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Testimony of Ronnie Lowenstein, Director of the New York City Independent Budget Office To the New York City Council Finance Committee On the Mayor's Preliminary Budget for 2011

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Good afternoon Chairman Recchia and members of the Finance Committee. My name is Ronnie Lowenstein, and I am director of the New York City Independent Budget Office. I am pleased to be here today to present IBO's just completed economic and tax revenue forecast along with some details from our ongoing analysis of the Mayor's Preliminary Budget for 2011 and four-year Financial Plan.

I am also pleased—and more than a little surprised—to sit here today and be able to say that New York City's fiscal picture looks better than most anyone would have expected 12 months ago. Based on IBO's latest revenue and expenditure projections under the Mayor's January budget plan, we estimate the city will end this fiscal year with a surplus of just under $3.0 billion. With the expectation that this surplus will be used to prepay some of next year's expenditures, we estimate 2011 will end with a small surplus that would be used to prepay upcoming expenditures. Our projection of a $2.6 billion shortfall for 2012 is nearly $550 million less than the Bloomberg Administration's estimate in January.

The city's relative fiscal health in the wake of the worst nationwide economic crisis since the 1930s is the product of a variety of factors such as the federal bailout of Wall Street and the Federal Reserve Bank's ongoing monetary stimulus, changes in the composition of employment in the city, and actions taken by this Council and the Mayor to control spending and raise revenues. But the city's ability to maintain its current position rests on two shaky pillars: the national economy and the even creakier New York State budget.

The U.S. economic recovery, which began in the second half of calendar year 2009, remains fragile. While there are positive signs nationally such as increases in U.S. output and temporary hiring and hours worked, the continued weakness in the labor and housing markets and the winding down of federal stimulus spending could undercut the recovery and weaken the economic and fiscal outlook for the city.

Absent a renewed downturn or "double dip" nationally, the current recession will be for New York City one of the *mildest* since World War II. IBO is now projecting an employment loss of

156,000 jobs (4.1 percent of total city employment) from the third quarter of 2008, when employment last peaked, through the first quarter of this year. While these job losses have had consequences for the city and particularly for the individuals and families most directly affected, the number of jobs lost was actually considerably below what IBO and other forecasters had expected a year ago and well below the losses suffered during the last two recessions.

The relative mildness of the recession in the city is surprising, especially given that the national downturn was precipitated by the implosion of the financial industry, which is centered here. There are a number of reasons the recession has not hit the city as hard as expected. Among the most important are the federal bailout of major financial firms and the firms' low borrowing costs that have helped return the industry to unexpected profitability and also helped limit financial industry job losses. Additionally, employment did not drop as steeply in business services as it had in prior recessions. And although local real estate values have declined, they have not fallen at the catastrophic rates seen in some parts of the country.

Another set of reasons for the comparatively mild recession here is longer-term structural changes in the makeup of local employment. Although manufacturing declined precipitously nationwide, by calendar year 2008 the city's manufacturing sector made up such a small share of total employment that the additional losses did not have a major effect on overall employment here. Conversely, health and education jobs comprise a growing share of New York City employment, and these jobs have proven to be comparatively recession-proof.

In fact, as employment begins to grow again in the city, IBO expects the health and education sectors— now almost a quarter of private-sector employment here—to lead the way. We expect that job losses will end in the first quarter of this calendar year, followed by modest job growth of 14,000 during the rest of this year and by an additional 103,000 over the next two years. The health and education sectors will generate nearly 31 percent of these new jobs through the middle of 2013, when city employment is expected to return to the peak of 3.8 million jobs before the recession.

Just as job losses have not been as steep as anticipated, the falloff in tax revenues has also not been as sharp as expected. Last year, IBO was projecting two years of declining tax revenues. While fiscal year 2009 did indeed experience a $2.7 billion decline in tax revenues from 2008, we now expect tax revenues to rise by 3.9 percent to $36.2 billion this year. But the rise in 2010 is the result of increases in the property and sales taxes as well as the elimination of homeowner rebates. Without these changes, we estimate tax revenues would be $1.8 billion lower this year and would have fallen for the second consecutive year.

