IBO

New York City Independent Budget Office

Fiscal Brief

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Analysis of the Mayor's Executive Budget for 2009

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NEW YORK CITY'S NEAR-TERM FISCAL PICTURE does not look as grim as some observers fear. Although IBO's latest forecast indicates that the city will lose 59,400 jobs between now and the middle of calendar year 2009 and that tax revenues will fall by nearly $2 billion next fiscal year, we project no budget shortfalls in 2009 and 2010.

The main reasons for this near-term balance, despite the slowing local economy, are fourfold: 1) IBO projects the city will end the current fiscal year with a surplus of $4.6 billion, an amount sufficient to help close the underlying shortfalls in 2009 as well as help with 2010 and 2011; 2) the Mayor has proposed annual spending reductions of more than $1 billion; 3) the decision to use a portion of resources from last year and this year, over and above the reported surpluses, for early retirement of debt has also eased the fiscal pressure for the next two years; and 4) IBO's projection of tax revenues for 2010 is $1.2 billion higher than the Mayor's.

The picture dims somewhat after 2010 even as IBO expects a moderate local economic recovery and modest growth in tax revenues. With spending rising at a considerably faster pace than revenues and no sizable surplus to cover the gap between 2011 revenues and expenditures, IBO projects a budget shortfall of $3.3 billion in 2011 and nearly $4.3 billion in 2012, 6.9 percent, and 8.7 percent of city-funded revenues respectively.

TAXES AND THE ECONOMY

U.S. Economy. IBO's forecast assumes that the U.S. economy entered a recession earlier this year. The downturn is expected to be mild and brief, with growth resuming before the end of the year. Our outlook for 2009 and beyond is for moderate growth through at least 2012.

IBO expects that final data on U.S. gross domestic product (GDP) will show a decline in the first half of 2008, followed by a sharp rebound in the second half of the year. On an annual basis, GDP growth (adjusted for inflation) is expected to be just 1.5 percent for 2008, accelerating to 3.3 percent in 2009 and 3.5 percent in 2010. U.S. employment is expected to decline for the first three quarters of 2008 before turning up in the last quarter. IBO forecasts essentially no U.S. employment growth (0.2 percent) for 2008 as a whole, and only modest employment gains (0.9 percent) in 2009. Healthier employment growth of 1.7 percent and 1.4 percent is projected for 2010 and 2011, respectively. The economic slowdown and eventual tightening of monetary policy are projected to bring inflation down from 3.0 percent this year to 2.0 percent in 2009.

Local Economy. Although the recent economic data for New York City are ambiguous, IBO is forecasting that a local recession is imminent, if it has not begun already. While we expect the city to enter the recession later than the rest of the country, the local downturn is expected to be longer, with recovery not occurring until the second half of 2009.

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While the recession in the rest of the country has been sparked by the collapse of the bubble in housing with the largest impacts seen in housing-related and manufacturing sectors, the downturn in the city is focused on the financial services sector. The loose lending standards and easy credit that helped inflate the housing bubble resulted in rapidly rising mortgage delinquencies that undermined the value of securities backed by those mortgages. This has forced some of New York's largest banks and Wall Street investment firms, which helped package and market these securities, to post enormous losses as they adjust their balance sheets to reflect the diminished value of their assets. In turn, lower asset levels have constrained the availability of credit. The member firms of the New York Stock Exchange collectively lost $11.3 billion in 2007. As losses have mounted, the firms have announced plans for large layoffs, although few of these job losses have as yet shown up in the official employment statistics. One explanation for why not is that many of those laid off remain on the payroll while receiving severance pay.

Job Losses. The most recent labor market data for New York City released last week provided new evidence that growth has slowed. Private- sector employment in April was still 35,500 jobs higher than 12 months earlier, but this was less than half the gain of 81,000 jobs between April 2006 and April 2007.

The strongest evidence of job losses is in the data for the securities industry. Since last August—when the current credit crisis began—securities employment in New York City has declined in all but one month. According to the latest monthly data, the number of securities jobs in April 2008 was just 300 (0.2 percent) higher than it was in April 2007 and 9,500 (5.0 percent) lower than it was in August 2007. Securities employment gains recorded in the spring and early summer of 2007 have been wiped out already, and more losses are expected.

