New York City 2006 Budget and Economic Outlook

Based on the Mayor's January 31, 2006 Financial Plan

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Fiscal Policy Institute

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In the Mayor's January 31, 2006 Financial Plan, the FY 2006 budget surplus has swelled to $3.3B. In a significant departure from past City fiscal planning, Mayor Bloomberg proposes to use this surplus to address long-term expenditure needs. However, he has not proposed comparable initiatives on the revenue side that could help the City better address out-year budget gaps.

- The super-charged real estate market, a 50% surge in Wall Street revenues and record Wall Street bonuses are the main factors pushing FY 2006 tax collections $2.9B ahead of the forecast last July following budget adoption.

- Also significant savings from actuarial changes in pension obligations, and state actions to moderate the growth in the local share of Medicaid spending.

- The major initiative to address long-term budget problems is the Mayor's proposal to establish a Retiree Health Insurance Trust with $1B in FY2006 and $1B in FY2007.

- The Mayor is also proposing to spend $1 billion over 5 years for pay-as-you-go capital and to restructure tobacco settlement debt to reduce the FY2008 gap by $500M.

The surge in tax collections has erased the FY 2007 gap, which was projected at $4.5B last summer and $2.3B in November.

- However, the 2007 gap is largely closed because of the FY 2006 surplus being used in 2007. Even after boosting the tax forecast in the fall and last month, total tax revenues are projected to decline slightly next year because of an expected 32% drop in real estate transaction taxes and lower capital gains.

- The Mayor emphasizes that combined "controllable" agency spending is flat in FY2007 (nominal terms), and that total "non-controllable" spending now exceeds all other agency spending and is projected to grow by $2.9B (15%).

- In a perennial and always dubious move, the Mayor's budget cuts more than $300M in spending for services (for CUNY, children, seniors, libraries and cultural organizations, e.g.) that the Council fights every year to restore.

- At the same time, despite imposing out-year budget gaps, the Mayor proposes to continue the $250M homeowner property tax rebate through 2010.

With real estate transaction taxes receding and projections for slower national economic growth in 2007, total City revenue growth is forecast to barely keep pace with inflation through 2010.

- The increase in the top two brackets in the City's personal income tax enacted in 2003 expired at the end of calendar year 2005. This had generated about $700M a year. (The State also allowed a similar PIT rate increase for high earners to expire.)

- With the end of the City's temporary PIT increase, the top rate is now lower than it was throughout the 1990s.

- Incomes for most high-income City residents are again rising sharply. The share of all families who have incomes over $200,000 has risen sharply since 2000, while the share of families with incomes between $25,000 and $200,000 has fallen. (Incomes in constant dollars)

- The City needs to do more to address the long-standing inequities in the City's property tax system, and should do that in a way that does not further erode the property tax base. The recent period of rapidly escalating property values worsened inequities.

Retiree Health Benefits Trust Fund

- The City now pays about $1B a year, on a pay-as-you-go basis, for health benefits for retired City workers.
- The Mayor is proposing to establish a Retiree Health Benefits Trust Fund with some of the current budget surplus to partially fund these costs in the future, easing the demands placed on the City's operating budget. The Fund would be irrevocable and the monies dedicated for this purpose.
- New Government Accounting Standards Board (GASB) rules that take effect in 2008 will require state and local governments to report the cost of providing retiree health insurance, similar to the existing need to report pension obligations. The GASB rules do not require advance funding for this purpose in the manner the Mayor is proposing.
- This appears to be both a sound use of the surplus (rather than using it to fund current spending) and a prudent step to help address retiree health insurance needs.

Public worker pension and health benefits are under the spotlight at all government levels in New York. It is important to understand the sources of the cost pressures and separate those from the broader agenda of those seeking to reduce worker benefits.

- Like social security at the national level, there is no funding crisis in the City pension funds.
  - The City's pension contribution is up considerably from the early 2000s mainly because of the bursting of the Wall Street and dot.com bubbles and the fact that the City's contribution had been lower than in prior years.
  - The projected increase through the out-years in the employer contribution level is nominal.
  - The average non-uniformed public worker pension is not tremendous.
- Health insurance costs are rising everywhere because of the lack of a coherent national health care policy and a failure to rein in drug prices.
- The City health plan option for which participants do not share in the premium cost is a bare-bones plan. Many workers are already contributing in order to get better coverage.

Questionable tax break policy still at the heart of the City's Far West Side (FWS) financing plan.

