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Analysis of the Mayor's Preliminary Budget for 2004

Overview

IBO

New York City

Independent Budget Office

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Overview

INTRODUCTION

The Independent Budget Office (IBO) has reviewed the Mayor's Preliminary Budget for fiscal year 2004 and Financial Plan through 2007, as required by the City Charter. IBO's review and analysis of the budget plan includes our own projection of revenues, repricing of the Mayor's policy proposals, and reestimate of the cost of delivering existing services. The following review is based on this comprehensive examination.

- Despite a substantial tax increase and spending reductions, IBO finds that a budget shortfall of up to $2.2 billion remains to be closed in 2004. Gaps in the following years grow from as much as $3.9 billion in 2005 to $4.1 billion in 2006.
- The Mayor's budget plan for 2004 depends upon $2.9 billion in initiatives outside his control. These include measures that require state or federal assistance or approval as well as the consent of municipal labor unions.
- City tax revenues will grow by $1.7 billion in 2004; $828 million of the rise is attributable to the second half of the property tax rate increase that takes effect in July. With the property tax hike, tax revenue will once again exceed their pre-recession 2001 peak.
- City-funded expenditures will grow by $1.6 billion in 2004 and total $32.8 billion despite the combined November and January plan cuts of $1.3 billion in agency spending. Rising Medicaid, pension, fringe benefit, and debt service costs are major factors for the increased spending.
- The Bloomberg Administration's plan for closing the 2004 budget gap includes nearly $1.6 billion in measures that will have no recurring value (roughly $1.3 billion) or diminishing value after 2004 (Personal Income Tax Reform).
- The Governor's state budget proposal, while failing to provide much of the assistance the Bloomberg Administration is seeking, would impose upwards of $140 million in new Medicaid costs for the city and reduce education aid to the city by at least $462 million, The state's own fiscal difficulties will pose significant hurdles to balancing the local budget.

Total Revenue and Expenditure Projections

Dollars in millions

	2003	2004	2005	2006	2007	Average Change
Revenues	$ 45,080	$ 44,483	$ 44,620	$ 46,119	$ 47,933	1.5%
city-funded revenues	*31,167*	*30,522*	*31,299*	*32,700*	*34,425*	2.5%
Expenditures	45,080	46,719	48,480	50,202	51,591	3.4%
city-funded expenditures	*31,167*	*32,758*	*35,159*	*36,783*	*38,083*	5.1%
IBO Surplus/(Gap) Projection	**$ -**	**$ (2,236)**	**$ (3,860)**	**$ (4,083)**	**$ (3,658)**	

SOURCE: IBO.

NOTES: IBO projects a surplus of $628 million for 2003, $7 million above the Bloomberg Administration's forecast. The $628 million is used to prepay 2004 expenditures, leaving 2003 with a balanced budget. City-funded revenues and expenditures exclude state and federal categorical grants. Projections are net of intra-city revenues and expenditures.

BUDGET GAPS

Largely because of the 18.5 percent increase in the property tax rate in the middle of the current fiscal year, IBO anticipates the city will end 2003 with a surplus of $628 million. These funds will be used to prepay some 2004 expenses and help shrink the gap by an equivalent amount.

Based upon IBO's estimates of city revenue and spending as well as a review of the Mayor's revenue and expenditure proposals, we anticipate that a shortfall of up to $2.2 billion remains in 2004. The potential budget gap grows in the following two years, to $3.9 billion in 2005 and $4.1 billion in 2006, and then falls slightly in 2007 to $3.7 billion.

To close the 2004 gap, the Mayor's plan depends upon $2.9 billion in initiatives outside his control. These include measures such as his proposal to extend the city's Personal Income Tax (PIT) to commuters, requests for state and federal assistance, and changes in collective bargaining agreements with municipal labor unions.

REVENUE ESTIMATES

The recession has hit New York City and its critical financial services industry harder and for a longer period than many economists had expected. The World Trade Center attack has of course also had a continuing effect on the city's economic condition. IBO projects that the recession, coupled with the aftershock from the trade center attack, will mean continued job losses in the city through calendar year 2003. We forecast job losses of 13,000 in calendar year 2003, followed by modest growth of nearly 29,000 jobs in calendar year 2004—mostly in the lower paying service sectors. The securities industry will continue to have job losses through the middle of calendar year 2004; due to the industry's high level of compensation, the loss of securities jobs has a disproportionate impact on the local economy.

Based on this economic forecast, IBO projects that if the 18.5 percent property tax rate increase had not been enacted, 2004 city tax revenue would have remained below its high point in 2001 prior to the recession. With the rate increase in place and modest growth in other tax sources, tax revenue is expected to total $24.8 billion in 2004, $1.7 billion more than we expect tax collections to total in 2003.