IBO forecasts a loss of 59,400 private sector jobs (1.9 percent) between the city's most recent employment peak in the first quarter of this year and the expected trough of this recession in the second quarter of 2009, after adjusting for seasonal change. This is roughly one-quarter of the jobs gained since the last downturn; in the 2001 recession, the city lost about 43 percent of the jobs gained during the preceding 1993–2000 expansion. A gain of 21,000 jobs (3.0 percent) in education, health, and social assistance (which together now represents more than one-fifth of New York City employment) is projected to partially offset a loss of 80,500 jobs (3.2 percent) elsewhere.

In the financial activities sector, which is expected to be the epicenter of the local downturn, IBO forecasts a loss of 33,300 jobs (7.1 percent), with a loss of 17,300 jobs (9.3 percent) from securities alone from its peak in the third quarter of 2007. Professional and business services, which derives much of its demand from financial activities, is projected to lose 21,200 jobs (3.6 percent). Information is expected to lose 8,600 jobs (5.1 percent), as coverage of the presidential campaign ends and other business diminishes. A loss of 7,400 jobs (5.8 percent) is projected for construction, which will be affected by tightened credit, as well as the economic slowdown.

Other Economic Indicators. After the huge losses in 2007, and anticipated losses for the first quarter of 2008, the securities industry as a whole is expected to slowly return to profitability. Securities industry profits are expected to be $2.8 billion for 2008, jump to $12.2 billion in 2009, and grow to $12.6 billion in 2010.

IBO projects that Wall Street job cuts, diminished bonuses, and job losses elsewhere in the city will mean a sharp decline in personal income growth this year and next. After 9.6 percent growth in 2007, IBO forecasts 4.1 percent personal income growth for 2008, 3.0 percent growth in 2009 as the city hits this recession's trough, and moderate income growth of 4.3 percent to 4.5 percent per year in 2010 through 2012.

Total Revenue and Expenditure Projections

Dollars in millions

	2008	2009	2010	2011	2012	Average Change
Total Revenues	$62,857	$60,103	$62,770	$65,943	$67,751	1.9%
Total Taxes	*37,731*	*35,763*	*38,327*	*40,501*	*41,981*	*2.7%*
Total Expenditures	62,857	60,103	62,770	69,247	72,049	3.5%
IBO Surplus / (Gap) Projections	**$0**	**$0**	**$0**	**$(3,304)**	**$(4,298)**	
Adjusted for Prepayments and Discretionary Transfers:						
Total Expenditures	$60,882	$62,956	$65,874	$69,865	$72,049	4.3%
City-Funded Expenditures	43,725	45,813	48,373	51,506	53,380	5.1%

SOURCE: IBO.

NOTES: IBO projects a surplus of $4.59 billion for 2008, $70 million above the Bloomberg Administration's forecast. The surplus is used to prepay some 2009 expenditures, leaving 2008 with a balanced budget. IBO projects a Budget Stabilization Account of $1.74 billion for 2009, $417 million above the Bloomberg Administration's forecast. Similarly we project a Budget Stabilization Account of $618 million for 2010, $268 million above the Bloomberg Administration's forecast. These additional funds are used to prepay expenses for the following fiscal years, leaving the 2009 and 2010 budgets in balance. Estimates exclude intra-city revenues and expenditures. Figures may not add due to rounding.

IBO forecasts a moderate recovery for the city economy after it bottoms out in mid-2009, with private- sector employment growth averaging 1.4 percent (43,500 jobs) per year from 2010 through 2012. Private sector employment is projected to exceed its most recent peak by the fourth quarter of 2010. A weaker recovery is expected for the financial industry, as Wall Street firms struggle to regain their footing. Profit growth will be slow and is forecast to reach $13.4 billion by 2012. For 2010 through 2012, IBO projects average annual growth rates of 0.6 percent for securities employment (1,100 jobs per year) and 0.1 percent for financial activities (300 jobs per year).

