

The City's Budget Gap Since 9/11:

Factors That Caused It, and Plans to Close It

An Analysis by the Citizens Budget Commission

March 2003

Introduction

This paper analyzes the causes of and chosen solutions to the City of New York's unprecedented budget gap for fiscal year 2004. Its point of departure is the fiscal year 2004 gap as projected in the four-year Financial Plan that accompanied the budget adopted in June 2001, before terrorists attacked the World Trade Center and the national economic downturn gathered momentum. It traces the changes to expected revenues and expenditures in seven subsequent Financial Plans through the Mayor's Preliminary Budget released in February 2003.

Three key points emerge from this analysis:

- Increases in spending had a larger impact on widening the budget gap than did falling tax revenues. Of the changes that worsened the fiscal year 2004 gap, \$3.1 billion were increased expenditures and \$2.9 billion were revenue declines. The drop in tax revenue was \$2.4 billion.
- Revenue increases, primarily tax rate increases, played a much larger part in closing the budget gap than did spending cuts. Revenue increases account for \$4.8 billion or 54 percent of the City's gap closing plan.
- Of the \$2.8 billion in savings that City agencies have identified to close the gap, most have no effect on City services. Rather, \$1.7 billion or 60 percent of these savings result from shifting costs to the State or federal governments, raising fees, finding efficiencies, and revising cost estimates. Actual cuts in services total about \$600 million.

Some elements of the plan to close the gap have not been implemented and are at risk. The City may have to find different means to achieve budget balance in fiscal year 2004, which would change the balance between revenue and spending measures.

The Causes of the City's Fiscal Year 2004 Budget Gap

In June of 2001, the City projected that the fiscal year 2004 budget gap would be \$2.6 billion. That structural gap was seen as manageable by many observers, although viewed with concern by the Citizens Budget Commission. Since then, a combination of declining revenues, rising expenditures, and other changes worsened the gap by \$6.2 billion. Without offsetting actions taken since then, the City would be facing a fiscal year 2004 budget gap of \$8.8 billion. (See Table 1.)

While lost revenues from the recession and the aftermath of September 11 are blamed frequently for widening the City's gap, rising expenses are a more significant factor. Tax revenues are expected to be \$2.4 billion lower in fiscal year 2004 than had been projected previously, but expenses have risen \$3.1 billion.

Table 1
The Causes of the Fiscal Year 2004 Budget Gap
City of New York
December 2001 Through January 2003 Financial Plans
(dollars in millions)

	Fiscal Year		
	<u>2002</u>	<u>2003</u>	<u>2004</u>
GAP TO BE CLOSED, JUNE 2001	\$0	(\$2,778)	(\$2,611)
CHANGES TO THE GAP	(\$1,084)	(\$3,878)	(\$6,218)
Declining Revenues	(\$1,297)	(\$2,082)	(\$2,943)
Tax revenue	(849)	(1,927)	(2,372)
Loss from federal tax changes		(128)	(119)
Other non-tax revenue	(198)	(27)	(452)
Cancelled sale of Off-Track Betting	(250)	-	-
Rising Expenditures	(\$492)	(\$2,042)	(\$3,107)
<i>Workforce expenditures</i>	(\$150)	(\$647)	(\$1,688)
Pension contributions	204	(150)	(729)
Collective bargaining	(201)	(255)	(617)
Worker health insurance costs	(153)	(242)	(342)
<i>Services and other expenditures</i>	(\$342)	(\$1,395)	(\$1,419)
Health and welfare	(204)	(416)	(597)
Education	107	(308)	(241)
Other agency spending	(165)	(554)	(431)
Judgements and claims	(80)	(117)	(150)
Other Changes	\$705	\$246	(\$168)
Debt service savings	419	527	63
Prior payables adjustments	360	-	-
Using general reserve	160	-	-
Intergovernmental changes	(234)	(281)	(231)
CUMULATIVE GAP, JUNE 2001 THROUGH JAN. 2003	(\$1,084)	(\$6,656)	(\$8,829)

Source: Citizens Budget Commission analysis, from City of New York, Office of Management and Budget, City of New York Financial Plan, June 7, 2001, December 4, 2001, December 31, 2001, February 12, 2002, April 16, 2002, June 26, 2002, November 14, 2002 and January 28, 2003 editions; State of New York, Office of the State Deputy Comptroller for the City of New York, Review of the Four-Year Financial Plan for the City of New York, Report 9-2003, (NY: Office of the State Deputy Comptroller, July 2002).