- Since the state's rejection of the West Side stadium in June 2005:
  - The MTA proposed, then dropped, a plan to use some of the MTA's budget surplus to develop the West Rail Yards
  - The City and the MTA have been negotiating the sale of the East Rail Yards
  - A design for the Javits Convention Center expansion has been approved but considerable controversy has emerged regarding the size and direction of the expansion and how to pay the rising costs of constructing the expansion.
- The City has set up the Hudson Yards Infrastructure Corporation (HYIC) to finance the construction of a platform over the East Rail Yards and the extension of the #7 subway line west and south to 34th Street and 11th Avenue. This means that the project will not be in the City's capital plan and thus will not be eligible to use General Obligation debt financing. It also means that the City is willing to forego the possibility of federal support for the extension of the #7 line.
- The City has also established the Hudson Yards Development Corporation (HYDC) to oversee the City's Far West Side planning, including the condemnation of certain properties. The HYDC had its first meeting in December.

Far West Side financing (continued)

- The HYIC plans to start selling $3 billion in bonds this summer and is still planning to repay the bonds mainly with Payments-In-Lieu-of-Taxes (PILOTs) on the commercial development in the Hudson Yards area. These PILOTs are premised on across-the-board tax breaks for all 24 million square feet of office space in the Hudson Yards area. The City's IDA will approve a uniform tax break policy before the HYIC sells any debt.

- In January of 2005, the City Council approved a HYIC financing plan that calls for $1B in appropriations out of the City's operating budget over 10 years starting in 2005 to pay the interest on HYIC debt until project revenues start flowing sufficient to meet debt service obligations. In October 2005, the Council authorized the expenditure of Hudson Yards PILOTs by the HYIC, and in effect, endorsed the use of across-the-board tax breaks. The City has not publicly released details of its plan to provide tax breaks.

- The City has not made an economic development case for the Hudson Yards tax breaks, which could cost hundreds of millions of dollars.

Far West Side financing (continued)

- For a project that entails the construction of 24 million square feet of office space, building in property tax breaks from the start would permanently institutionalize property tax breaks for Manhattan commercial projects. This would likely seriously compromise the City's commercial property tax base. Homeowners and other commercial property owners would then be forced to bear the property tax burden to offset the reduced taxes for FWS office buildings.

- The property tax is by far the largest NYC tax and supplies nearly half of all City tax revenues. The City would be far better off dropping the PILOT provision and instead making new office developers pay taxes on the full value of their property. The financing plan approved by the Council already permits the use of general tax revenues to pay the debt service on HYIC debt. Dropping the commercial property tax subsidies would prevent the erosion of the property tax base and could help wean Manhattan developers from an excessive reliance on public subsidies.

- The City needs to make sure that public financing for large development projects is fiscally sound and economically justified. Tax breaks should be directly reflected in public budgets as expenditures.

The City's impressive tax revenue growth since 2002 doesn't mean that the economy has been providing enough good-paying jobs

- Even without the tax rate increases, the City's personal income tax collections increased by 45% from FY 2002-06, and property-related taxes increased by 30%.
- On the other hand, total payroll jobs have increased by 2% since the low-point in August 2003. City resident employment, according to the state Labor Department, has increased by less than 2% since 2000, and the annual average level for 2005 was slightly below the 2002 level.
- Nominal median hourly wages have increased by about 5% from 2002 to 2005. However, inflation has been about twice that, meaning that real wages for all but the highest earners in NYC are down considerably since 2002, even among those workers with 4-year college degrees, and the middle class is shrinking.
- The Mayor's budget presentation touts the fact that in 2005 the unemployment rate fell to its lowest level since 2000 and ascribed this to "our five-borough economic development strategy." However, the fall in the unemployment rate is largely an artifact of a weaker economy in 2005 than in 2000, an economy with 150,000 fewer payroll jobs, much higher long-term unemployment, higher under-employment, a lower labor force participation rate, and a lower employment-to-population ratio.