Much of the growth that IBO expects will resume in 2004 will be reflected in business tax collections. But much of the dollar growth in 2004 tax revenue will come from the property tax. IBO projects the property tax will total $11.2 billion in 2004, $1.2 billion more than this fiscal year—largely because of the increase in the property tax rate, which took effect in the second half of 2003.

EXPENDITURE ESTIMATES

IBO projects city-funded spending to reach $32.8 billion in 2004—$1.6 billion more than estimated for the current fiscal year. This rise occurs despite spending by city operating agencies actually falling in 2004. From 2003 through 2007, IBO projects agency spending will grow at an average annual rate of less than 1 percent.

In 2004, the combined November and January plans cut agency expenditures by $1.3 billion. Approximately half of the spending reductions would come from the elimination or cutback of specific programs and services, and from other, unspecified cuts in agency budgets. While not linked to specific programs, these cuts could ultimately affect service delivery as well. The other half of the agency spending reductions would come from reestimates of service needs, shifting costs to federal or state resources, and similar actions.

The largest cuts, in dollar terms, are shouldered by the police and education departments. In percentage terms, however, several smaller agencies, such as the Department of Employment, Department of Youth and Community Development, and the Department for the Aging took larger cuts, ranging from 4 percent to 8 percent.

A number of factors contribute to the rise in spending despite agency cutbacks. One is the increasing cost of Medicaid for the city. IBO estimates the city's share of Medicaid in 2004 will equal $4.4 billion, $212 million more than last year. Pension costs also are rising rapidly due to the need to cover losses in pension fund investments as well as cost-of living-adjustments required by the state. The city's contributions to its five pension funds are projected to grow by $827 million in 2004, and total $2.6 billion. Even if the pension funds resume their 8 percent assumed return on investments in 2004, pension costs are expected to grow at an average annual rate of nearly 27 percent, and total $4.6 billion in 2007. Also increasing at a fairly fast pace are the cost of fringe benefits for city employees—particularly health care. Spending for fringe benefits will rise by an estimated $146 million in 2004, and total $2.8 billion (excluding public school employees). Fringe benefits are projected to total $3.4 billion in 2007.

Another factor in the continued rise in spending is debt

Pricing Differences Between IBO and the Administration

Items that Affect the Gap

Dollars in millions

	2003	2004	2005	2006	2007
Gaps as estimated by the Mayor	**$ -**	**$ -**	**$ (1,495)**	**$ (2,008)**	**$ (2,034)**
IBO Pricing Differences					
Revenues					
Taxes					
Property	(10)	(9)	138	162	96
Personal Income	119	129	125	223	503
General Sales	57	74	93	134	174
General Corporation	(29)	41	(48)	(144)	(8)
Unincorporated Business	(13)	(6)	(39)	(68)	(62)
Banking Corporation	3	7	(6)	(17)	(38)
Real Property Transfer	16	33	24	8	(6)
Mortgage Recording	28	(1)	(36)	(13)	32
Utility	5	6	7	9	12
Hotel Occupancy	(3)	(4)	5	3	(9)
Commercial Rent	(23)	(25)	(20)	(18)	(24)
Other Taxes, Peg's and Audits	(18)	(29)	(40)	(37)	(37)
	132	216	203	242	633
PIT / Commuter Tax Proposal	-	206	192	62	(255)
STaR Reimbursement	(7)	18	18	45	65
Total Revenues	125	440	413	349	443
Expenditures					
Public Assistance	2	28	58	62	62
Medicaid	(39)	(73)	(137)	(167)	(328)
Department of Education	(25)	(11)	(53)	(53)	(54)
Campaign Finance	4	(4)	12	(34)	12
Overtime	(60)	(65)	(65)	(65)	(65)
Total Expenditures	(118)	(125)	(185)	(257)	(373)
Total IBO Pricing Differences	**7**	**315**	**228**	**92**	**70**
Uncertainties					
PIT / Commuter Tax Proposal	-	(1,168)	(850)	(221)	255
Anticipated State and Federal Actions	-	(600)	(1,050)	(1,250)	(1,250)
Labor Cost Containment	-	(600)	(600)	(600)	(600)
Airport Rent	-	(190)	(93)	(96)	(99)
Total Uncertainties	**-**	**(2,558)**	**(2,593)**	**(2,167)**	**(1,694)**
Prepayment Adjustment	(7)	7	-	-	-
IBO Surplus/(Gap) Projection	**$ -**	**$ (2,236)**	**$ (3,860)**	**$ (4,083)**	**$ (3,658)**

SOURCE: IBO.

