IBO

New York City Independent Budget Office

Fiscal Brief

May 2003

Analysis of the Mayor's Executive Budget for 2004

Also available...

Detailed Tables on IBO's Revenue and Expenditure Estimates

...on the Web at www.ibo.nyc.ny.us

SUMMARY

Buffeted by a weak local economy and rising expenditures, New York City continues to face significant fiscal difficulties. The Mayor's Executive Budget estimates a budget shortfall of $3.8 billion for 2004.

IBO projects the city will lose 38,000 jobs this calendar year. With recovery in the local economy now not expected to pick up steam until calendar year 2004, IBO has lowered its baseline tax revenue forecast (excluding the Legislature's tax changes for the city) for fiscal year 2004 to $24.6 billion—a decline of $1.3 billion since last November.

Even if the recently enacted state Assembly and Senate measures survive the Governor's threatened vetoes, many of the spending cuts and revenue raising initiatives contained in the Executive Budget for 2004 will still be necessary. The proposed spending cuts, tax increases, and revenue raisers follow significant steps already taken by the Mayor and City Council. Last November, the city raised its property-tax rate by 18.5 percent and implemented $1.1 billion in spending cuts and measures to raise fees and fines.

Among the key findings in this analysis of the Mayor's Executive Budget:

- Spending will grow from $44.3 billion in 2003 to $45.9 billion in 2004, a 3.6 percent increase. While IBO projects that revenue will rise at an average annual rate of 1.6 percent from 2003 through 2007, spending will grow more than twice as fast, and rise to $51.2 billion in 2007.
- Spending on debt service and pensions and fringe benefits for city workers (excluding public school employees) will increase by $2.9 billion in 2004. In contrast, agency spending on service delivery will continue to decline. Under the November, January and April Programs to Eliminate the Gap, spending of city funds by agencies would fall by a combined $1.9 billion.
- Assuming the Albany aid package remains as passed by the Assembly and Senate, there would be sufficient revenue to avoid the Mayor's $1 billion contingency plan.

As IBO publishes this report in accordance with its City Charter-mandated deadline, the fate of Legislative aid package remains uncertain. Once that is settled, IBO will provide a more detailed analysis of the tax changes and other aid. IBO

New York City
Independent Budget Office
Ronnie Lowenstein, Director
110 William St., 14th floor
New York, NY 10038
Tel. (212) 442-0632
Fax (212) 442-0350
e-mail: ibo@ibo.nyc.ny.us
http://www.ibo.nyc.ny.us

CHANGES SINCE NOVEMBER

Last November, with the city facing an estimated $6.4 billion budget gap in 2004, the Mayor presented a plan to close the shortfall. The November plan had four major components, two of them under direct city control: a $2.3 billion property-tax rate increase (reduced by $600 million by the City Council) and $1.1 billion in agency spending reductions and revenue initiatives that have been largely implemented. The other key components required aid or approval from other entities: a $1 billion extension of the city's personal income tax to commuters; $600 million in concessions from labor; $400 million in state assistance; and $200 million in federal aid.

IBO Revenue Projections
Dollars in millions

	2003	2004	2005	2006	2007	Average Change
Tax Revenue						
Property	$ 9,955	$ 11,175	$ 11,761	$ 12,195	$ 12,557	6.0%
Personal Income	4,503	4,740	5,074	5,438	5,847	6.7%
General Sales	3,566	3,675	3,903	4,123	4,372	5.2%
Business Income Related	2,159	2,277	2,406	2,535	2,793	6.6%
Real Estate Related	1,325	1,205	1,200	1,285	1,350	0.5%
Other Taxes and Tax Audits	1,505	1,503	1,535	1,558	1,578	1.2%
Total Taxes Before Proposals	*23,013*	*24,575*	*25,879*	*27,134*	*28,497*	*5.5%*
Tax Proposals - excluding PIT reform	1	48	31	31	31	n/a
STaR Reimbursement	652	666	700	756	792	5.0%
Transitional Finance Authority - 9/11	1,500	-	-	-	-	n/a
Discretionary Transfers	(802)	802	-	-	-	n/a
Other Revenues	5,819	4,718	4,496	4,499	4,536	-6.0%
State and Federal Grants	14,139	13,123	13,135	13,224	13,352	-1.4%
Total Revenue	**$ 44,322**	**$ 43,932**	**$ 44,241**	**$ 45,644**	**$ 47,208**	**1.6%**

SOURCE: IBO.
NOTES: Personal income tax includes the portion dedicated to the Transitional Finance Authority and excludes discretionary transfer. Other non-tax revenues include unrestricted intergovernmental aid, other categorical grants, inter-fund revenues, miscellaneous revenues, and disallowances. Discretionary transfers reflect an additional projected surplus of $27 million for 2003 above the Executive Budget forecast. Miscellaneous revenues are net of intra-city revenues.

Since November, the Mayor has presented his Preliminary Budget for 2004 and most recently his Executive Budget. In those two plans, the Mayor lowered his tax revenue projections by $592 million and presented $1.1 billion in proposals for reducing agency expenditures, including 4,500 layoffs, and raising revenue. From November through April, there was little progress on the key gap-closing measures that required state, federal, or union consent.