The State of Working New York 2005: Treading Water in a Tenuous Recovery

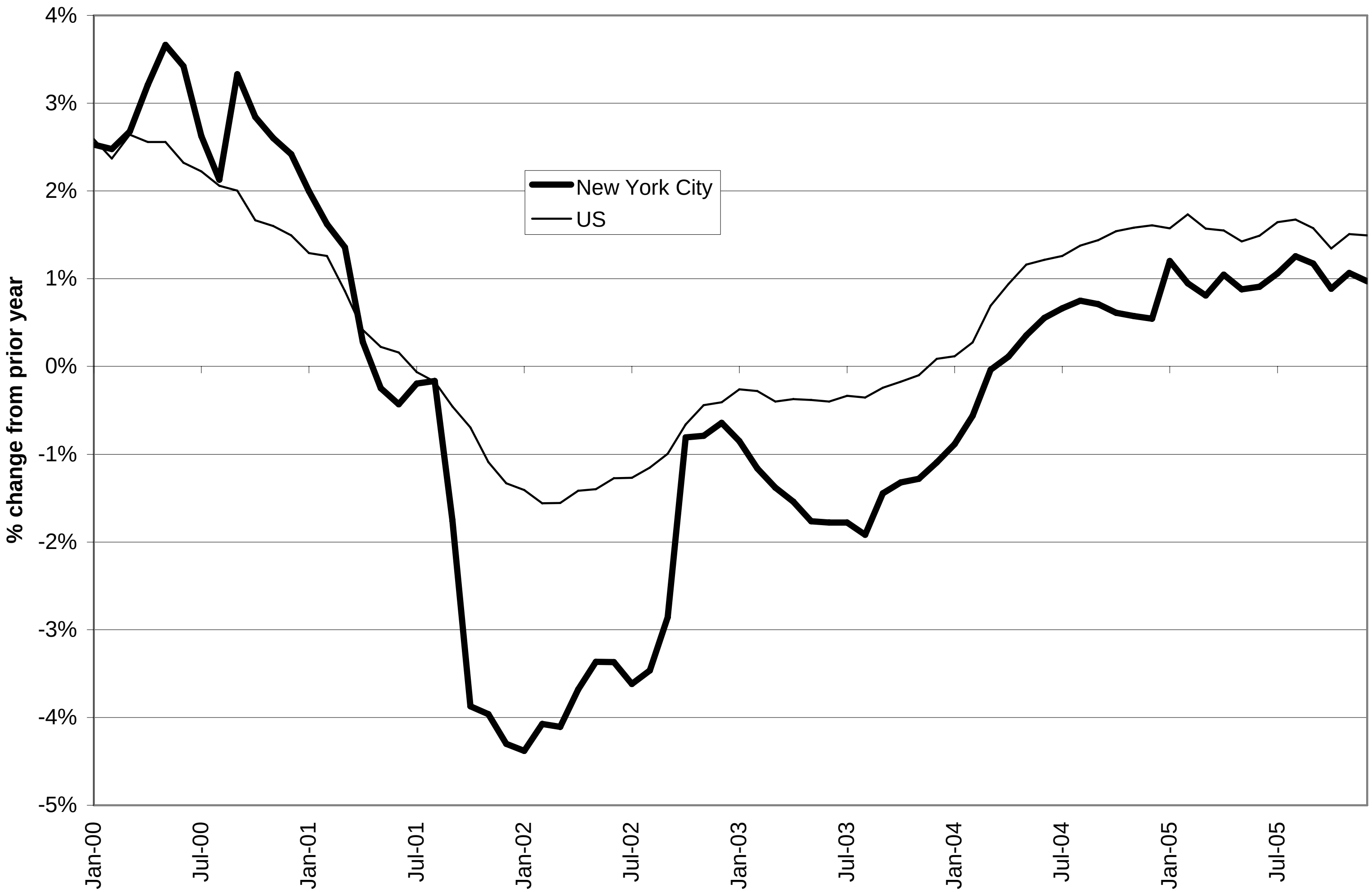
- "Treading water in a tenuous recovery" is the descriptive subtitle of the latest edition of FPI's biennial report on the State of Working New York.

- National recovery that started in mid-2003 is the weakest recovery in terms of job growth since 1949.

- The recovery is tenuous because it has been largely fueled by borrowing on the part of households (through mortgage debt) and all levels of government. Total national debt has increased 50% faster than the growth in GDP.

- Workers and their families are treading water in this recovery largely because the growth in wages (14%) has dramatically trailed the growth in profits (65%). (measured from 1st Q 2001 to 1stQ 2005) Real hourly wages have fallen; housing, energy and health care costs are rising; and income polarization has intensified.

Since mid-2003, NYC has been adding jobs, but at a slow pace…reflecting sluggish national growth.



