



CITIZENS BUDGET COMMISSION

One Penn Plaza * Suite 640 * New York, NY 10119

March 27, 2007

Hon. Michael R. Bloomberg
Office of the Mayor
City Hall
New York, NY 10007

Dear Mayor Bloomberg:

Under your leadership, the City has benefited from an economic revival whose fiscal effects are clear in the \$4 billion surplus for the current fiscal year projected in your January 2007 Financial Plan. A surplus of that magnitude is good news for New Yorkers.

The fiscal affairs of the City have markedly improved since September 11, 2001, when dramatic action was required to maintain the City's fiscal solvency, including borrowing for operating purposes and requiring the City's taxpayers to shoulder a significant additional burden. As the economy now continues to thrive beyond expectations, the City's strong fiscal position presents a unique opportunity to rethink these obligations and to focus on long-run priorities.

With this opportunity squarely in focus, I am writing to share the Citizens Budget Commission's analysis of the Fiscal Year 2008 Preliminary Budget and to make recommendations for your Executive Budget to be presented in April 2007. We hope you will consider two recommendations: (1) revise municipal tax policy to promote the City's economic competitiveness, and (2) use surplus resources to improve the City's long-term fiscal viability.

1. Revise local tax policy to promote the City's economic competitiveness.

Your January Financial Plan proposed a tax relief package totaling \$1.3 billion in fiscal year 2008. It includes a new, across-the-board 5 percent property tax rate cut worth \$750 million and an extension of the \$400 property tax rebate for homeowners established in fiscal year 2005, bringing total property tax relief to about \$1 billion. Your plan also includes about \$200 million in new tax cuts for some businesses: increasing tax credits for unincorporated businesses, creating new credits for S-Corporations, phasing-out one alternative tax base calculation, and simplifying tax filing for small firms. Finally, the City sales tax would be eliminated for high-priced clothing and footwear items, a tax loss of about \$100 million.

These proposals are important and innovative. They raise the issues of how much, and how best, to cut taxes in a time when reductions are fiscally responsible and economically desirable. These issues are best addressed by giving priority to the objective of promoting the City's attractiveness for job growth.

Based on this criterion, the CBC reaches these conclusions about the three components of your tax relief package:

The proposed changes in the local business income taxes are highly desirable. These measures will better align New York City's business taxes with those of competing locations. New York City's unincorporated business owners bear highly unusual double taxation on net income through the City's Personal Income Tax and its Unincorporated Business Tax. Similarly, the City levies the General Corporation Tax on S-Corporations, while competing cities do not. Your proposals to lessen the double taxation of unincorporated businesses and to bring taxes on S-Corporations more in line with competing markets will increase New York City's ability to attract and retain jobs.

The proposed elimination of the local sales tax on high-priced clothing will not be very effective. Even if the City's tax were eliminated, these items will remain subject to a combined State and MTA regional sales tax of 4.375 percent. Little retail activity is likely to be returned to New York City as a result of this change. Consumers currently leaving the City to shop for clothing in lower tax locations will still have the lure of no sales tax in New Jersey. In addition, exempting items priced above \$110 will benefit primarily shoppers, some of whom are tourists, with the financial ability to buy high-end clothing and footwear on a regular basis. Consequently, the proposed sales tax change will make an already regressive tax even more so.

The proposed property tax reductions can be restructured to enhance their impact on economic competitiveness. Since fiscal year 2001, property tax revenues have increased by \$5.3 billion; most of the increased property tax burden has been borne by renters in large buildings and users of commercial property. Small residential properties (Class 1) are responsible for only 16 percent of this growth, while large residential buildings (Class 2) and commercial property (Class 4) each accounted for almost 40 percent. During the same period, Class 1 property accounted for 67 percent of the growth in market value, while Class 2 and Class 4 property comprised 18 percent and 13 percent of the market value growth, respectively.

The recent rebate for homeowners has helped those bearing the smallest burden, and an across-the-board rate cut will not address the accumulated inequities or provide adequate relief to Class 2 and Class 4 owners and users. The \$1 billion proposed in property tax reductions can be better targeted to promote economic growth while relieving excessive burdens on the neediest homeowners. Cuts should be larger for the heavily burdened apartment buildings (and the renters who use them) and for the current and prospective employers bearing the high rates imposed on their offices and other facilities. The burden on the neediest homeowners can be addressed most efficiently and equitably through so-called "circuit breaker" provisions to the personal income tax that give credits to homeowners whose property tax liability is an unusually high share of their annual income. Lower income renters below a set income threshold should also be eligible for rent relief in a circuit breaker program conditioned on rent-to-income ratios.

2. Use surplus revenues to promote the City's long-term viability.

The January Financial Plan identifies a current year surplus of \$4 billion. You propose to deposit a portion of these funds, \$500 million, into the Retiree Health Benefits Trust Fund for future retiree health care liabilities. This investment represents smart use of surplus funds. The remaining surplus would not be devoted to such long-term purposes; instead, these funds would be "rolled over" into future years to support growth in ongoing operating expenses. Instead of rolling the funds to

support operating spending next year, steps should be taken to reduce budget gaps by curbing future spending. More of the current year's surplus should be used for measures that yield enduring gains.

Good fiscal times present an opportunity to shift focus beyond short-term budget balancing toward long-term issues. We highlight two opportunities.

Repay the debt issued for operational purposes during the fiscal crisis following the terrorist attacks of September 11, 2001. To deal with possible budget deficits the City borrowed \$2 billion to support operations through the Transitional Finance Authority (TFA). These bonds are scheduled to be repaid over a 20-year period and represent a current recurring annual liability of about \$150 million. The City has recovered and is thriving once again. The current surplus revenues could be used to retire the \$1.8 billion in TFA operating debt that remains outstanding or higher cost debt of a commensurate amount. In this way, the undesirable debt incurred for operating purposes at the start of your tenure would be eliminated before the end of your mayoralty.

Deposit additional surplus funds in the health insurance trust fund as you develop a long run funding plan for post-employment benefit liabilities. CBC has strongly supported the \$2 billion in deposits to the Retiree Health Insurance Benefit Trust, and the additional \$500 million planned for fiscal year 2008. These deposits represent the kinds of investments the City should be making with surplus funds and constitute the beginnings of a plan to address these long-run costs. Additional deposits would be a better use of surplus resources than funding next year's operating expenses.

New York City has been a leader in disclosing actuarial liabilities for post-employment benefits other than pensions (OPEB), which are over \$53 billion, and in taking steps to fund those liabilities. But progress in funding such long-term liabilities should not depend entirely on unexpected surpluses and mayoral initiative. Multi-year plans based on clear policies for addressing these liabilities should be developed to guide future administrations in determining how much can regularly be set aside to meet such obligations. More can be done now, and a firm precedent should be set for future commitments.

Any long-run plan to manage and fund OPEB liabilities should include initiatives that reduce the liability. The current policy of full City funding of health insurance premiums for all retirees and their dependents is far out of line with private sector practices, as well as practices of most other public sector employers. The CBC recommends requiring retirees to bear a part of the cost of their post-employment health insurance. Billions in OPEB liabilities could be erased if the City were to align its health insurance benefit policies with those of most other large employers by requiring a contribution towards premiums from retirees.

I hope you find the CBC's support and suggestions helpful as you formulate the Executive Budget. We would be pleased to discuss our concerns with you and your staff.

Sincerely,

James L. Lipscomb
Chairman

Diana Fortuna
President