Baseline Tax Revenue Projections. With evidence of a downturn in the U.S. economy and expectations that the unprecedented losses on Wall Street have begun to pull the local city economy into recession, IBO is projecting that baseline tax revenue growth—which assumes current law remains in effect—will be nearly flat this year, with revenues of $37.7 billion, and then fall by 5.2 percent in 2009 to $35.8 billion. The economy is expected to begin recovering during the second half of calendar 2009, leading to the resumption of moderate revenue growth in fiscal year 2010. Tax revenues that year are projected to increase by 3.7 percent to $37.1 billion, still below their 2008 level. Moderate revenue growth—averaging 5.0 percent annually—will continue in the last two years of the plan, bringing tax revenues to $40.9 billion in 2012.

IBO's tax revenue forecast is slightly higher than the Mayor's Office of Management and Budget's (OMB) for 2008 ($136 million, or 0.4 percent) and 2009 ($394 million, or 1.1 percent). The difference is much greater for 2010, when IBO's tax revenue forecast exceeds OMB's by $1.2 billion (3.4 percent) and it remains above $1 billion for 2011. OMB assumes that the looming downturn in the city will be steeper than does IBO, with peak to trough job losses of over 90,000—about a third larger than IBO's projection of 59,400. OMB also expects virtually no personal income growth for calendar years 2008 and 2009, while IBO foresees sharply lower, but still positive, growth. Similarly, OMB's forecast assumes that office rents and residential property values will fall further than IBO has estimated. After the city economy hits bottom—second quarter 2009 in both the IBO and OMB forecasts—IBO also expects a brisker recovery, with seasonally adjusted city employment climbing back to its previous peak by the last quarter of 2010; OMB projects weaker employment growth over this period and for about another year beyond. These differences in both the severity of the downturn and vigor of the recovery likely explain the sharp divergence in the revenue forecasts for 2010-2012.

2008. Despite the economic warning signs and the modest year-to-year growth anticipated in 2008, total tax revenue is expected to exceed the Mayor's conservative forecast when the budget was adopted last June. IBO's current forecast is now 5.4 percent above last June's Adopted Budget projection and 5.7 percent above the city's estimate in January's Preliminary Budget.

Most of the unanticipated strength so far this year has been in taxes that are relatively sensitive to the business cycle. Personal income tax revenue is now expected to be nearly $1 billion million higher than was projected by OMB last spring and 12.7 percent higher than the total for 2007. Consistent with the local employment data—which have yet to show declines in the local job market—income tax withholding collections are up by 8.3 percent over 2007. Estimated payments, which are most frequently paid by those with significant non-wage income, are expected to grow by 41.9 percent for the year, mostly the result of an 85.8 percent jump in payments made by taxpayers filing for extensions in April.

IBO's forecast of revenues from the sales tax—another cyclically sensitive revenue source—is up 4.1 percent from the Adopted Budget. Adjusted for the extension of the clothing sales tax exemption to all clothing items regardless of price, baseline sales tax revenues are now expected to grow by 7.1 percent this year. The strength of the tourism sector—boosted by foreign tourists attracted by the weak dollar—has contributed to this sales tax growth, but other factors including personal income growth estimated at 9.6 percent during calendar year 2007 are significant contributors as well.

Two taxes that have tracked the initial forecasts fairly closely are the real property transfer tax and the mortgage recording tax, collectively known as the "transfer taxes." These taxes reflect the state of the real estate market, and with sales transactions down and prices beginning to decline these taxes are now expected to fall by a total of 20.5 percent from their record high in 2007 to $2.6 billion in 2008. This decline, however, is very close to what had been anticipated last spring.

Business income taxes—which are paid by local firms and banks, as well as national firms that have a presence in the city—are forecast to fall by 5.0 percent from their 2007 record high of $6.0 billion, although the decline will be less than was expected last spring. Among these taxes, the unincorporated business tax has actually continued to grow this year and is now expected to increase by 12.1 percent to $1.9 billion. Much of this revenue growth has been attributed to hedge funds and private equity partnerships.

2009. With job losses and weaker personal income growth anticipated for calendar year 2008 and the first part of 2009, IBO expects tax revenues to fall in the coming fiscal year by 5.2 percent. By comparison, between 2001 and 2002, when job losses were nearly three times greater than IBO expects in the current downturn, baseline revenues fell by 7.0 percent.

