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Testimony of Ronnie Lowenstein
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To the New York City Council Finance Committee
On the Mayor's Executive Budget for 2015 and Financial Plan

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Good afternoon Chairwoman Ferreras and members of the committee. My name is Ronnie Lowenstein and I am director of the New York City Independent Budget Office. Thank you for the opportunity to discuss with you the main findings of IBO's latest economic forecast for the city and our estimates of tax collections and spending under the framework of the Mayor's Executive Budget for 2015 and four-year financial plan.

Contrary to the assertions of some fiscal observers, the city's budget gaps are not ballooning. By historical standards, the budget shortfalls we anticipate are relatively modest. These shortfalls—smaller than the budget gaps estimated by the Mayor—are largely the result of our expectation that tax revenues will be higher than those projected by the de Blasio Administration. Under our forecast, city tax revenues will grow at a moderate but steady rate. And even after accounting for the costs of the anticipated settlement with the municipal labor unions, IBO expects that spending will grow at a slower rate than revenues over the 2014 through 2018 period.

IBO projects that the city will end the current fiscal year, for which just three weeks remain, with a surplus of \$1.8 billion, \$131 million more than estimated by the de Blasio Administration. The Mayor has projected a balanced budget for next fiscal year. In contrast, we anticipate that the upcoming year will end with a surplus of just over \$830 million. For 2016, we project a shortfall of \$1.6 billion, or about \$930 million less than the budget gap expected by the Mayor. Our budget gap estimates for 2017 and 2018 are also substantially smaller than those projected by the Mayor.

Let me provide some context for the budget gaps we project. While \$1.6 billion is a large number to most of us, it is a comparatively small share of city-generated revenue: 2.9 percent of tax collections, fines, fees and other locally generated revenues based on IBO's projections for 2016. For some perspective on this number, we reviewed Executive Budgets from the past two decades, covering the five terms of Mayors Giuliani and Bloomberg. We found that for the comparable point in time—two years beyond the then-current fiscal year—projected budget gaps averaged 7.4 percent of city-generated revenues. The budget gap estimates for the ensuing fiscal years were similarly several times

greater as a share of city-generated revenue than our estimates of shortfalls under the de Blasio Administration's financial plan.

The reason we project a surplus in 2015 and smaller budget shortfalls than the Mayor in the subsequent years is our estimates of higher tax collections. IBO's tax revenue forecast exceeds the Mayor's estimates by nearly \$800 million in 2015, \$1.1 billion in 2016, and \$2.3 billion by 2018.

Our higher tax estimates are not the result of an optimistic outlook for the local economy. IBO projects that local employment growth will slow from a gain of about 83,000 jobs last year to just below 76,000 this year. For 2015 through 2018, we expect job growth to average 56,400 per year—disappointing compared with the average gain of nearly 86,000 jobs the city enjoyed over the past three years. Our forecast assumes that a substantial share of those new jobs will be in relatively low-paying industries such as education and health care, where the average wage was \$50,000 in 2013, and leisure and hospitality, where wages averaged \$42,100.

We expect Wall Street to play a smaller role in the city's growth than it has in recent years, a far cry from the driving force that propelled the last expansion. IBO forecasts that Wall Street profits will remain fairly flat, averaging about \$15 billion a year over 2014 through 2018. Wall Street is expected to generate only about 1,200 new jobs a year over that same period, 2 percent of our projected increase in local jobs but 15 percent of the total increase in wages and salaries.

Nor are our year-to-year expectations for tax revenue growth extraordinary. IBO forecasts that tax revenues will rise at an average rate of 4.2 percent from 2014 through 2018, growing from \$47.3 billion this year to \$55.8 billion by the end of the financial plan period. Once again using history to put these numbers in context, our projected annual growth rate is well below the average increase of more than 7 percent a year in the three years immediately following the 2008-2009 recession and roughly a third of the almost 12 percent average during the boom years of 2003 through 2007.

The moderate rate of growth we anticipate in tax revenues is matched by a similarly moderate forecast of spending growth. IBO's projection for spending increases incorporates the de Blasio Administration's estimates of the cost of a contract settlement with the municipal unions. We expect that total city expenditures will grow at an average rate of 2.7 percent a year, from \$76.2 billion to \$84.7 billion in 2018 after adjusting for the use of the projected 2014 surplus to prepay some 2015 expenses. Looking just at city-funded expenditures and again adjusting for the use of the 2014 surplus, we expect spending to grow at an average annual rate of 3.4 percent and rise from \$54.8 billion this year to \$62.7 billion in 2018.

Other than the \$5.6 billion in new funding added to the financial plan to cover the costs of the expected labor pact, most of the newly proposed spending initiatives are relatively small such as the one-time, \$70 million in aid for the housing authority or the roughly \$40 million a year to implement Vision Zero. Two other comparatively large initiatives—the expansions of pre-K (\$300 million) and middle school after school-programs (\$145 million)—are being funded with state dollars.

As in the past, there are several areas where IBO's spending projections differ from those of the de Blasio Administration. The single largest difference in 2015 is our expectation of \$45 million in additional spending by the education department. That estimate includes \$28 million in city funds needed to meet our projection of higher enrollment at charter schools than assumed under the Mayor's budget. We also anticipate that federal Medicaid reimbursements for certain special education services will fall \$17 million short of the Mayor's projection, requiring the city to make up the difference. By 2018, we anticipate that the education department will need \$326 million more than currently budgeted—\$279 million for charter school enrollment growth (based only on schools already open or approved for opening) and the rest to cover a continued shortfall in Medicaid reimbursements.

While our latest economic forecast and tax revenue and spending projections point to a relatively positive fiscal outlook for the city, there are ample reasons for caution. On the economic and tax revenue side, there are legitimate reasons to question whether the local economy can continue to add jobs at the pace we project without being led by Wall Street. On the spending side of the budget equation, there are a number of potential risks. For example, it is not clear that all unions will accept the terms of the proposed labor settlement—and in particular the police and fire unions have vociferously objected to the pattern ratified by the teachers' union. The ongoing fiscal problems faced by the New York City Housing Authority and the Health and Hospitals Corporation could also lead to mounting pressure on the city to provide additional aid.

Again, thank you for the opportunity to be here today and I am glad to answer any questions you have about IBO's review of the Mayor's budget plan and our economic forecast.

IBO's full, 17-page report on the Mayor's Executive Budget, including details of our latest economic forecast and tax revenue and spending projections, is available here: <http://bit.ly/1kaP0v4>.