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Testimony of Ronnie Lowenstein
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To the New York City Council Finance Committee
On the Executive Budget for 2014 and Financial Plan

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Good afternoon Chairman Recchia and members of the City Council Finance Committee. I am Ronnie Lowenstein, director of New York City's Independent Budget Office. I am pleased to be here today to present some of the highlights of IBO's latest economic forecast and reestimate of revenues and expenses under the Mayor's Executive Budget for 2014 and Financial Plan through 2017.

If one takes our latest economic forecast and couples it with our current estimates of revenues and expenditures under the Mayor's budget plan, New York City's fiscal picture looks remarkably bright. We project a relatively small surplus next fiscal year and a modest shortfall the year after. But these bottom line estimates of the city's surpluses or gaps only tell part of the city's budget story.

As you well know, all of the city's 152 contracts with its municipal labor unions have expired—some lapsed more than three years ago, including contracts with some of the largest unions. The Mayor's budget plan assumes there will be no retroactive raises—a fiscal bet that may be hard to win.

To gauge the potential cost of a settlement with the unions, IBO estimated the cost under one plausible scenario. If we assume that the unions for teachers and principals received the same 4 percent raises that other unions agreed to in the previous round of bargaining and that all the unions with contracts that expired in 2010 or later accepted 2 percent raises for two years, and as in the past these raises were passed on to nonunion city employees as well, the cost would total $4.5 billion at the end of this month. These higher salaries would increase the city's labor costs by $1.8 billion in 2014 and each year after.

While the issue of expired labor contracts clouds the background of the city's fiscal outlook, in the foreground the picture seems clearer. On the national level, the economic signals generally appear poised for growth: business profits are strong and housing sales are up while household debt is down and interest rates remain low. Although the expiration of the federal payroll tax cut and the effects of sequestration will temper increases in gross domestic product in calendar year 2013, growth will accelerate in the next two years.

Locally, there has been strong employment growth over the past two years, with an increase of 86,700 jobs in calendar year 2011 and nearly 80,000 more in 2012, although the city's unemployment rate remained high at more than 9 percent. We expect job growth will slow to about 57,000 this year, affected by weaker national growth during the middle of this year, and then rebound with job increases of more than 72,000 in 2014 and 81,000 in 2015. These increases are expected to be accompanied by a long-awaited decline in the local unemployment rate to 6 percent in 2015.

As we have noted in past months, the growth in jobs is not matched with a commensurate increase in wage gains, as the composition of the city's workforce shifts towards lower paying industries. Employment growth is being led over the 2013-2017 period by sectors such as professional and business services, education and health care, and leisure and hospitality. Average salaries in education and health care are about $47,000 and in leisure and hospitality $41,000. While professional and business services wages average $100,100 annually, even that pales in comparison with Wall Street, where average wages are nearly $338,000. But Wall Street is expected to have only modest job growth in 2013 through 2017.

IBO's forecast of employment and wage growth leads to an expectation of solid, but not exceptional, increases in city tax revenues in fiscal years 2013 through 2017. We project tax revenues will increase at an annual average rate of 4.8 percent, growing from $44 billion this year to $54 billion in 2017. Tax revenues are expected to increase 7.5 percent this year over 2012 as some households and firms shifted capital gains and bonuses into calendar year 2012 in anticipation of federal tax changes. This boosted personal income and real property transfer taxes in the city's current fiscal year, but means that we expect local tax revenues will grow by a far more modest 1.5 percent next fiscal year.

Nonetheless, IBO projects that growth in tax collections will outpace spending growth over the next few years. IBO projects that total city spending will grow from $71.7 billion this year to $79.7 billion in 2017, growing at an average annual rate of 2.7 percent. Spending on most services is expected to be flat over that period, with growth largely confined to a few categories of spending.

One major growth category is spending on health care and other fringe benefits for city employees, which is expected to increase at an annual average rate of 6.9 percent and total $6.4 billion in 2017. Another fast-growing cost is debt service, which is projected to increase at annual average rate of 6.6 percent and total $7.7 billion in 2017. Although not growing as fast in percentage terms, spending by the Department of Education is rising sharply in dollar terms—projected to increase by $2.6 billion through 2017 and total $21.7 billion. A large share of this increase is based on expected growth in state education aid.

IBO's spending estimate for 2014 includes our projection that city agencies will need about $120 million more than the Mayor budgeted. This additional spending includes needs such as $71 million for employee health insurance, $20 million for a likely runoff election this fall, $15 million for overtime for correction officers, and $14 million for shelters for homeless families and single adults.

Our spending estimates for the city do not take into account budget restorations that the Council negotiated just for this year or additional cuts proposed for 2014 for some of these same programs—programs that the Council has typically endeavored to maintain but that are getting increasingly expensive to restore. For example, fully restoring the proposed cut to the subsidy to the city's library systems will cost more than $100 million in 2014 and maintaining the current number of after-school slots in the Out-of-School Time program will require an additional $61 million.

While these and other programs will need additional resources if they are to be maintained at current service levels, other issues may present steeper budget hurdles. Reaching settlements on the expired labor contracts could prove to be very costly depending upon how they are resolved. Additionally, the Mayor's budget plan counts on $1.5 billion in revenue from the sale of new taxi medallions, a proposal buffeted by lawsuits and repeated shifts in expectations of when the revenue will flow. And still emerging plans for increasing the city's resilience to Sandy-like storms in the future may also prove costly. For reasons such as these, the story of the city's budget is likely to be one of more fiscal challenges in the months ahead.

Thank you for the opportunity to testify today and I will be pleased to answer your questions.