With the exception of the property tax and the hotel occupancy tax, virtually all of the city's major taxes are expected to decline from their 2008 levels in 2009. The property tax, which is forecast to grow by 6.6 percent to $13.9 billion, will be sustained by the substantial pipeline of assessment increases from prior years for apartment and commercial buildings that are still being gradually phased-in under the city's complex property tax system. With the anticipated cooling of the New York City property market, assessment growth for 2009 in such buildings is expected to be 3.4 percent compared with a 16.7 percent gain in 2008. With smaller additions to the pipeline expected for 2009 and in the next few years, the amount to be phased in will begin to shrink and eventually slow property tax growth. The projected gain in the hotel tax reflects the expectation that tourism will remain strong this year and next, which will sustain demand for hotel rooms.

The unprecedented decline in Wall Street profits in calendar year 2007 and 2008 are expected to have its biggest effect on business income tax revenues during fiscal year 2009, when they are projected to fall to $5.0 billion, down 12.8 percent from their 2008 level and 17.1 percent from their 2007 peak. With job losses expected to mount during the second half of 2008 and early 2009, personal income tax revenue is also projected to decline, falling by 11.1 percent from the 2008 level to $7.7 billion. With slower personal income growth offset by the continued influx of tourists, sales tax revenues are expected to decline only slightly in 2009, falling by 0.4 percent.

With property markets expected to continue to contract, the combined transfer taxes are forecast to fall further to $1.9 billion, a decline of 27.6 percent from 2008 to 2009, and 42.4 percent from their 2007 high.

2010. IBO expects overall tax revenue growth to resume in 2010, with revenues increasing by 3.7 percent to $37.1 billion. By way of comparison, following the last downturn, which was deeper and longer, local economic growth resumed in mid-2003 with tax revenues growing 3.7 percent in fiscal year 2003 and 10.1 percent in 2004, after accounting for the tax increases enacted at the time.

Much of the gain in revenues in 2010 again comes from the property tax, which is expected to grow by 8.4 percent as the pipeline reaches a peak for the forecast period. With Wall Street profits expected to total $12.2 billion in calendar 2009 and $12.6 billion in 2010, business tax revenues are forecast to resume growing, recovering moderately to $5.3 billion, an increase of 5.5 percent over 2009, but still well below the 2007 peak.

Personal income tax revenue is expected to fall again in 2010, albeit by a smaller amount, with a projected decline of 2.9 percent. The decline results from a sharp 14.7 percent drop in estimated payments plus an increase in refunds that more than offsets the anticipated resumption of withholding growth. Sales tax revenue is expected to show only a modest gain of 1.6 percent, while the transfer taxes are expected to finally stop falling, remaining essentially unchanged from their 2009 levels.

EXPENDITURES

IBO projects that total city spending under the Mayor's Executive Budget for 2009 and financial plan through 2012 will grow faster than revenues from taxes and other sources. Based on the Mayor's plan, IBO estimates that total city spending will grow from $62.8 billion in 2008 to just over $72.0 billion in 2012.

In presenting his budget plan the Mayor noted the need for fiscal prudence and stressed that city-funded spending would grow by just 0.1 percent in 2009. IBO finds that on an annual operating basis—the level of funds actually expended to run the city in a given year—city-funded expenditures are growing in 2009 by slightly more than $2 billion, or 4.8 percent, and by an additional $2.6 billion, or 5.6 percent, in 2010.

Spending Reductions. Projected spending would be higher without the Mayor's proposals for agency spending reductions under the Program to Eliminate the Gap. The Mayor proposed a variety of spending cuts in the financial plan released in January and additional reductions in the Executive Budget for a combined total of nearly $1.2 billion in savings in 2009. The budgets of most agencies are reduced by similar shares, including the education and police departments, which were exempted from some prior gap-closing programs. Much of the savings continue in the out-years of the financial plan.

The largest savings come from the Department of Education: $428.3 million. The education spending reductions, roughly 35 percent of the overall savings plan, are to come from individual school budgets as well as central administration, although IBO has found that some of the central administration reductions proposed in January will also affect local school budgets [see page 27, IBO's review of the 2009 Preliminary Budget].