As job growth and the local economy pick up, we estimate tax revenues will grow by $2.1 billion to $38.2 billion in fiscal year 2011. This growth will be spread fairly evenly among all the major taxes, with a proposal to extend the sales tax to aviation fuel and another to include co-ops under the mortgage recording tax play comparatively minor roles in the projected increase.

From 2010 through 2014, IBO projects total tax revenues will grow from $36.2 billion to $45.9 billion, an average annual increase of 6.1 percent, while city-funded spending, adjusted for the use of the surplus to make prepayments for the upcoming year, will rise over the same period from $44.6 billion to $52.7 billion, an average annual increase of 4.3 percent. Expenditure growth has been tempered by a series of agency actions that began in April 2007, including nearly $484.0 million in gap closers proposed by the Mayor for this year and $1.1 billion for next year.

Under the Mayor's Financial Plan, total spending for most city services would remain relatively flat. As in past years, growth in spending on pensions and fringe benefits for public employees is expected to outpace the overall rate of city expenditure growth. Likewise, debt service, adjusted for prepayments, is also expected to grow faster than most other spending.

Another exception is spending on public assistance, which is expected to rise sharply this fiscal year and remain higher than in the recent past. Public assistance expenditures are projected to increase from $1.2 billion in 2009 to $1.6 billion this year and a similar level in 2011. A number of factors are fueling this growth such as a rise in the welfare caseload from 334,000 in September 2008 to 358,000 in December 2009, the expansion of the Mayor's Advantage Rental Assistance program, and a state-mandated increase in the welfare grant.

Conversely, spending on city schools is not projected to rise to previously expected levels. We now project school spending to be $18.5 billion in 2011, about $500 million less than anticipated last spring. IBO projects that school spending will then drop by about $250 million in 2012. These changes are due to a combination of city cuts and a drop in state aid that was part of Albany's midyear budget reductions.

New York State's fiscal distress poses significant uncertainty for the city's budget condition. The Governor's proposed budget eliminates at least $750 million in state aid, including about $440 million in education aid and more than $300 million in unrestricted aid. The Mayor's Preliminary Budget for 2011 and four-year Financial Plan does not take into account the Governor's proposals, although the Bloomberg Administration released a contingency plan that illustrates the potential effects of the Governor's proposals.

While there are ample reasons for concern about the sustainability of the national recovery and the effects a double-dip recession may have on the city's fiscal condition, actions by the state may pose the greatest near-term risk for the Mayor's budget plan.

Thank you and I would be glad to answer any questions you may have.

Total Revenue and Expenditure Projections

Dollars in millions

	2010	2011	2012	2013	2014	Average Change
Total Revenues	$63,194	$64,148	$66,381	$70,026	$72,470	3.5%
Total Taxes	*36,186*	*38,241*	*40,674*	*43,580*	*45,860*	*6.1%*
Total Expenditures	63,194	64,026	69,001	71,777	73,555	3.9%
IBO Surplus/(Gap) Projections	**-**	**$123**	**$(2,620)**	**$(1,751)**	**$(1,085)**	
Adjusted for Prepayments and Discretionary Transfers:						
Total Expenditures	*$65,875*	*$66,984*	*$69,001*	*$71,777*	*$73,555*	*2.8%*
City-Funded Expenditures	*$44,576*	*$46,594*	*$48,920*	*$51,078*	*$52,716*	*4.3%*

SOURCE: IBO.

NOTES: IBO projects a surplus of $2.958 billion for 2010, $75 million above the Bloomberg Administration's forecast. The surplus is used to prepay some 2011 expenditures, leaving 2010 with a balanced budget. Estimates exclude intra-city revenues and expenditures. Figures may not add due to rounding. City funded expenditures exclude state, federal and other categorical grants, and interfund agreement amounts.