Source: BLS, NYS Dept. of Labor. City seasonal adjustment by FPI

Over the last year, more high-wage industries have started to add jobs, but several sectors are still well below their pre-recession levels. (1st of 2 slides)

NYC seasonally adjusted employment	TOTAL NONFARM	TOTAL PRIVATE	Const.	Manuf.	Wholesale Trade	Retail Trade	Utilities	Transp. and W'hous'g	Information	Finance and Insurance	Real Estate Rental & Leasing
Current employment December 2005	3,584,768	3,035,367	108,578	112,791	145,768	278,083	14,939	99,590	161,473	326,790	116,503
Share of all employment	100.0%	84.7%	3.0%	3.1%	4.1%	7.8%	0.4%	2.8%	4.5%	9.1%	3.2%
Change Peak to Latest (12/00-12/05)	-169,878	-154,813	-16,287	-58,055	-8,971	-6,350	-79	-19,061	-31,135	-44,751	-3,067
	-4.5%	-4.9%	-13.0%	-34.0%	-5.8%	-2.2%	-0.5%	-16.1%	-16.2%	-12.0%	-2.6%
Changes in three periods:											
Peak to Trough (12/00-8/03)	-239,307	-229,208	-12,550	-47,093	-7,129	-17,577	-117	-15,649	-30,471	-53,381	-5,134
	-6.4%	-7.2%	-10.1%	-27.6%	-4.6%	-6.2%	-0.8%	-13.2%	-15.8%	-14.4%	-4.3%
First 16 months of Recovery (8/03-12/04)	34,899	35,574	-1,198	-7,882	-673	9,790	-853	263	855	428	2,131
	1.0%	1.2%	-1.1%	-6.4%	-0.5%	3.7%	-5.7%	0.3%	0.5%	0.1%	1.9%
2005 (12/04-12/05)	34,530	38,821	-2,539	-3,080	-1,169	1,437	891	-3,675	-1,519	8,202	-64
	1.0%	1.3%	-2.3%	-2.7%	-0.8%	0.5%	6.3%	-3.6%	-0.9%	2.6%	-0.1%

Over the last year, more high-wage industries have started to add jobs, but several sectors are still well below their pre-recession levels. (2nd of 2 slides)

NYC seasonally adjusted employment	Professional Scientific & Technical Services	Management of Companies and Enterprises	Administration and Support and Waste Management	Educational Services	Health Care	Social Assistance	Leisure and Hospitality	Other Services	GOV'T
Current employment December 2005	298,740	57,369	195,401	151,122	378,538	157,234	281,452	151,462	548,951
Share of all employment	8.3%	1.6%	5.5%	4.2%	10.6%	4.4%	7.9%	4.2%	15.3%
Change Peak to Latest (12/00-12/05)	-31,403 -9.5%	4,922 9.4%	-20,409 -9.5%	18,185 13.7%	27,760 7.9%	9,780 6.6%	18,962 7.2%	2,062 1.4%	-14,869 -2.6%
Changes in three periods:									
Peak to Trough (12/00-8/03)	-45,106 -13.7%	5,805 11.1%	-26,278 -12.2%	9,344 7.0%	11,456 3.3%	4,574 3.1%	-3,621 -1.4%	-767 -0.5%	-9,060 -1.6%
First 16 months of Recovery (8/03-12/04)	3,791 1.3%	-2,355 -4.0%	2,522 1.3%	2,757 1.9%	10,327 2.9%	665 0.4%	14,162 5.5%	2,902 2.0%	-1,558 -0.3%
2005 (12/04-12/05)	9,912 3.4%	1,472 2.6%	3,347 1.7%	6,084 4.2%	5,977 1.6%	4,541 3.0%	8,421 3.1%	-73 0.0%	-4,251 -0.8%

Strong job growth emerges in 2005 on Wall St. and in computer services and advertising.

	Change 12/04-12/05		Employment December 2005
Detailed NYC industry			
Securities, Commodity Contracts, and other Financial & Related Activities	8,201	5.0%	173,764
Ambulatory Health Care Service	4,289	3.2%	138,689
Individual and Family Services	3,651	3.3%	113,933
Employment Services	3,032	4.6%	68,438
Full-Service Restaurants	2,726	3.0%	94,314
Advertising and Related Services	2,661	5.6%	50,355
Computer Systems Design and Related Services	2,347	7.2%	34,721
Food and Beverage Stores	1,972	3.4%	59,941
Services to Buildings and Dwellings	1,900	5.4%	37,211
Limited-Service Eating Places	1,525	3.0%	52,353
Ten industries adding most jobs	24,103	3.0%	823,719
All NYC employment	34,530	1.0%	3,584,768

Source: NYS DOL Current Employment Series. Seasonal adjustment and analysis by FPI.