THE EXECUTIVE BUDGET

Despite this lack of progress, the Executive Budget put an increased emphasis on some of the measures that relied on actions by others. The total request for assistance from the state grew to $2.7 billion, according to the Mayor's budget presentation. This was the largest part of the plan for closing the Bloomberg Administration's estimated $3.8 billion budget gap in 2004. Other "outside" help was to come in the form of $200 million in assistance from the federal government and $200 million as the beginning of the settlement of airport back rent from the Port Authority of New York and New Jersey.

The Executive Budget also included $620 million in agency gap-closing measures and $75 million in savings through changes in the delivery of social services. At the same time, the $600 million in concessions from labor were dropped as part of the gap-closing plan and instead became a contingency (along with another $1 billion in spending reductions) in case the state did not take the requested steps.

Economic Update. Although the end of major combat in Iraq has boosted consumer confidence, other economic data are less encouraging. At the national level, modest increases in real gross domestic product (GDP) have not been accompanied by job growth. The unemployment rate rose to 6.0 percent in April, while payroll employment dropped by 48,000 from the previous month's total.[1] Since January of this year, 525,000 jobs have been lost nationally.

While the city's unemployment rate fell to 8.5 percent in March, data on jobs located in the city are less encouraging. Payroll employment in March was down 61,500 (1.7 percent) from 12 months earlier, while securities industry employment was down 8,200 (4.8 percent).

Economic Outlook. IBO expects the national recovery to strengthen in the second half of calendar year 2003 and the local recovery to pick up steam by mid-2004. At the national level, real GDP is projected to grow at a moderate rate of 2.5 percent this year and a stronger 3.4 percent in 2004.

Strong job growth is not expected until next year, however. IBO projects payroll employment to grow nationally at an anemic rate of 0.4 percent this year, and then grow by nearly 2 percent in 2004 and 2005.

New York City's recovery is expected to trail the national recovery. IBO projects that the city will lose 37,900 jobs this calendar year, and then experience very moderate job growth of 0.8 percent in 2004. Stronger job growth is expected locally for 2005 and 2006, 1.6 percent and 1.3 percent, respectively.

Tax Revenue Forecast. With recovery of the local economy now expected to occur later than anticipated, the outlook for tax revenue has worsened. Since last fall, IBO's baseline tax revenue forecast for fiscal year 2004—which excludes the Albany tax provisions—has fallen by $1.3 billion, although our outlook remains $327 million higher than the Mayor's. Thanks in large part to a full year of the property-tax rate increase, total tax revenues in 2004 will grow by 6.9 percent from the 2003 level to reach $24.6 billion, finally surpassing the pre-recession peak of $23.2 billion in 2001. With the property-tax rate increase fully phased in, tax revenue growth is expected to slow after 2004, averaging 5.1 percent annually through 2007.

The 2004 outlook for the city's business income taxes—heavily influenced by projections of Wall Street profitability as well as corporate profits in the broader economy—has been scaled back by nearly 11 percent since the fall. Although the outlook has been reduced, business income taxes are still expected to show growth of 5.5 percent from 2003's dismal level. With economic recovery expected in the second half of calendar year 2004, business income tax revenue growth is expected to pick up in fiscal years 2005 through 2007, averaging 7.0 percent annually. Nevertheless, business tax collections in 2007 will still be almost $200 million below their 2001 peak.

With job losses pulling down wages and a substantially reduced projection for capital gains realizations in 2003, IBO's personal income tax outlook has also shrunk since last fall. Revenues for 2004 are expected to total $4.7 billion, 5.2 percent higher than in 2003. Despite the expected growth in 2004, revenue will still be $1.0 billion less than the $5.7 billion collected in 2001. Even with anticipated average annual growth in 2005 through 2007 of 7.3 percent, personal income tax revenue is not expected to exceed its 2001 level until 2007.

The outlook for sales tax revenue has changed only modestly since the fall. IBO now expects revenue to grow 3.1 percent in 2004 to $3.7 billion. This would put sales tax revenue slightly above their 2001 level. Although continuing concern over the employment situation among consumers and lingering hesitancy among potential travelers to the city will curb growth in the near term, IBO expects sales tax revenue growth to quicken. After 2004, revenue is expected to rise 6.0 percent annually, with collections reaching $4.4 billion by 2007.

The second half of the 18.5 percent property-tax rate increase will take effect for 2004. This accounts for two-thirds of the 14.7 percent growth in the levy forecast from 2003 to 2004. The balance is due to increased assessments, with the rapid appreciation of property values in the late 1990s through 2002 still contributing to assessment growth for many properties. With this pipeline running out, growth in assessments and property tax revenue is expected to slow in the coming years. IBO projects that property tax revenue after accounting for refunds, abatements, and prior year collections will be $11.2 billion in 2004, 12.3 percent higher than in 2003. With slower assessment growth, revenue growth will average 3.9 percent annually from 2004 through 2007.

