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Testimony of Ronnie Lowenstein
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To the New York City Council Committee on Finance
On the Mayor's Executive Budget for 2018

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Good afternoon Chair Ferreras-Copeland and members of the City Council. I am Ronnie Lowenstein, director of the city's Independent Budget Office. As always, I appreciate the opportunity to come here and present some of the key findings from our latest economic and tax revenue forecast and re-estimate of spending under the Mayor's Executive Budget.

Everyone in this Council chamber is acutely aware that just two days ago the Trump Administration released its budget proposal for the upcoming federal fiscal year—a plan that if adopted as presented would have far-ranging consequences for the city. Given initial responses in Washington, though, it appears highly unlikely that the President's budget will be adopted in its current form. Because of the breadth and depth of the spending and tax policy changes contained in the Trump plan, it is also very unlikely that a new budget will be completely adopted by October 1. And once it is adopted, it will take time—in some cases years—before the effects are fully felt in the city. Our projections and analysis were completed before the Trump budget was released and so do not reflect its potential effects. But as our report makes clear, the potential changes coming from Washington cast a long shadow of uncertainty over all our estimates.

With this important caveat in mind, I will begin outlining our current estimates by looking back at my testimony in March when I appeared before you to present our forecast and comments on the Mayor's Preliminary Budget. In March, I noted that our forecast for tax revenues for the current year and next year were very similar to those of the Mayor's Office of Management and Budget. Since then the differences have widened: our tax revenue projections for 2017, and especially for 2018, have increased while those of the Mayor's office have declined.

For 2017, this means we anticipate the city will end the current fiscal year with a surplus of just over $4 billion, $310 million more than the de Blasio Administration assumes. Our estimate of a bigger surplus is the product of our forecast of $220 million more in tax revenue coupled with about $90 million less in spending.

Looking ahead to fiscal year 2018, the divergence widens. IBO's tax revenue forecast exceeds the de Blasio Administration's projection by $1.1 billion. This additional revenue is offset by our somewhat higher expectations for spending. As a result, we estimate the city will end 2018 with a surplus of $943 million under the proposals presented in the Executive Budget. As required, the Mayor presents a balanced budget for 2018.

Assuming our estimated 2018 surplus is used to prepay some of the next year's expenses, we project a budget shortfall of $1.9 billion in 2019—roughly half the size of the gap forecast by the Mayor's budget office. Put into context, that is just under 3 percent of city-funded spending, an order of magnitude the city has routinely managed in years past.

Turning back again to when I was here in March, I also expressed concern that recently sluggish growth in tax revenue would undermine a key tool the city has used to address future year budget gaps. The city's preference for cautious revenue forecasts typically results in greater-than-expected increases in tax collections, building up surpluses that are used to prepay some expenses for the upcoming fiscal year—thereby reducing or eliminating projected budget shortfalls. Although tax revenues for 2017 will exceed the levels expected at the time the budget was adopted last spring, the additional collections fall far short of what is needed to eliminate the gap for 2018.

With less robust growth in tax collections, the de Blasio Administration has turned towards a savings plan that would reduce projected spending in 2017 and 2018 by $2.8 billion. The savings plan has been the target of some criticism for leaning too heavily on funding swaps, job vacancy accruals, and re-estimates of program costs rather than productivity savings. For example, one of the largest sources of savings is from re-estimates of debt-service costs because the city's financial plans have repeatedly assumed interest rates will be substantially higher than the actual rates turn out to be.

Such "naturally occurring" debt-service savings were evident in the Bloomberg Administration's budget actions as well. Likewise, savings from eliminating budgeted funding for positions that are vacant, funding swaps, and other re-estimates were common in the Program to Eliminate the Gap, or PEG plans, put forth by prior mayors. While not disputing the importance of pushing agencies to operate more efficiently, these other measures have also long been part of mayoral savings plans.

Closely related to the Executive Budget's savings plan are the proposals for new or increased spending. Overall, we estimate that when adjusted for the use of surpluses to make prepayments for upcoming year expenses, city-funded spending will grow at an annual average rate of 3.9 percent over the financial plan period—nearly a percentage point below our forecast of annual average growth in tax collections.

Next fiscal year coincides with citywide elections, so it is not surprising that there are some new and costly initiatives in the Mayor's budget. But the immediate effect on city spending from these proposals is relatively limited.

Two of the very biggest in dollar terms—$1.9 billion to deepen the subsidies for the Mayor's housing plan in order to make more apartments available to lower income households and $1.1 billion to begin the closing of Rikers Island—come with relatively little near-term effect on the expense budget because they are capital budget expenditures. Additionally, the Mayor proposes to repurpose capital dollars that had previously been budgeted for Department of Correction projects.

Looking just at the operating budget, perhaps the most high-profile new initiative is 3-K for All. It starts in relatively modest fashion with an expenditure of $17 million in two school districts in 2018 and expands to eight districts in 2021. According to the Mayor's plan, a full rollout to all 32 school districts would occur only with sufficient state or federal funds.

There is another portion of the expense budget that has been questioned by some fiscal observers, including a few in this room: the adequacy of the reserves in the budget. In addition to the roughly $4 billion in the Retiree Health Benefits Trust, the Mayor's financial plan now includes $1.25 billion in reserve for each year, 2018 through 2021. These are dollars that show up as an expense but in fact have no specific allocation—they are there in case a problem arises, such as a slowing economy that causes lower-than-expected tax collections or cutbacks in anticipated aid from Washington or Albany. IBO sees reserves as temporary plugs, funds to help a jurisdiction get through the initial phase of a shortfall and provide time to make necessary changes in a budget for the longer term. We believe that the financial plan has enough of a cushion to provide this Council, the Mayor, and other elected officials with the time necessary to make the difficult budgetary decisions in the face of a downturn or steep federal cutbacks.

While it is essential that the city maintain adequate reserves, it is worth recalling that our reserves can also become targets. Just last year, Albany looked at the city's relatively strong fiscal condition and aimed several proposals in this direction that would have cost the city hundreds of millions of dollars annually. Two of the proposals were dodged: increased city payments for the city university system and for Medicaid. A third proposal, that the city up its contribution to the Metropolitan Transportation Authority's capital plan, was ultimately agreed to by the city.

Thank you again for the opportunity to be here today. IBO's full report on the Mayor's Executive Budget, which we released on May 15, presents many more details on our spending projections along with much more information describing our economic and tax revenue forecasts. We have copies with us here and they are, of course, also available on our website at http://bit.ly/2qnG2St. I would be pleased to answer any questions you may have at this time.