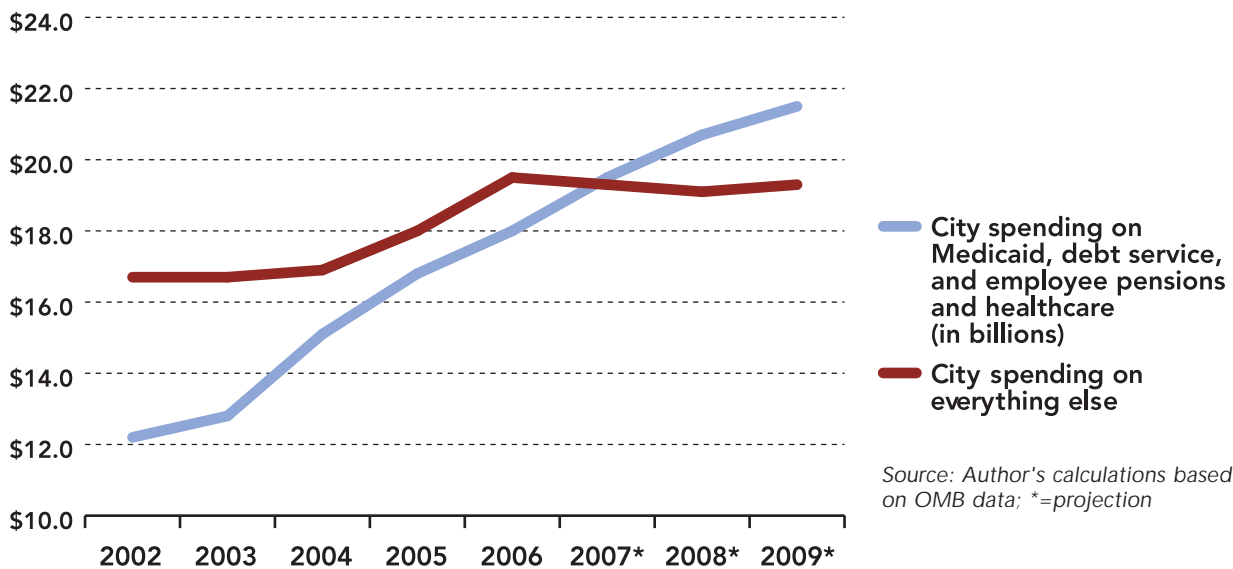
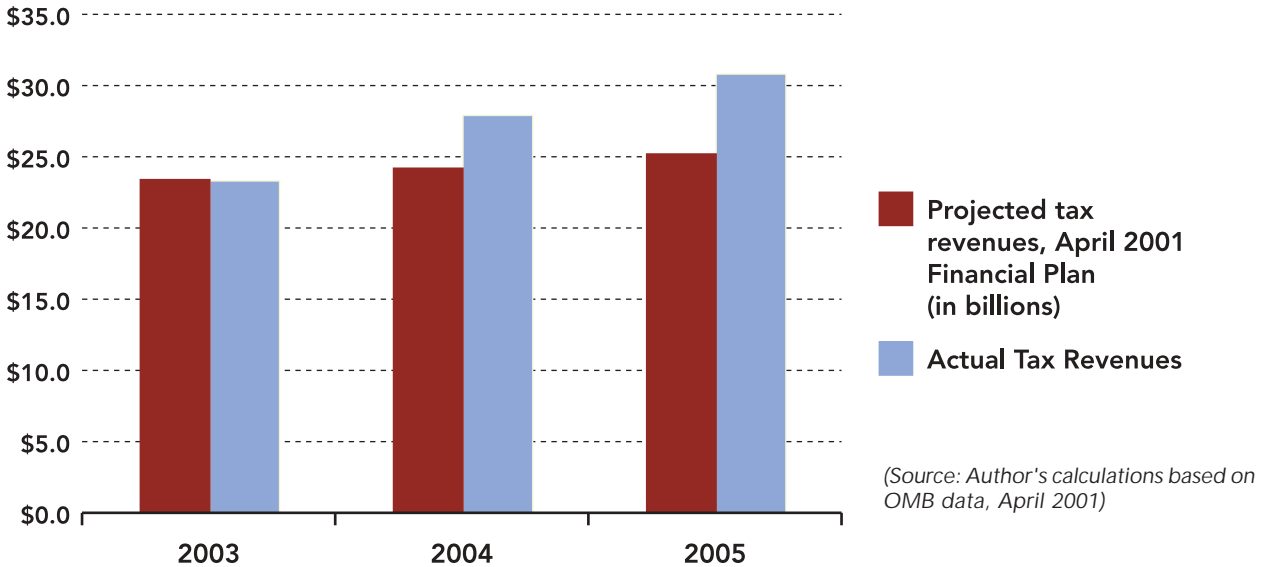


Figure 3. City tax revenues have met or exceeded pre-9/11 projections, due to tax increases, high real-estate taxes due to transaction volume, and the continued economic recovery.