NOTE: Negative pricing differences (in parentheses) widen the gaps, while positive pricing differences narrow the gaps.

service. During the last two fiscal years (2001 and 2002), general city debt-funded capital spending, in inflation adjusted terms, surged from an average annual level of $3.2 billion between 1996 and 2000 to $4.5 billion a year—a 40 percent increase. The increased city borrowing to finance this level of capital spending will help push debt service up at an average annual rate of 5.6 percent between 2004 and 2007. Several refundings of city general obligation and Transitional Finance Authority (TFA) debt substantially lowered debt service in 2003, and will help lower costs through 2007. At the same time, however, the $2 billion in TFA bonds issued to fund World Trade Center-related operating expenses will add $95 million in debt service in 2004 and $165 million annually over the next three decades.

To help hold down the growth in debt service, the Bloomberg Administration ordered cuts to the four-year capital program that totaled 24 percent for city debt-funded projects. These cuts would begin to bring the rate of city capital spending back down to roughly its level of the late 1990s.

ONE-TIME RESOURCES

The Bloomberg Administration's plan to close the 2004 budget gap includes nearly $1.6 billion in measures that will have no recurring value or diminishing value after 2004. In other words, these "one shots" will be of little or no help in addressing the substantial shortfalls the city will face in the years after 2004. But unlike the borrowing done to help close this year's gap, the one-time resources proposed for 2004 do not come at the cost of increased expenditures in future years.

The largest single one shot is the anticipated settlement with the Port Authority of New York and New Jersey on back rent owed for the city's airports. The city estimates $600 million from this settlement, although the Governor has talked about $500 million.

A number of agency spending cuts only will produce savings in 2004. Among these are $32.6 million in savings from debt refunding, $23.7 million by delaying some Fresh Kills closure expenditures, and $21 million in personnel savings in the police department.

The Mayor's plan for altering the city's Personal Income Tax would have diminishing returns because in addition to extending the tax to commuters it would also lower the tax rates. In 2005, the new PIT revenue from this proposal would be $317 million less than in 2004. IBO estimates that by 2007 the Mayor's PIT reforms would actually *cost* the city $255 million.

The $628 million budget surplus that IBO projects at the end of 2003 will be used to prepay some 2004 expenses. While helping to lower the 2004 gap, the surplus will not ease the projected gaps in future years.

UNCERTAINTIES

While a preliminary budget often includes a few "trial balloons," the 2004 plan contains a number of measures the Mayor first presented in November but which have received little support since then. The January plan acknowledges that these initiatives, which require help from the state and federal governments and municipal labor unions, have not yet been achieved. Although the Mayor may ultimately succeed in securing all or part of these measures, they pose a sizable risk to his plan.

The biggest of these initiatives is the proposed change to the city's Personal Income Tax. If this proposal is not approved by the state—and both the Governor and Senate Majority Leader have expressed their doubts—IBO estimates it will result in $1.2 billion less in tax revenue for the city in 2004.

Other proposals that present significant risks to the Bloomberg Administration's plan for balancing the 2004 budget include $400 million in actions from the state and federal governments as well as $200 million in "transportation initiatives"—tolling the East River bridges and having the Metropolitan Transportation Authority assume responsibility for the private bus routes now subsidized by the city.

The proposal for $600 million in savings from labor concessions and/or productivity also is very uncertain. Recognizing this, on February 25 the Bloomberg Administration directed city agencies to prepare contingency cuts of $600 million in case an agreement with the municipal labor unions on savings could not be reached by April 1.

Another labor issue with ramifications for the city budget is future wage increases for the municipal workforce. Most union contracts have already expired, and the remainder will in 2004. The Bloomberg Administration's budget plan includes no funds for wage increases. In fact, the Mayor has said there will be no retroactive pay raises and no raises that are not self-funded by workers through additional productivity savings. This may prove a hard bargaining line to hold.

The federal and state budgets also pose some very significant uncertainties for the city. The President's proposal to end the tax on dividend income could both lower city PIT revenue (the city links its income tax to the federal tax) and make it more expensive for the city to issue bonds, since they would no longer have the competitive advantage of being the only tax free investment. The President's proposals for converting Medicaid and Head Start funding into block grants also could have consequences for the city budget in the future.

The Governor's proposed budget included little of the new aid the Mayor had been seeking. Moreover, the Governor's plan for education spending would *reduce* aid to the city by at least $462 million, including the elimination of all support for universal pre-kindergarten and the program to reduce class size in the lower grades. Nor did the Governor's budget proposal include the $275 million the Mayor sought to help fund the 20-minute extension of the school day negotiated last year.

The Governor's proposed changes to Medicaid also would have fiscal consequences for the city. IBO estimates that if adopted the changes would add upwards of $140 million a year to the city's Medicaid expenditures.

