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Testimony of Ronnie Lowenstein
To the New York City Council Finance Committee
On the 2010 Preliminary Budget and Four-Year Financial Plan

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Good afternoon Chairman Weprin and members of the committee. I am Ronnie Lowenstein, director of the New York City Independent Budget Office, and am pleased to be here to discuss our most recent revenue and expenditure projections based on the Mayor's Preliminary Budget for fiscal year 2010 and financial plan through fiscal year 2013.

Just six months ago, New York City appeared to have dodged the worst of the economic problems plaguing much of the country. This is no longer the case. The U.S. and global recession has gripped New York City hard, and as our newest economic forecast indicates, we now expect the local downturn to be deep and protracted.

IBO now estimates the city will lose 270,000 jobs from its employment peak in the first quarter of 2008 through the second quarter of 2010. With these larger expected job losses—roughly 30,000 more than we estimated in January—comes a lower forecast of tax revenues. IBO projects that total tax revenues, even after accounting for December's increase of the property and hotel occupancy tax rates, will fall by $2.6 billion to $34.7 billion this fiscal year. And even if we include the expected revenue from the Mayor's proposed sales tax increases, we estimate total tax revenues will decline by an additional $1.3 billion in fiscal year 2010.

These declining tax revenue projections are what's driving IBO's estimate of the city's growing budget shortfalls. Even if we assume the Mayor's proposed gap-closing actions for fiscal year 2010 are achieved, our new lower tax revenue forecast implies there is still an additional problem that remains to be addressed. We now estimate a budget gap of $1.2 billion in 2010. Our budget gap projection for 2011 is now $4.8 billion, $1.6 billion more than the Mayor estimated in January.

While the federal stimulus bill will provide the city with some fiscal relief, it is not yet clear how much. A significant portion of the stimulus comes in the form of funds to foster infrastructure projects and expand programs, assistance that does nothing to close the city's expense budget gaps. The largest share of the stimulus package provides aid to individuals and families, which will help bolster the local economy but will not provide the city with direct fiscal relief. The biggest source of local fiscal relief in the stimulus bill is the increase in the federal matching rate for Medicaid and the Mayor has already penciled in $1 billion of budget relief from this change for his 2010 Preliminary Budget.

As foreboding as our forecast already appears, there is ample reason for concern that conditions could worsen. Until there is a turnaround in the national economy—which is dependent upon restoring the health of the financial system and in particular the credit markets—the local economy will continue to founder. It is far from clear that the financial system has begun to stabilize, let alone return to health. But even when the national economy does rebound and the financial market revives, the financial industry is likely to be more highly regulated and employ less leverage, and therefore will almost certainly be less profitable. If these structural changes occur, Wall Street will no longer generate the levels of city tax revenue that it has in the recent past.

I will now continue with some more of the details behind our economic and revenue outlook:

U.S. Economic Outlook. The U.S. economic downturn is now expected to be the worst the since the Depression. Job losses are mounting, vehicle sales are their lowest since the 1980s, housing starts are at their lowest levels since the 1950s, and consumer confidence is as dark as it has ever been.

The nation has lost jobs for 14 consecutive months, including losses of over 650,000 in each of the last three months. With the loss of 651,000 jobs in February, the unemployment rate rose to 8.1 percent, the highest rate since 1982. Since employment peaked in December 2007 the nation has lost a total of 4.4 million jobs (a decline of 3.2 percent on a seasonally adjusted basis) and even with the federal stimulus plan we anticipate job losses to reach 5.7 million (4.1 percent) and the unemployment rate to reach 9.3 percent.

In the fourth quarter of 2008, output in the U.S. economy (real gross domestic product) contracted sharply, falling at an annual rate of 6.2 percent. IBO expects real GDP to continue shrinking through the third quarter of 2009, with output falling 2.2 percent for the year as a whole. Although recovery is expected to begin in late 2009, growth will be weak throughout 2010, increasing by only 1.8 percent on an annual basis.

New York City Outlook. Until September 2008, New York City appeared to escape much of the impact of the U.S. downturn. But when the nationwide housing crisis turned into a financial sector meltdown, New York City—a global center for the financial industry—was hit particularly hard. We now expect the city economy to contract more sharply and recover more slowly than the U.S. as a whole.

Although New York City began losing jobs in the middle of last year, it was not until the last quarter of 2008 that employment began to steeply decline. Overall, the city has lost 59,900 jobs since January 2008, with much deeper declines expected in 2009. The financial industry will be the hardest hit with job losses continuing into 2011 when they will reach nearly 77,300. In the securities industry, which is the highest paying subsector within the financial industry, losses are expected to total 48,800 by mid-2010, a decline of over 25 percent from the employment peak in 2008. The securities sector is expected to continue to gradually lose jobs through the third quarter of 2012, when they will total 50,900.