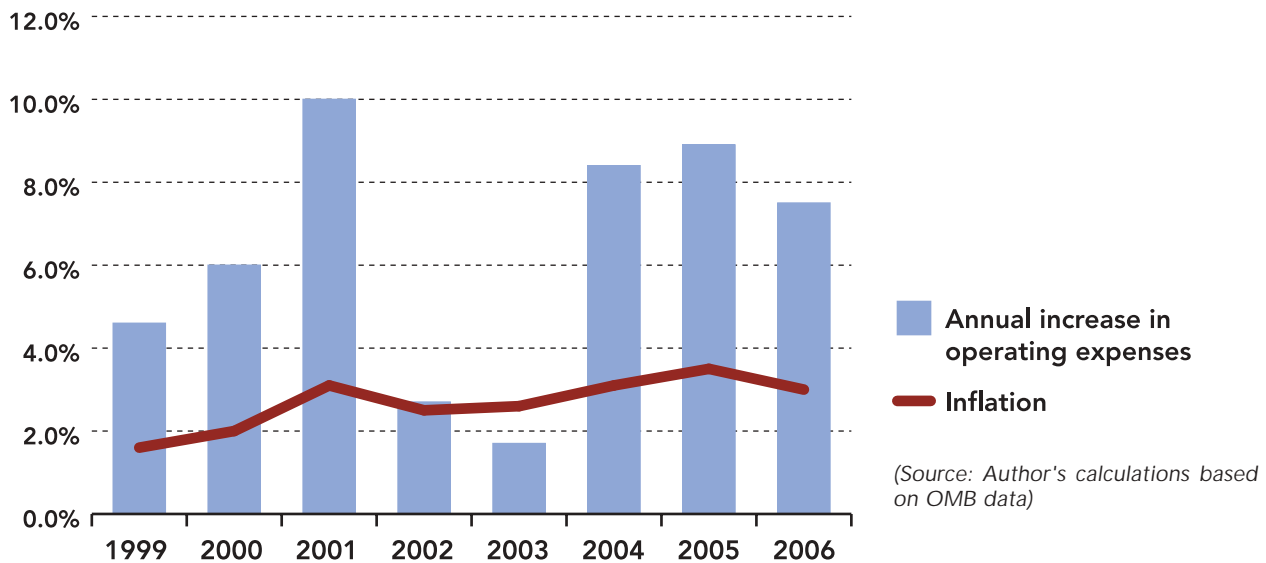


But those higher-than-expected tax revenues are matched by higher-than-expected costs. Next year, tax revenues will likely exceed last year's projection by as much as \$2 billion, but next year's costs will exceed last year's projections by \$2.1 billion.⁵

This is because the long-term problem, before and after 9/11, hasn't changed: The city's budget remains unaffordable. New York regularly spends beyond its means.

This pattern held during the second term of Mayor Giuliani, when city-funded spending increased at an annual rate of 6.7 percent⁶, and has held during the Bloomberg era, when city-funded spending has increased at an annual rate of nearly 6.9 percent, more than double the city's average inflation rate.

Figure 4. City spending has grown faster than inflation during all but one year of former Mayor Giuliani's second term and of Mayor Bloomberg's current term.



Today's projected deficits – beginning with about \$4.5 billion projected for next year - echo yesterday's; the only difference is that they have grown larger, both in absolute terms and, with projected deficits averaging 10.8 percent of city revenues over the next three years, in terms of their size in relation to the city-funded budget.