While much can change as budget negotiations proceed in Albany, the state's own $11.5 billion budget shortfall poses a significant barrier to gaining the new aid the city wants—or restoring newly proposed cuts or changes in state aid. Given the uncertainty of several of the Bloomberg Administration's key proposals for closing the budget gap as well as the fluidity of state budget negotiations, closing the city's 2004 budget shortfall will pose major challenges for the Mayor and City Council.

IBO Expenditure Projections

Dollars in millions

	2003	2004	2005	2006	2007	Average Change
Health & Social Services						
Social Services	$ 5,955	$ 6,005	$ 6,128	$ 6,288	$ 6,464	2.1%
Children Services	2,361	2,267	2,275	2,275	2,275	-0.9%
Health	2,265	2,308	2,380	2,427	2,455	2.0%
Homeless	640	665	669	668	669	1.1%
Other Related Services	551	403	403	403	403	-7.5%
Subtotal	11,772	11,648	11,855	12,061	12,266	1.0%
Education						
DOE (excl. Labor Reserve)	12,603	12,396	12,558	12,751	12,943	0.7%
CUNY	432	423	423	423	423	-0.5%
Subtotal	13,035	12,819	12,981	13,174	13,366	0.6%
Uniformed Services						
Police	3,444	3,285	3,317	3,315	3,315	-0.9%
Fire	1,152	1,057	1,056	1,054	1,054	-2.2%
Correction	874	841	850	844	844	-0.9%
Sanitation	969	950	965	965	965	-0.1%
Subtotal	6,439	6,133	6,188	6,178	6,178	-1.0%
All Other Agencies	5,711	5,538	5,651	5,831	5,904	0.8%
Labor Reserves						
Department of Education	49	47	57	57	57	n/a
All Other Agencies	326	288	290	293	293	n/a
Debt Service	3,321	3,871	4,961	5,076	5,295	12.4%
Pensions	1,784	2,611	3,246	4,074	4,567	26.5%
Fringe Benefits (exculding DOE)	2,643	2,789	2,976	3,183	3,390	6.4%
Anticipated State and Federal Actions	-	975	275	275	275	n/a
Total Expenditures	$ 45,080	$ 46,719	$ 48,480	$ 50,202	$ 51,591	3.4%

SOURCE: IBO.

NOTES: Debt service includes Transitional Finance Authority (TFA) debt service expenditures. Expenditures are net of intra-city sales.

IBO Revenue Projections

Dollars in millions

	2003	2004	2005	2006	2007	Average Change
Tax Revenues						
Property	$ 9,916	$ 11,158	$ 11,721	$ 12,168	$ 12,555	6.1%
Personal Income	4,626	4,781	5,131	5,589	6,181	7.5%
General Sales	3,566	3,675	3,903	4,123	4,372	5.2%
General Corporation	1,142	1,307	1,397	1,421	1,632	9.3%
Unincorporated Business	786	842	881	911	979	5.6%
Banking Corporation	227	299	360	420	432	17.5%
Real Property Transfer	480	451	474	488	515	1.8%
Mortgage Recording	475	383	377	423	503	1.4%
Utility	287	277	286	289	297	0.9%
Hotel Occupancy	203	223	256	272	272	7.6%
Commercial Rent	375	388	405	417	431	3.5%
PILOT's	145	144	147	152	155	1.7%
Other Taxes and Tax Audits	853	823	812	813	810	-1.3%
Total Taxes Before Proposals	23,081	24,751	26,150	27,486	29,134	6.0%
Tax Proposals - excluding PIT reform	*3*	*40*	*23*	*23*	*23*	*n/a*
Total Taxes After Proposals	*23,084*	*24,791*	*26,173*	*27,509*	*29,157*	*6.0%*
Other Revenues						
STaR Reimbursement	652	676	698	760	801	5.3%
Miscellaneous Revenues	3,130	3,408	2,880	2,862	2,882	-2.0%
Transitional Finance Authority - 9/11	1,500	-	-	-	-	n/a
Anticipated State and Federal Aid	650	-	-	-	-	n/a
All Other	2,151	1,647	1,548	1,569	1,585	-7.3%
Total Other Revenues	8,083	5,731	5,126	5,191	5,268	-10.1%
State and Federal Grants	13,913	13,961	13,321	13,419	13,508	-0.7%
Total Revenues	$ 45,080	$ 44,483	$ 44,620	$ 46,119	$ 47,933	1.5%

SOURCE: IBO.

NOTES: Pesonal Income Tax includes Transitional Finance Authority (TFA) dedicated personal income tax. All other non-tax revenues include unrestricted intergovernmental aid, other categoricals grabts, inter-funded revenues, and disallowances. Miscellaneous revenues are net of intra-city revenues.