The next largest source of savings is $135.6 million in the police department. A large portion of this savings comes from reducing the number of officers the police department plans to hire. In January the Bloomberg Administration announced its plan to delay the hiring of 1,000 new police officers to the beginning of fiscal year 2010. Under the Mayor's May financial plan, the delay is extended to the beginning of 2011. The Bloomberg Administration now also expects to hire fewer officers on July 1, 2008 than previously planned, which will leave uniformed staffing more than 500 officers below the 36,838 anticipated in the January plan for that date.

In addition to spending reductions, the Program to Eliminate the Gap also includes $141.7 million in revenue initiatives. These include $6.0 million in revenue by more aggressively seeking payments from private insurers for Early Intervention services and using $5.9 million in federal Food Stamp funds for job training for recipients.

The Program to Eliminate the Gap also proposes a number of reductions to libraries, summer jobs for youth, and other services routinely restored by the City Council. Given the current controversy over the City Council's initiatives and member items, it is unclear whether restorations will again be "routine."

Growing Expenditures. Despite the savings and revenue initiatives, city spending continues to grow. Much of this growth is driven by just a few portions of the budget such as debt service and pensions and fringe benefits for city workers over which the city has limited near-term control. While most spending on programs is flat through 2012 there are a few exceptions: expenditures on education and sanitation have relatively large increases and additional funds are provided for specific needs or new initiatives in other parts of the budget as well.

Debt Service. Despite the Mayor's decision to delay some capital projects, debt service on the money borrowed to pay for projects already underway and those that will proceed through 2012 is rising at a fast pace. IBO's projects debt service will reach nearly $6.5 billion in 2012, including Transitional Finance Authority borrowing. When IBO adjusts for the use of the surplus to prepay some debt service, the average annual growth rate is 9.9 percent.

Pensions and Fringe Benefits. The city's contributions to employee pension funds are also expected to grow substantially, rising from $5.6 billion in 2008 to nearly $6.8 billion in 2012, an average annual increase of 4.7 percent. A significant portion of the growth is due to the Mayor's assumption that the pension funds' investment returns will be 0 percent in 2008 as opposed to the usual assumption of an 8 percent return on investments. To make up for the shortfall the city will have to increase its contributions to the funds starting in 2010. The additional city liability is $121 million in 2010, $222 million in 2011, and $327 million in 2012. Spending on health insurance and other fringe benefits for city workers is also expected to grow considerably, rising to $4.5 billion in 2012 (not including expenditures for education department employees), an average annual increase of 6.2 percent when adjusted for the prepayment of some of these benefits.

Education and Other Spending Growth. Despite the reductions that are part of the Program to Eliminate the Gap, the agency with the largest spending increase is the Department of Education, which will see its total budget (including funds from the labor reserve) rise from $16.8 billion in 2008 to $20.4 billion in 2012. The increase is driven by a rise in both city and state funds for schools. With much of the proposed state cuts in school aid restored, IBO projects that state aid to the city's schools over the 2008-2012 period will rise by $2.2 billion and reach $10.1 billion. City funding for its schools over the same period is projected to rise by nearly $1.4 billion and reach $8.4 billion.

Sanitation department spending is expected to increase nearly $200 million by 2012 and reach more than $1.4 billion. This increase results largely from a contingency fund for expenses related to closing the Fresh Kills landfill and for potential increases in the cost of exporting the city's waste.

Spending is growing in a number of other areas in the budget for a variety of reasons. For example, the budget includes $21.1 million in additional funds for 2009 and $15.4 million in 2010-2012 recognizing that the number of families in the city's homeless shelter system is higher than anticipated by the Bloomberg Administration.

Balance Busters? There are a number of factors that could bust IBO's projection of balanced budgets in 2009 and 2010. A recession that is deeper or longer than forecast by IBO would cause tax revenues to be significantly below our projections. Labor settlements above the budgeted level of 4 percent wage increases for the current round of contract negotiations would add substantially to city expenditures. In addition, if the Mayor and City Council choose to alter the financial plan and keep all or part of the 2006 property tax rate cut in place in 2010 or beyond, it would cost the city as much as $1.3 billion annually.