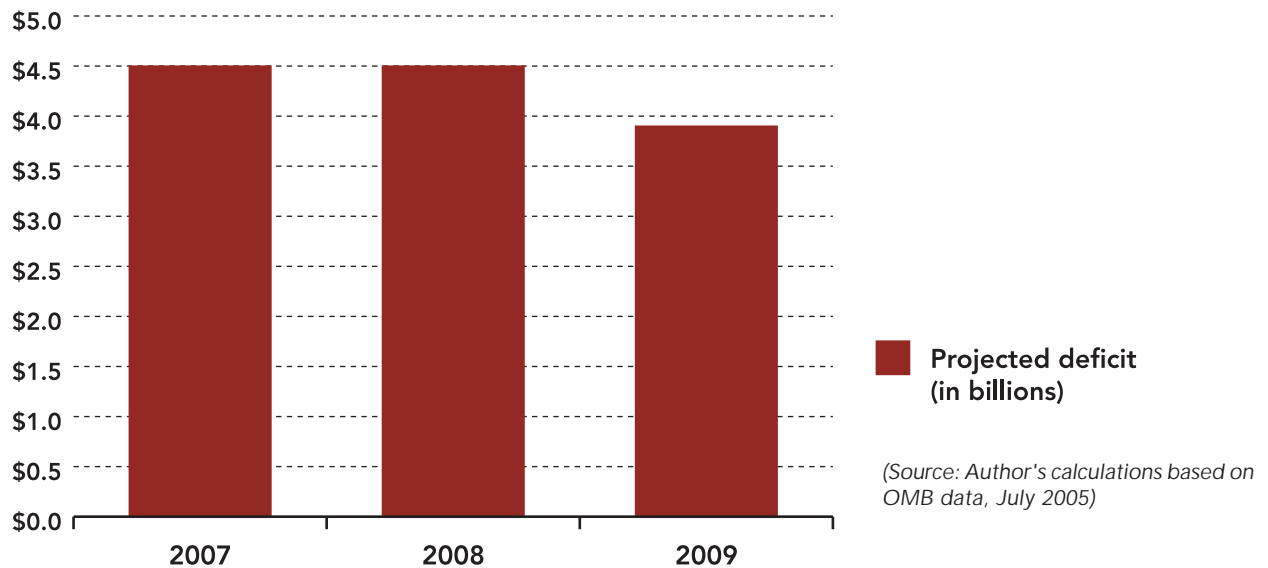
The mayor lists as one of his first-term accomplishments the fact that he has cut billions from each annual city budget (\$3.8 billion this year alone).⁷ That is not quite true: Bloomberg cut these billions in *projected* spending, not in actual spending. But it is true that most government *programs* haven't grown significantly during Bloomberg's nearly completed term.

Operational spending in key city agencies has risen at or below the rate of inflation during the Bloomberg administration. Nearly across the board, Bloomberg has done more with, if not fewer resources, the same level of resources.⁸ The mayor's 311 hotline, which centralizes and tracks non-emergency complaints and service requests to the city, shows that competent and creative management allows a mayor to do more in terms of services without spending significantly more on day-to-day operations.

Yet Bloomberg has not made progress on cutting back spending or deficits.

If growth in public-employee pensions & benefits, Medicaid and debt service had hewn to inflation during the Bloomberg administration, New York would not face a significant deficit next year.⁹ New York continues to face significant deficits due to "uncontrollable" spending because that spending is controllable only if the mayor changes the way the city does business.

Figure 5. Despite its recovery in tax revenues since 9/11, New York continues to face significant future budget deficits.



Thinking differently: Pensions & benefits for city workers

On pensions & benefits for public employees, in particular, the city has hit a wall in terms of what it can accomplish under a strategy of pragmatic management of the *status-quo*.