The profits of Wall Street firms, which as recently as 2006 were at a near record high of almost $21 billion, have seen an unprecedented decline in the subsequent 24 months. After continuing to grow in the first half of 2007 they began to collapse in the third quarter as problems emerged in the mortgage security market. For the year as a whole the net loss for the industry was $11.3 billion. In 2008 the losses were even more staggering; when final data are reported IBO expects that they nearly quadrupled to $45.1 billion. IBO projects that the industry as a whole will lose another $8.3 billion in 2009, before returning to relatively modest profitability in 2010 with annual profits averaging roughly $9 billion through 2013, far below the 2006 level.

Tax Revenues. The outlook for tax revenues has darkened with the economic outlook. There was essentially no growth in tax revenues during fiscal year 2008 and we expect them to decline by $2.6 billion (7.0 percent) in the current fiscal year and $1.3 billion (6.0 percent) in 2010, even after accounting for the already enacted property and hotel tax rate increases and the Mayor's proposed sales tax increases. IBO's revenue forecast is significantly below the Mayor's Office of Management and Budget's for 2010 through 2013, with the difference exceeding $1 billion each year in 2010 through 2012, with much of the difference due to IBO's more pessimistic outlook for tax revenues paid by businesses in the city.

Much of the declines are in the personal and business income taxes which are highly sensitive to the business cycle and in the property transfer taxes which reflect conditions in the real estate markets. From 2003 through 2007, these taxes more than doubled, growing by 118.4 percent, while the rest of the city's tax sources—which are dominated by the property tax—grew by 32.2 percent. With the downturn in financial and real estate sectors, this group of taxes is now shrinking much faster than most of the city's other sources. Indeed, in 2008 through 2010, while they are expected to contract by 64.0 percent, the rest of the city's taxes are actually expected to grow by 9.4 percent.

From 2003 to 2007, when Wall Street profits were expanding along with the financial asset bubble, the city's business income tax receipts grew by 163.4 percent from $2.3 billion to $6.0 billion; by far the fastest growth in these taxes' history. But in 2008 that trend reversed with a decline of 10.0 percent in business tax revenues. IBO now projects that in 2009 revenues will decline by another 14.5 percent and then fall further in 2010. Over the three years, business tax collections are projected to fall by a cumulative $2.4 billion (40.7 percent), which is the fastest decline in the history of these taxes. Slow growth is expected to resume in 2011, but by 2013, business income tax revenue will still be only $4.4 billion, well below the 2007 peak.

The growth in the property transfer taxes started earlier, but they grew even faster than the business income taxes in the 2003 to 2007 period; revenues more than tripled in those years from $1.0 billion to $3.3 billion. Since then the city's real estate market has essentially stalled. The number of residential sales has fallen sharply, accompanied by what has so far been a relatively modest decline in median home sales prices. Sales of commercial properties and apartment buildings, particularly large transactions, have all but dried up as investors face increasing difficulty in securing financing. Revenues from the transfer taxes have shrunk with the markets, falling by 22.7 percent in 2008. IBO expects them to fall further in 2009 by 40.3 percent, with yet another fall of 22.1 percent expected for 2010, leaving revenues in that year roughly equal to where they were in 2003.

The city's personal income tax revenue also grew robustly during the expansion, with growth continuing into 2008. From 2003 through 2008 the personal income tax nearly doubled, rising from $4.5 billion to $8.7 billion (96.2 percent). With local employment shrinking and many of the job losses concentrated in the highest paying sectors, along with an expectation that capital gains realizations will be much lower given the losses in equities and real estate, IBO is projecting major declines in the personal income tax for 2009 and 2010. Revenues are expected to fall by 17.4 percent this year and 21.7 percent next year, before finally starting to recover in 2011 when revenues are forecast to grow by 15.8 percent.

The real property tax, which is the city's largest single revenue source, is the one major tax that is not expected to show a large decline in the next few years. Because of the requirement that changes in market values be phased in over five years when determining assessments for tax purposes, the property tax base (billable assessed value) is expected to continue growing at over 5 percent annually through 2012. Combined with the tax rate increase that was enacted in December 2008, property tax revenues are expected to grow by 10.0 percent from 2009 to 2010 and then by 6.3 percent in 2011. As the pipeline of previous market value increases is gradually used up and the more recent declines in values are incorporated in the assessments, property tax revenue growth is expected slow further in 2012 and 2013 and could even become negative In the following years.

To Conclude, the city has entered what is expected to be severe and protracted period of economic retrenchment which will lead to two consecutive years of tax revenue declines. Even after the local economy begins to recover—and IBO expects the city's recovery to lag the nation's—tax revenue growth is expected to be much slower than we enjoyed in the years of expansion from 2003 through 2007. With lower tax revenue, a prior year surplus that will be largely expended this year, and continued spending growth in large parts of the budget that are not immediately controllable by the Mayor, IBO expects the city to face an ongoing challenge to meet its legal requirement to produce annual budgets that are balanced. With New York State facing even greater fiscal challenges, it is unlikely that the state will be a significant source of budget relief, and indeed state leaders may add to the city's burden as they look to solve their own problems. Relieving this fiscal stress will likely require some combination of significant budgetary reductions and/or revenue increases.

Thank you and I would be happy to answer any of your questions.