IBO Expenditure Projections

Dollars in millions

	2010	2011	2012	2013	2014	Average Change
Health & Social Services						
Social Services						
Medicaid	$5,095	$5,791	$6,260	$6,440	$6,625	6.8%
All Other Social Services	3,136	3,092	3,128	3,116	3,116	-0.2%
HHC	11	96	122	122	122	n/a
Health	1,695	1,604	1,617	1,620	1,626	-1.0%
Children Services	2,721	2,568	2,571	2,573	2,573	-1.4%
Homeless	770	711	701	701	701	-2.3%
Other Related Services	692	513	481	481	481	-8.7%
Subtotal	**$14,120**	**$14,374**	**$14,880**	**$15,053**	**$15,244**	**1.9%**
Education						
DOE (excluding labor reserve)	$18,214	$18,462	$18,215	$18,987	$19,340	1.5%
CUNY	714	678	664	665	665	-1.8%
Subtotal	**$18,928**	**$19,140**	**$18,879**	**$19,651**	**$20,005**	**1.4%**
Uniformed Services						
Police	$4,512	$4,362	$4,399	$4,373	$4,373	-0.8%
Fire	1,749	1,639	1,625	1,621	1,619	-1.9%
Correction	1,019	1,019	1,022	1,018	1,018	0.0%
Sanitation	1,283	1,354	1,383	1,382	1,438	2.9%
Subtotal	**$8,563**	**$8,374**	**$8,429**	**$8,394**	**$8,449**	**-0.3%**
All Other Agencies	**$6,743**	**$6,495**	**$6,576**	**$6,655**	**$6,720**	**-0.1%**
Other Expenditures						
Fringe Benefits (excluding DOE)	$3,730	$3,834	$3,825	$4,816	$5,168	8.5%
Debt Service	3,404	2,578	6,286	6,579	6,815	n/a
Pensions	6,636	7,143	7,570	7,716	7,825	4.2%
Judgments and Claims	663	717	775	835	898	7.9%
State Education Building Aid (TFA)	250	319	431	518	609	n/a
General Reserve	200	300	300	300	300	n/a
Labor Reserve:						
Education	217	350	369	367	367	n/a
All Other Agencies	271	338	457	552	707	n/a
Expenditure Adjustments	(531)	64	225	340	449	n/a
TOTAL Expenditures	**$63,194**	**$64,026**	**$69,001**	**$71,777**	**$73,555**	**3.9%**

SOURCE: IBO.

NOTES: Debt service expenditures, if adjusted for prepayments, would grow at an annual average rate of 6.9 percent from 2010-2014. Similarly, fringe benefits would grow at an annual average rate of 6.4 percent. Expenditure adjustments include energy, lease, prior year payable adjustments and non-labor inflation estimates. Estimates exclude intra-city expenses. Figures may not add due to rounding.