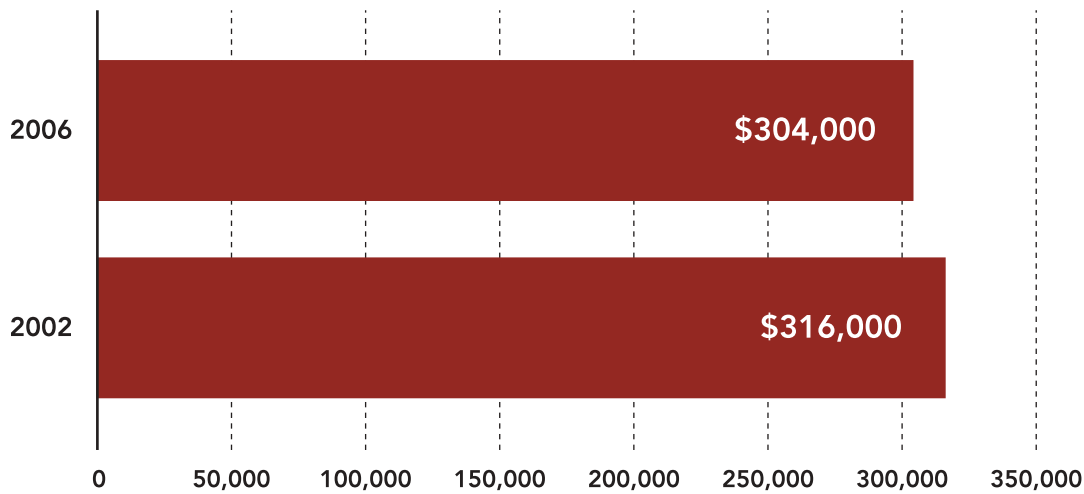
To wit: Since Bloomberg took office, he's actually *cut* public employment across the board, from record headcount during the boom years of the late 1990s. Due to the cuts in headcount, spending on salaries & wages is up less than 11 percent since the last year of the Giuliani era, roughly tracking inflation.

But when one includes the cost of funding pension and other benefits (including healthcare) for both current and future retirees, total spending on city workers is actually up nearly 36 percent in four years. Including contributions to pension funds that support current and future retirees, as well as payments for healthcare and other benefits, New York now spends about \$95,000 per *working* city employee, up from \$70,000 four years ago.

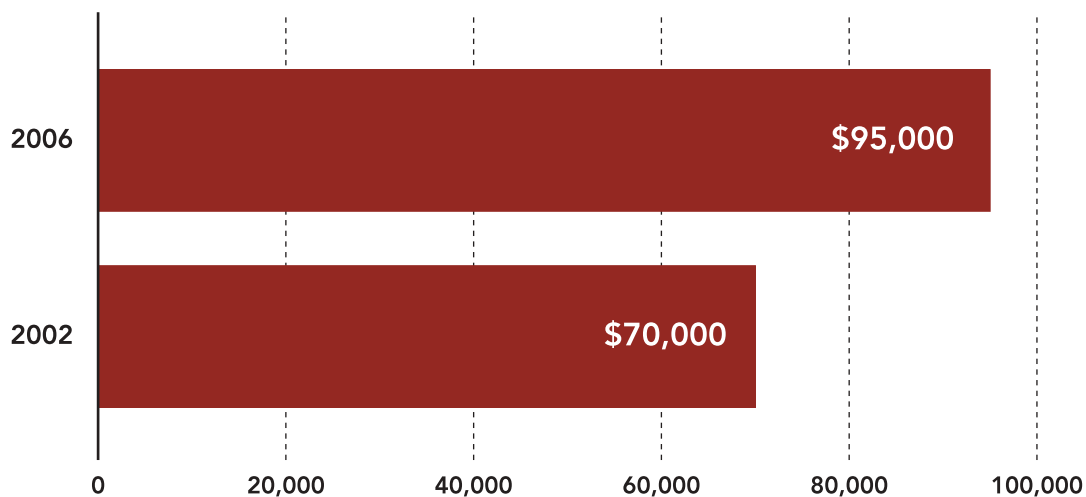
Bloomberg's success at maintaining city services while modestly paring back headcount is eclipsed by the fact that the city must continue to fund the growing costs of pensions & benefits for workers and retirees. The longer New York continues under this current state, the more these costs will grow – and the more future New Yorkers will pay for the cost of having done business for so long the old way.

An analysis of expenditures just on uniformed services – police, fire, sanitation and corrections - tells this story. Since the first year of Bloomberg's administration, operational spending on police, fire, sanitation and corrections services is up only one percent a year, well under annual inflation, and employee headcount is down three percent (including 2,000 fewer police officers). But the cost of pensions and benefits for

Figure 6. Under Mayor Bloomberg, the number of city-funded employees is down ...



... but spending per employee is up.



(Sources: Author's calculations based on OMB data)

employees is up 92 percent, or 24 percent annually. Total costs are up 29 percent, or nearly nine percent annually. New Yorkers must pay more now per employee, and more per retired employee. The city will not save much on its recently achieved productivity enhancements on sanitation workers, for example, if benefits for working and retired sanitation employees keep going up. The city might have fewer sanitation employees, but it will pay more for each of them.