Declining Revenue. Compared to the assumption in the fiscal year 2002 Adopted Budget, estimated revenues for fiscal year 2004 have declined \$2.9 billion. This decline is primarily due to a \$2.4 billion shortfall in tax revenues, stemming from the national recession, the collapse of the stock market, and, to a lesser extent, the economic impacts of the September 11 terrorist attacks. Other expected revenues were lost because of federal tax changes and changes in miscellaneous revenues.

Rising Expenditures. City-funded spending in fiscal year 2004 is now projected to be \$3.1 billion more than was expected in June of 2001. Some of the spending increases were deliberate policy choices—such as the settlement with the teachers’ union—and others result from external factors, such as Medicaid increases and the need for higher pension fund contributions due to the falling value of the pension funds’ assets.

Spending on the City’s workforce accounts for more than half of the fiscal year 2004 increase posted since June 2001. Most of this increase results from the City fully absorbing the higher costs of benefits for its employees. Pension costs have exceeded expectations by \$729 million, and the City will spend \$342 million more on employee health insurance as health insurance premiums have risen more rapidly than expected. Furthermore, collective bargaining settlements will surpass budgeted levels by \$617 million primarily because of a generous settlement with the teachers’ union. In all, the City will be spending \$6,954 more in compensation per employee in fiscal year 2004 than had been planned in June of 2001.

Spending on other functions and services rose more than \$1.4 billion. Medicaid costs rose more rapidly than forecasted, and the City is allocating more for education than was anticipated in June of 2001. Increases for other services exceed \$400 million.

Closing the Fiscal Year 2004 Budget Gap

Implemented and proposed measures to address the \$8.8 billion problem include increased recurring revenues, one-shot revenues, additional intergovernmental assistance, reduced City-funded spending, labor actions, and borrowing. (See Table 2.) Increased revenues account for the bulk of actions taken to close the gap.

Increased Revenues. Increased revenues account for \$4.8 billion or 54 percent of all gap-closing actions. These include recurring revenue that will benefit the budget in subsequent years, non-recurring revenue that will help balance the budget only in fiscal year 2004, and federal and State assistance.

Recurring revenues total \$3.6 billion or 40 percent of the gap. The largest source of new recurring revenue is the recently enacted increase in the property tax, yielding \$1.7 billion in fiscal year 2004. The City is counting on \$962 million from reform of the personal income tax, including a new tax on commuters. In addition, the City’s decision in late 2001 to re-implement the 14 percent surcharge on the personal income tax will yield \$370 million in fiscal year 2004.

Table 2
Closing the Fiscal Year 2004 Budget Gap
City of New York
December 2001 Through January 2003 Financial Plans
(dollars in millions)

	Fiscal Year		
	<u>2002</u>	<u>2003</u>	<u>2004</u>
CUMULATIVE GAP, THROUGH JAN. 2003	(\$1,084)	(\$6,656)	(\$8,829)
TOTAL GAP-CLOSING PROGRAM, THROUGH JAN. 2003	\$1,084	\$6,656	\$8,829
New Revenue Sources	(\$160)	\$1,819	\$4,782
<i>Recurring Revenues</i>	<i>\$172</i>	<i>\$1,458</i>	<i>\$3,561</i>
Reimposition of personal income tax surcharge	172	349	370
Decoupling local taxes from federal tax law change		108	99
State-approved tax changes, incl. cigarette tax		164	113
Property tax increase - 18.49 percent		837	1,727
Personal income tax reform/commuter tax			962
Regional transportation initiatives			200
Airport rent			90
<i>One-Shot Revenues</i>	<i>(\$332)</i>	<i>\$361</i>	<i>\$1,221</i>
Use of prior year's surplus	(332)	(289)	621
Federal Emergency Management Agency funds		650	-
Port Authority airport back rent			600
Intergovernmental Assistance	\$0	\$2	\$452
Menu of federal actions			200
Menu of State actions		2	252
Borrowing	\$0	\$2,127	\$229
Transitional Finance Authority financing		1,500	-
Use of Municipal Assistance Corporation reserve		250	-
Sale of tax benefits		100	-
Pension cost-of-living adjustment stretch out		277	229
Lower City-Funded Expenditures	\$1,244	\$2,708	\$3,366
Labor actions			600
Agency actions (see Table 3)	1,244	2,499	2,819
Debt financing flexibility		262	-
Procurement savings		27	27
Community development block grant flexibility		20	20
Increase general reserve		(100)	(100)
REMAINING GAP, THROUGH JAN. 2003	\$0	\$0	\$0

Source: Citizens Budget Commission analysis, from City of New York, Office of Management and Budget, City of New York Financial Plan, June 7, 2001, December 4, 2001, December 31, 2001, February 12, 2002, April 16, 2002, June 26, 2002, November 14, 2002 and January 28, 2003 editions.