IBO Revenue Projections

Dollars in millions

	2010	2011	2012	2013	2014	Average Change
Tax Revenue						
Property	$16,023	$16,937	$17,590	$18,107	$18,571	3.8%
Personal Income	6,900	7,377	7,865	9,029	9,800	9.2%
General Sales	5,016	5,285	5,659	6,070	6,446	6.5%
General Corporation	2,059	2,463	2,879	3,182	3,388	13.3%
Unincorporated Business	1,494	1,627	1,720	1,863	2,034	8.0%
Banking Corporation	907	625	820	1,010	1,087	4.6%
Real Property Transfer	615	690	771	871	966	12.0%
Mortgage Recording	390	536	622	683	753	17.9%
Utility	400	411	424	438	452	3.1%
Hotel Occupancy	341	352	361	343	353	0.8%
Commercial Rent	585	584	588	600	611	1.1%
Cigarette	97	95	94	92	92	-1.3%
Other Taxes, Audits, and PEG's	1,358	1,042	1,045	1,044	1,045	-6.4%
Total Taxes	**$36,186**	**$38,023**	**$40,438**	**$43,332**	**$45,596**	**5.9%**
Tax Proposals						
Aviation Fuel	-	$158	$171	$178	$189	n/a
Co-op Mortgage Recording Tax	-	60	65	70	75	n/a
Total Taxes Including Tax Proposals	**$36,186**	**$38,241**	**$40,674**	**$43,580**	**$45,860**	**6.1%**
Other Revenue						
STaR Reimbursement	$905	$944	$995	$1,078	$1,080	4.5%
Miscellaneous Revenues	4,479	4,248	4,306	4,344	4,366	-0.6%
Unrestricted Intergovernmental Aid	340	340	340	340	340	0.0%
Disallowances	(15)	(15)	(15)	(15)	(15)	0.0%
Total Other Revenue	**$5,709**	**$5,517**	**$5,626**	**$5,747**	**$5,770**	**0.3%**
Total City Funded Revenue	**$41,895**	**$43,758**	**$46,300**	**$49,327**	**$51,631**	**5.4%**
State Categorical Grants	$11,454	$11,808	$12,457	$13,106	$13,245	3.7%
Federal Categorical Grants	7,978	6,875	5,980	5,949	5,948	-7.1%
Other Categorical Aid	1,369	1,236	1,194	1,194	1,196	-3.3%
Interfund Revenues	497	471	450	450	450	-2.5%
TOTAL Revenues	**$63,194**	**$64,148**	**$66,381**	**$70,026**	**$72,470**	**3.5%**

SOURCE: IBO.

NOTES: Estimates exclude intra-city revenues. Figures may not add due to rounding.

Pricing Differences Between IBO and the Bloomberg Administration

Items that Affect the Gap

Dollars in millions

	2010	2011	2012	2013	2014
Gaps as Estimated by the Mayor	**-**	**-**	**$(3,160)**	**$(3,665)**	**$(3,849)**
Revenues					
Taxes					
Property	(11)	22	57	365	692
Personal Income	83	57	32	778	1,133
General Sales	135	163	298	410	471
General Corporation	(229)	(177)	(14)	67	102
Unincorporated Business	(124)	(33)	(14)	43	116
Banking Corporation	213	(24)	67	154	188
Real Property Transfer	26	50	80	96	117
Mortgage Recording	9	71	84	42	9
Utility	6	13	13	17	18
Hotel Occupancy	(8)	(7)	1	6	9
Commercial Rent	7	33	40	43	43
Cigarette	1	1	2	2	4
	108	169	646	2,022	2,901
Tax Proposals					
Aviation Fuel	-	(11)	(12)	(13)	(17)
Co-op Mortgage Recording Tax	-	10	7	(1)	(3)
STaR Reimbursement	(4)	2	16	24	25
Total Revenues	**$103**	**$170**	**$656**	**$2,031**	**$2,906**
Expenditures					
Public Assistance	(3)	(25)	(30)	(30)	(30)
Homeless	-	(7)	(7)	(7)	(7)
Police Overtime	(25)	(75)	(75)	(75)	(75)
Correction (including overtime)	-	(15)	(5)	(5)	(5)
Campaign Finance	-	-	-	-	(25)
Total Expenditures	**(28)**	**(122)**	**(117)**	**(117)**	**(142)**
Total IBO Pricing Differences	**$75**	**$48**	**$539**	**$1,914**	**$2,764**
IBO Prepayment Adjustment 2010/2011	**(75)**	**75**	**-**	**-**	**-**
IBO Surplus / (Gap) Projections	**-**	**$123**	**$(2,620)**	**$(1,751)**	**$(1,085)**

SOURCE: IBO.

NOTES: Negative pricing differences (in parentheses) widen the gaps, while positive pricing differences narrow the gaps. Figures may not add due to rounding.