Bloomberg calls pension and healthcare costs “uncontrollable” because pension benefits, including cost-of-living increases, are set by the State Legislature, and the State Constitution prohibits the legislature from altering benefits that have already been earned by employees for past work. Further, healthcare and other

“fringe” benefits are determined by the city and by individual labor unions via collective bargaining, and cannot be pared back by the city unilaterally.

Of course, Albany could give the mayor relief on future pension benefits by gradually switching pensions state-wide from defined-benefit systems (in which the state and city must take full responsibility for a guaranteed level of benefits) to defined-contribution systems (in which the city and state would put money in personal accounts held, and controlled, by individual workers). And the unions could give the mayor relief by agreeing that all city employees and retirees will pay premiums toward their own healthcare (the majority do not).

It is important for the city’s future that the mayor work to bring about such reforms at the state and union level, as a sustainable pension & benefit structure for employees and retirees is vital to the city’s future fiscal health.¹⁰ But if Albany and the unions won’t give the mayor relief on public employees, Bloomberg could try a different tack in the meantime: Finding a different type of employee for some city functions.

The city could outsource some civilian work like payroll administration to the private sector, for example, and could even outsource some uniformed work, such as selected sanitation routes. Further, the city could put the free Staten Island Ferry, currently run by its Department of Transportation, up for bid for a long-term private-sector operating concession (and the city cannot claim that safety considerations prevent it from doing so). Or the mayor could even use the mere possibility of outsourcing union jobs to achieve more from the unions during collective-bargaining rounds; a decade ago, then-Philadelphia mayor Ed Rendell used this tactic to gain cooperation from municipal unions in putting that city on a more sustainable fiscal path.¹¹

But the city has not made efforts to diversify its work force away from city employees under Bloomberg. In fact, in one case, Bloomberg did the opposite: The city helped to finance and negotiate a takeover of four formerly private (but non-competitive, as they held a monopoly in their service areas) bus lines in New York City by the state-run Metropolitan Transportation Authority, where the formerly private-sector employees at the bus lines are now assured of government-level wages and benefits.¹²

In the private sector, outsourcing is a common management tool to control costs and achieve labor-force flexibility. In New York City’s public sector, outsourcing, even on a limited basis, represents a radical rethinking of how to run city government.

Thinking differently: Medicaid

New York State controls eligibility and benefits for Medicaid within parameters set by the federal government. The city must pay a quarter of most Medicaid costs; its share of spending has risen nearly 40 percent over Bloomberg’s term, to nearly \$5 billion. Although the state agreed this year to take over a portion of future *growth* in the city’s Medicaid program, New York’s *current* Medicaid spending is too high, and will continue to grow at about three percent a year under the state’s new cap.

Medicaid spending is rising at an unsustainable rate across the nation, due mostly to higher drug costs and higher nursing-home care costs. But New York City, in particular, has a stake in maintaining an unsustainable Medicaid *status-quo* unless it radically rethinks the city government’s role in poverty spending.

New York guarantees healthcare to all comers, many poor and uninsured, at its public hospitals. The city needs a steady stream of Medicaid patients to help fund its city-subsidized Health & Hospitals Corporation, which runs the public hospitals. Because 25 percent of the city’s Medicaid bill is paid by the state, and 50 percent is paid by the federal government, the city believes that enrolling as many individuals as are eligible actually saves it money at the hospitals, as 75 percent of the bill is paid by third parties.

But Medicaid is not enough to keep the public hospitals fiscally sound. In addition to more than \$1 billion in capital subsidies to the Health & Hospitals Corporation over Bloomberg's nearly completed term, the city provides about \$1 billion in operating subsidies to the public hospitals each year, including benefits for workers. The city's conflicted interest in Medicaid due to the public hospitals was well framed by its budget office in January: "The federal and state governments must find ways to control Medicaid costs and relieve localities of this significant fiscal burden, *without jeopardizing the health services provided by our public hospital system ...*" [italics ours].

The mayor has not asked two fundamental, and interrelated, questions necessary for real reform of Medicaid: Why must the city government run a network of unprofitable public hospitals, and why must the city government assume responsibility for providing free or nearly free healthcare for more than one-third of its population?