Expenditures. The Mayor's plan for 2004 includes further reductions in agency spending. By IBO's estimate, under the November, January and April Programs to Eliminate the Gap (PEGs), spending of city funds by agencies would fall by a combined $1.9 billion. Over half of the spending reductions—$1.04 billion—would come from the elimination or cutback of specific programs and services or other unspecified reductions. Some examples from the Executive Budget: the Brooklyn and Queens zoos would be shut, 12 out of 30 child health clinics would be closed, the frequency of curbside trash collection would be reduced, most branch libraries would be open less than five day a week, and the police department would eliminate Operation Condor.

The Mayor expects restructuring, or consolidation, of social service programs to save $75 million. The savings would be achieved primarily by replacing city tax-levy dollars with federal funds, reducing spending on administration, and by substituting less expensive services for more costly programs.

Spending Will Grow Faster than Revenue. Despite the cutback in spending by operating agencies, total city expenditures will rise at more than twice the rate of revenue growth through 2007. While IBO projects that revenue will rise at an average annual rate of 1.6 percent from 2003 through 2007 (excluding the Legislature's recent actions), spending will grow at an average annual rate of 3.7 percent over the same period. IBO projects that under the Mayor's plan expenditures would grow from $44.3 billion in 2003 to $45.9 billion in 2004 (3.6 percent), and rise to $51.2 billion in 2007.

The rise in spending is fueled by growing debt service and pension and fringe benefit costs for city workers, which will rise by a combined $2.9 billion in 2004. IBO anticipates these costs will grow at an average annual rate of 18.1 percent through 2007. All other agency spending, including state and federal dollars, will decline by $1.4 billion in 2004. From 2003 through 2007, IBO expects this agency spending to rise at an average annual rate of just 0.2 percent.

THE MAYOR'S ALBANY REQUEST

The Mayor's $2.7 billion in requested state actions included measures that either require state approval or that provide direct aid to the city. The largest part was the reform of the city's personal income tax to include commuters. Under the Executive Budget version of this proposal, the amount of revenue expected from this extension of the personal income tax grew by $400 million to total $1.4 billion.

The plan also included $753 million for education aid, consisting of $478 million to maintain state funding for class-size reduction in kindergarten through third grade, to continue the universal pre-kindergarten program, other education aid, as well as $275 million towards the cost of the extended school day negotiated as part of the teachers' contract last year.

The Executive Budget also included a request of $252 million in "other state gap-closing initiatives," such as authorizing the sale of additional taxi medallions, imposing a surcharge on absentee landlords who own one-to-three family homes, and raising Department of Finance fines. Additionally, the Albany request included a takeover of the private bus lines subsidized by the city and reduction in the city's subsidy to New York City Transit to save $200 million. The final part of the request was for $100 million to restore other proposed state cuts.

THE ALBANY AID PACKAGE

Earlier this month the state Legislature passed a set of bills covering statewide funding restorations and tax changes and providing aid specifically for New York City. As presented in the Executive Budget, about $850 million of the $3.8 billion shortfall resulted from funding cuts and other proposals contained in the Governor's statewide budget. The Legislature restored much of these cuts and took other actions that effectively provide the city with the revenue necessary to meet the state's share of the Mayor's gap-closing plan.

Much of the Legislative aid diverges widely from the Mayor's requests. Rather than giving the city the ability to tax commuters in order to raise $1.4 billion, the Legislature authorized the city to raise taxes on its *own residents* through a temporary personal income surcharge, a three-year 0.125 percent increase in the local sales tax, and closing a variety of tax loopholes. But in another significant departure from the Executive Budget requests, the state's assumption of the remaining Municipal Assistance Corporation debt will save the city $500 million annually through 2008.

Declining Value. Significant portions of the aid package provide only short-term benefits to the city. The personal income tax surcharge phases out over three years. The sales tax increase is temporary, scheduled to end by 2007 as well. The aid package's sale of taxi medallions will provide $65 million annually before ending after three years. And the refinancing of bonds by the Battery Park City Authority will provide a one-time $165 million benefit in 2004. Much like in other years, the education and health care restorations are only for 2004.

CONTINGENCIES

As IBO publishes this report to meet its City Charter mandated deadline, the fate of the Albany aid remains uncertain. The Governor has threatened to veto the bills, although he could choose to veto only portions of them. If the Governor vetoes any parts of the bills, the Legislature would need to vote by a two-thirds margin to override the vetoes.

Assuming the Albany aid package remains as passed by the Legislature, the Mayor would have sufficient tax revenue and state aid to avoid implementing his $1 billion contingency plan. This plan contains numerous programmatic cuts along with the layoff of 10,000 municipal workers. Another contingency measure includes $600 million in concessions from municipal labor. The Executive Budget contains no funding for new city labor contracts, all of which will expire by June 30, and the Mayor has indicated there will be no raises that are not paid for with productivity initiatives.

The Albany aid package does not affect the $620 million in city agency cuts and revenue initiatives and $75 million in savings from the restructuring of some social services that also are part of the Executive Budget's gap-closing plan. These measures, or actions with a similar value, are still required in order to eliminate the city's $3.8 billion budget shortfall. IBO

END NOTE

[1] All U.S. labor market and New york City unemployment data reported here are seasonally adjusted. Local payroll employment data are not adjusted.