The City is closing \$1.2 billion of the fiscal year 2004 gap with one-time resources. It expects \$621 million in surplus funds from the current fiscal year generated as a result of the mid-year property tax increase to be transferred to fiscal year 2004. The Governor has indicated that a one-time payment of \$600 million in back airport rent will be available from the Port Authority.

Intergovernmental Assistance. The City is seeking nearly \$500 million in intergovernmental aid. Its plan offers a menu of revenue and expense measures to federal and State officials. The Governor's Executive Budget did not include this aid; in fact, his proposals would increase the size of the City's gap in ways that are not reflected in this analysis.

Borrowing. In contrast to fiscal year 2003, when the City relied on \$2.1 billion in borrowing, planned fiscal year 2004 borrowing is \$229 million. This amount is the fiscal year 2004 savings to the City from delay of payments to the City's pension funds required to finance cost-of-living increases mandated by the State Legislature. The City will pay interest to the pension funds for what is effectively a loan.

Reduced Expenditures. Actual and proposed actions since June 2001 to reduce City-funded spending total \$3.3 billion. These include \$600 million targeted for productivity savings and concessions in current labor negotiations.

City agencies have identified \$2.8 billion of the reductions in City-funded spending. These changes fall into five categories: productivity and efficiency measures (providing the same level of services for fewer dollars); service cuts; re-estimates of the costs of providing a service; decisions not to implement planned service increases; and substitution of other sources of revenue for existing revenue streams. This last method does not lead to less total spending on a service, but rather shifts responsibility for funding the service to other levels of government or new revenue streams.

Of the total for agency initiatives, less than one-quarter or \$636 million results in cuts to existing services. (See Table 3.) Other changes include \$637 million from lowered spending estimates, \$84 million in delayed or cancelled expansions of existing programs, and \$275 million in productivity or efficiency initiatives. Agency spending changes totaling \$487 million could not be classified because the City's description of them lacked sufficient detail.

The City has found alternative revenue to support \$700 million in agency spending. In some cases, these involve shifts to State, federal or capital budget sources. In other cases, revenues are being increased through greater collections of existing fees or fines (traffic violation fines, for example) or implementation of new fees.

Table 3
Composition of Agency Actions to Close the Fiscal Year 2004 Budget Gap
City of New York
June 2001 through January 2003
(dollars in thousands)

<u>Agency Action</u>	<u>Cumulative Amount</u>	<u>Percentage</u>
Expenditure Changes	(\$1,632,912)	58%
Productivity and efficiency	(275,143)	10%
Service cut	(636,263)	23%
Expenditure re-estimate	(637,316)	23%
Cut in planned spending increase	(84,190)	3%
Revenue Changes	(\$699,151)	25%
Increases in existing fees and fines	(210,585)	7%
New fees and fines	(185,872)	7%
Funding shift to federal government	(158,153)	6%
Funding shift to State government	(105,064)	4%
Funding shift to capital budget	(39,477)	1%
Not Sufficient Detail	(\$486,937)	17%
Total	(\$2,819,000)	100%

Source: Citizens Budget Commission analysis, estimated from data provided by City of New York, Office of Management and Budget.

Founded in 1932, the Citizens Budget Commission (CBC) is a nonpartisan, nonprofit civic organization devoted to influencing constructive change in the finances and services of New York State and New York City governments. The Chairman of the CBC is H. Dale Hemmerdinger.

This analysis was prepared under the auspices of the CBC's Budget Policy Committee. The Committee is co-chaired by Eugene J. Keilin and Heather L. Ruth. The other members of the Committee are Lawrence D. Ackman, Lawrence B. Bittenwieser, Denis Curtin, Evan A. Davis, Stephen DeGroat, Cheryl Cohen Effron, Roger Einiger, Paul Francis, Bud H. Gibbs, Kenneth D. Gibbs, James F. Haddon, Walter Harris, Craig M. Hatkoff, H. Dale Hemmerdinger, Fred P. Hochberg, Peter C. Kornman, Robert Kurtter, Dick Levine, Jeffrey Lynford, Norman Mintz, Lionel I. Pincus, Robert E. Poll, Lester Pollack, Jules Polonetsky, Carol Raphael, Laraine Rothenberg, Edward L. Sadowsky, Bart Schwartz, Joan Steinberg, Barry F. Sullivan, Merryl Tisch, Lesley Daniels Webster, and Stephen H. Weiss.

Douglas Offerman, Senior Research Associate, and Marcia Van Wagner, Deputy Research Director and Chief Economist, prepared this analysis. Charles Brecher, Research Director, and Diana Fortuna, President, provided guidance and editorial review. An electronic version of the report is available on the CBC's website at www.cbcny.org.

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