New York's large stake in a dysfunctional national healthcare system for the poor is straining New York's finances, just as New York's stake in a dysfunctional welfare system strained New York's finances throughout the 1960s, 70s and 80s. But the city is not re-assessing its approach here.

In fact, the city's strategy has been to partner with the state in *increasing* Medicaid enrollment for healthy individuals. After 9/11, the state, with the city's support, offered a one-page Disaster Relief Medicaid application, waiving some documentation requirements for new enrollees. That initiative, plus Family Health Plus for low-income adults, another initiative begun by the state with city support, and HealthStat, a city program launched by Giuliani, have added nearly one million people to city Medicaid rolls.¹³ Total city enrollment in Medicaid has grown from 2 million city residents when Bloomberg took office to 2.8 million today, a 40 percent increase.¹⁴

If the city were to rethink its commitment to an unsustainable hospital system, it could lobby Albany to tighten eligibility for Medicaid, to reduce optional benefits, and to crack down on fraud; all these elements help to make New York's per-capita Medicaid spending the most expensive in the country. The city and state also could work together on a real reform plan to push legitimate costs down, as the state of Florida recently did¹⁵.

But New York has a stake in ensuring that no one takes too close a look at the city's Medicaid program to ferret out real inefficiencies across the board, as a more efficiently managed Medicaid system statewide likely would eat into public-hospital revenues.

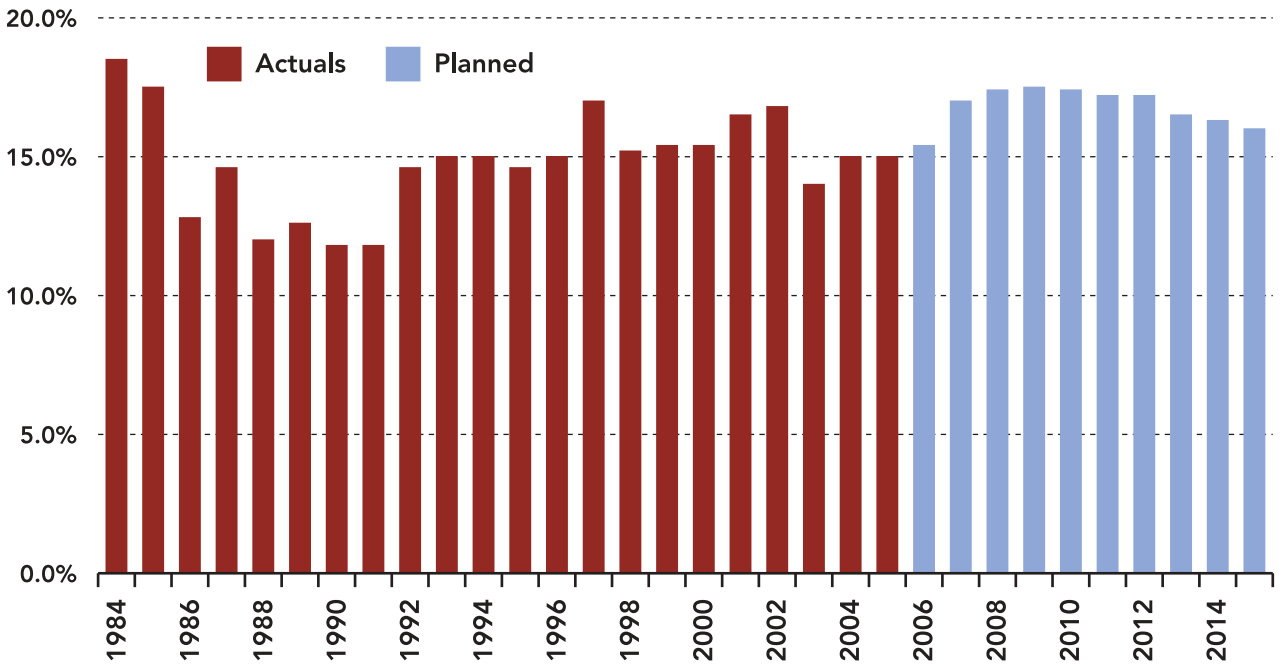
Thinking differently: Debt service

New York raises debt for long-term capital assets, including construction and maintenance of schools & hospitals, subsidized housing, and transportation infrastructure. The city considers debt to be an "uncontrollable" cost because, obviously, it cannot renege on existing obligations to its creditors.