Continued, although moderating, weaknesses in employment in apparel, construction, air transportation, banking, insurance, and government.

	Change 12/04-12/05		Employment December 2005
Detailed NYC industry			
Apparel Manufacturing	-2,349	-8.2%	26,155
Local Government	-2,313	-0.5%	445,362
Specialty Trade Contractors	-2,175	-2.9%	73,450
Scheduled Air Transportation	-1,982	-7.8%	23,520
Commercial Banking	-1,300	-3.4%	37,500
Federal Government	-1,257	-2.2%	55,169
Insurance and Employee Benefit Funds	-1,182	-19.8%	4,802
Insurance Carriers and Related	-1,082	-1.9%	54,967
Building Equipment Contractors	-1,000	-2.2%	44,700
Religious, Grant-making, Civic & Professional Org's.	-870	-0.9%	94,466
Ten industries losing most jobs	-15,510	-1.8%	860,091
All NYC employment	34,530	1.0%	3,584,768

Source: NYS DOL Current Employment Series. Seasonal adjustment and analysis by FPI.

Median hourly wages rose for many NYC workers through 2002, but have fallen across the board since, especially among college-educated workers.

Real median hourly wage*	**1999**	**2002**	**2005**	**1999-2002**	**% change 2002-2005**	**1999-2005**
All NYC resident workers	$15.02	$15.24	$14.42	1.5%	-5.4%	-4.0%
Males	$15.54	$16.63	$15.38	7.0%	-7.5%	-1.0%
Females	$14.42	$13.85	$13.35	-4.0%	-3.6%	-7.4%
White, non-Hispanic	$19.23	$20.43	$18.75	6.2%	-8.2%	-2.5%
Black, non-Hispanic	$13.82	$13.30	$12.80	-3.8%	-3.8%	-7.4%
Hispanic	$11.27	$11.08	$11.00	-1.7%	-0.7%	-2.4%
Less than high school	$8.66	$8.87	$8.75	2.4%	-1.4%	1.0%
High school	$12.02	$12.47	$12.00	3.7%	-3.8%	-0.2%
Some college	$14.42	$14.41	$13.39	-0.1%	-7.1%	-7.1%
Bachelors and higher	$23.11	$24.35	$22.00	5.4%	-9.7%	-4.8%
Native born, including P.R.	$16.94	$18.01	$16.25	6.3%	-9.8%	-4.1%
Foreign born	$13.11	$12.77	$12.50	-2.6%	-2.1%	-4.7%

*2005$; NY metro CPI used to deflate nominal wages.
source: CPS, analysis by FPI.

The official 2005 NYC unemployment rate of 5.8% provides a misleading picture of the condition of NYC's labor market. Long-term unemployment is much higher (35%) than nationally. NYC's underemployment rate is 10.1%. Among blacks, underemployment is 14%, and for Hispanics, 12.4%.

Labor force statistics, New York City, 2005

	All	males	females	White only	Black only	Hispanic	Other
Labor force participation rate	58.9%	67.3%	51.6%	59.6%	59.5%	57.3%	58.6%
Employment to population rate	55.5%	63.2%	48.7%	57.3%	54.4%	53.3%	56.2%
Unemployment rate	5.8%	6.0%	5.6%	3.9%	8.7%	6.9%	4.0%
Long-term unemployment share	34.8%	39.9%	28.6%	30.1%	41.3%	32.0%	30.6%
Underemployment rate*	10.1%	9.9%	10.4%	6.7%	14.0%	12.4%	8.4%
Part-time workers share	17.0%	12.9%	21.7%	16.8%	17.8%	17.6%	15.5%
Part-time for economic reasons share	16.5%	20.5%	13.8%	9.8%	18.4%	24.4%	17.6%
Share of labor force	100.0%	53.2%	46.8%	37.9%	24.7%	23.9%	13.6%
Labor force	3,707,854						

Source: Fiscal Policy Institute analysis of Current Population Survey (CPS) data

*Underemployment adds discouraged workers and those working part-time who would prefer full-time work

Key NYC Economic Trends Since 2000

- While NYC's economy has been in recovery since mid-2003, the pace of job growth is modest, largely because of historically weak national job growth. Tourism is booming and finance and professional jobs are increasing but remain well below 2000 peak levels.
- At the end of 2005, NYC still has 150,000 fewer private-sector jobs (-5%) than 5 years ago, with employment in several sectors still down by 10% or more.
- The housing bubble and the tenuous recovery may come to an end as the Federal Reserve has increased interest rates 13 times since mid-2004 and is intent on cooling the over-heated housing market.
- At best, NYC workers and their families are treading water economically. Median wages and incomes have fallen and poverty has risen, particularly among married couple families with children.
- The share of NYC families with incomes in the middle range has declined sharply since 2000, with most moving downward.
- Official unemployment understates labor market difficulties – under-employment and long-term unemployment are both very high in NYC.