But the city can control future *growth* in debt. New York's debt, at \$52 billion today, will reach \$61 billion by 2009. While the rate of growth in outstanding debt has slowed slightly during the Bloomberg years, to 4.6 percent annually from 6.6 percent annually during the 1990s, the city's debt level is still growing; by next year, debt-service costs will consume more than 17 percent of tax revenues, up from about 14 percent in 2003, and the highest it will have been since 1985. As State Comptroller Alan Hevesi noted in July, "The tasks of balancing the city's capital needs against other municipal services is never an easy one, but the rising debt burden is an area of increasing concern."¹⁶

New York can't fix its debt problem unless it thinks differently, by changing both what it spends its money on, and how it spends it.

Figure 7. Debt Service as a Percentage of City Tax Revenues, 1984 through 2015



Source: OMB

While New York spends more than three-quarters of its capital money on core assets like schools, transportation infrastructure, and public buildings and equipment, the city also commits significant capital money for expenditures on functions that are not at the core of city government. For example, during the Bloomberg administration, the city will have committed more than \$1 billion over four years in capital commitments to public hospitals, about \$1.2 billion to building and maintaining subsidized housing and about \$1.3 billion to “economic development.”

The city should not be in the business of building housing, which is a market function, nor should it be in the business of subsidizing companies to convince them to expand or relocate here.

But the city will likely spend \$100 million in capital funds to seize and prepare property in downtown Brooklyn for developer Forest City Ratner, which wants to build a “mixed-use complex,” including a basketball arena and apartment towers, over the MTA-owned railyards near Prospect Heights. If the project is truly viable on the free market, the city’s money is unnecessary.

In his bid for a second term, Bloomberg has recently unveiled a similar plan to revitalize Willets Point, Queens. But it is not clear why the city should interfere by planning and subsidizing commercial and retail space over what is currently a functional, privately-owned area of auto-body shops. The city could significantly ease its debt burden by keeping its role in “economic development” limited to auctioning off unused city property to the highest private-sector bidders for privately financed development.

In changing how it spends its money, the city could explore innovative financing options for public-transportation infrastructure. For example, last year, the city of Chicago leased its Chicago Skyway toll road to an international private-sector infrastructure group for \$1.8 billion in cash; in return, the private-sector group will collect the tolls. New York could explore with the state a similar transaction for one of its currently free bridges across the East River, and use the money from the lease to invest in constructing new infrastructure or maintaining existing assets.

The city also could pressure Albany to repeal the Wicks Law to cut construction costs, making each capital dollar go further. The Wicks requirement that the city issue four contracts for construction jobs rather than issue one contract to a general contractor adds an estimated 14 percent to capital costs.¹⁷ But, of course, this means taking on the trades unions.

Finally, if New York could pare back its other “uncontrollable” costs – benefits for city workers and Medicaid – the city would have more money to commit to pay-as-you capital spending, particularly for maintenance of older assets; much of the city’s new debt could be reserved for new construction of infrastructure.

Thinking the same, or differently? Education spending

In one major “controllable” area of the budget, Bloomberg’s idea of reform has resulted in significantly higher spending.

City-funded spending on education has increased by 20 percent in the past four years, from \$4.8 billion to \$5.8 billion. This spending increase is not due to the hiring of more teachers or civilian employees under the Bloomberg administration.¹⁸

Rather, the cost increases are due in large part to higher salaries & wages, which have risen 15 percent, from \$6.95 billion to \$8 billion over four years.¹⁹ (If the teacher’s union ratifies its newest contract with the mayor, the costs of that contract will add another \$1 billion to past budgets (and thus to next year’s deficit, as the wage increases must be funded retroactively), and nearly \$1 billion to annual spending when fully phased in.²⁰)

The two contracts Bloomberg has negotiated with teachers during his tenure will have raised salaries by 33 percent when the second contract goes into effect. This extra spending was not beyond Bloomberg’s control; in fact, it is part of his strategy.

But the raises have bought the mayor only a portion of the flexibility the mayor says he has pursued to reform the school system.

Bloomberg is now able to reward “master teachers” with extra money so that they can mentor newer teachers, and he is now able to keep some senior teachers in poorly performing districts; he’s also wrung an after-school teaching period four days a week to benefit low-performing students.

But Bloomberg has not been able to negotiate real merit pay for teachers based on classroom performance, nor has he made much headway in simplifying the city’s complicated contract with teachers. Taxpayers have had to fund double-digit increases in education spending to nudge the status quo only slightly in Bloomberg’s direction.

Managing the status-quo: What happens if we don't change our ways?

As Manhattan Institute senior fellow E.J. McMahon explains in detail in a new report, "Pricing the 'Luxury Product': New York City Taxes Under Mayor Bloomberg," the city has already experienced several tax hikes over the past four years to manage the fiscal status-quo.

Barring a sustained economic miracle, or a rethinking of city government, New Yorkers can expect even more job-killing tax hikes. Further, when the city eventually is run by a mayor who is not as adept as is Bloomberg at wringing efficiencies from the margins of the city's operating budget, New Yorkers can expect an eventual decline in city services, as spending on the essentials is increasingly crowded out by spending on the uncontrolled "uncontrollables."

Conclusion

New York faces a difficult choice over the course of the next four years: Reform city government, or suffer more tax hikes and gradual cuts in basic services as inflation eats away at operational-spending levels in essential departments.

Unless the next mayor embraces an entrepreneurial rather than a managerial approach to governing, New Yorkers can expect no relief from continued budget deficits, and from the inevitably higher taxes needed to fund them.

ENDNOTES

¹ Campaign Finance Board Debate, Nov. 1, 2001. Bloomberg was referring to a measure of spending that includes federal and state grants as well as city-funded spending; this budget has now grown to nearly \$52 billion for the current fiscal year (2006).

² "The Overview: Taxes and Spending," New York Times, Nov. 4, 2001.

³ "Financial Plan: Fiscal Years 2002 to 2006," City Office of Management and Budget, January 2002.

⁴ "Budget Summary," City Office of Management and Budget, Apr. 25, 2001.

⁵ "Review of New York City's Financial Plan," State Comptroller, July 2005.

⁶ Before 9/11.

⁷ "Since this administration began, we have acted to reduce the FY2006 gap by \$3.8 billion," Office of Management and Budget, January 2005.

⁸ According to the Mayor's Management Report, crime is down 20 percent in four years. Quality-of-life summonses are up nearly 30 percent since 2000, while summonses for "unreasonable noise" have more than doubled. Fire-response times are up nearly three percent, but fatalities are down. In sanitation, 91.5 percent of streets are considered acceptably clean, up 5.6 percentage points since 2000.

⁹ If Giuliani's last city-funded budget had grown at the rate of inflation over the past four years, the city-funded budget would be about \$33.6 billion today.

¹⁰ Bloomberg may have negotiated against taxpayers when it comes to employee pensions. Under the city's recently negotiated contract with the teachers' union, the city has agreed to study the feasibility of pushing the State Legislature to allow teachers to retire at age 55, after 25 years of service, as long as the change represented no cost to taxpayers. But there is no way to implement such a change without significantly exacerbating the city's future pension liabilities.

¹¹ "Philadelphia Mayor Ed Rendell: 1996 Municipal Leader of the Year," American City and County, Nov. 1, 1996.

¹² "Next Stop: Competition?" City Journal, Spring 2005.

¹³ "New York City's \$4 Billion Medicaid Bill: What is Driving the Rise in Costs?" and "As Medicaid Enrollment Has Surged, Composition of the Caseload Has Changed," Independent Budget Office, May and June 2003.

¹⁴ Author's correspondence with Independent Budget Office, Oct. 27, 2005.

¹⁵ Florida has applied for and won a federal waiver to experiment with private managed-care of Medicaid.

¹⁶ New York City's Growing Debt Burden," State Comptroller, July 2005.

¹⁷ "January 2005 Financial Plan," OMB.

¹⁸ Instructional headcount has decreased by five percent, to 91,000 from 95,000, while civilian headcount at the education department has fallen by three percent, to 21,600 from 22,200. (School enrollment and class sizes have decreased only slightly.)

¹⁹ Both the state and federal governments, as major contributors to education funding, pay for a share of the costs attributed to salaries & wages.

²⁰ "Review of New York City's Financial Plan," State Comptroller, July 2005; "The Comptroller's Comments on the Adopted Budget for Fiscal Year 2006," City Comptroller, July 2005; author's calculations based on IBO figures of \$77 million in annual cost increases for a one-percent teachers' raise (the figure includes payments for pensions and benefits).

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