NYC 2006 Labor Market Outlook

- Increased commercial and infrastructure spending could boost construction employment and offset the eventual slowing in residential.
- Job growth in retail trade, neighborhood services and restaurants will be helped by bonus season spending but could slow in 2006 due to higher energy costs and interest rates.
- Job growth will likely continue, though not accelerate, in Wall Street securities.
- As long as national economic growth continues, NYC job growth should persist in professional services, particularly management consulting, computer services and advertising.
- Strength in tourism will continue to boost job growth in the arts, hotels and restaurants.
- The pace of job loss should continue to ease in apparel manufacturing and banking, the industries beset by the steepest declines.
- The cooling housing market will bring job growth to an end in real estate and mortgage banking.
- The job outlook is mixed in the information and media sector with gains in publishing but losses in broadcasting, cable and telecommunications.
- Most segments within the private educational, health care and social services complex will continue to generate new jobs.
- Overall, NYC's net job growth over the next year or two is likely to stay in the 1% range (a net annual gain of 30,000 to 40,000 jobs). The aging out of baby boomers will create a significant number of openings for skilled workers over the next several years.

New York's widening income polarization

- NYS has the widest income gap between rich and poor of all 50 states (high incomes 8.1 times greater than low incomes), and the 6th widest gap between the rich and those in the middle.

- These gaps have grown dramatically over the last 20 years. For most of the 1980s and 1990s, the richest families gained steadily while the poor and those in the middle held steady or lost ground. For a few years in the late 1990s, a sustained period of growth tightened the labor market enough that people at the bottom and the middle finally saw meaningful increases. However, over the entire 20-year time period, only one state (Arizona) experienced greater growth in income disparity between the rich and the poor than NYS.

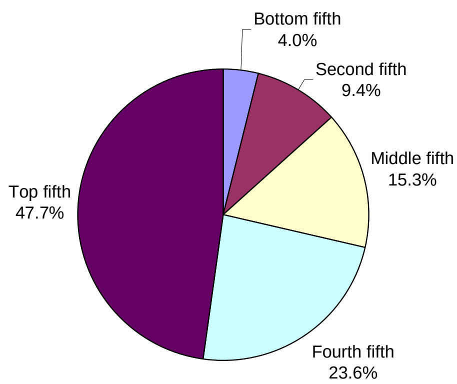
- While NY has had a relatively unequal income distribution for some time, in the early 1980s it ranked 11th among the 50 states.

- Polarization has increased since the early 2000s as real median wages have fallen and capital gains and bonuses and wages at the top have soared.

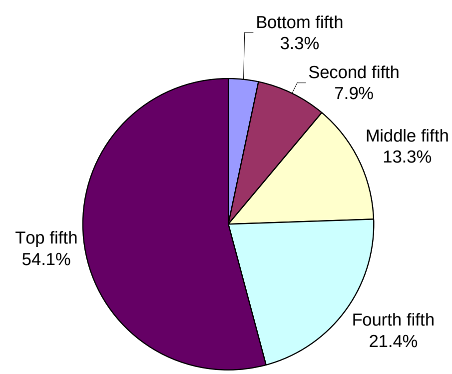
Between the early 1980s and the early 2000s, only the top fifth of New York City families increased their share of total city income.

Within the top fifth, most of the increase was at the very top. The share of total city income going to the <u>richest</u> 5% of NYC families increased from 19.9% to 25.6%

Early 1980s



Early 2000s



Source: EPI analysis of pre-tax family income from CPS March supplements.

An Agenda for a Better New York: 2006

To inform discussions in this election year regarding how to most effectively respond to New York's fiscal and economic challenges, the Fiscal Policy Institute will work with a wide array of organizations and individuals to craft a comprehensive and forward-looking policy agenda for New York.

This comprehensive agenda will be organized around three broad dimensions:

1. Promoting high-road and sustainable growth

2. Re-working the State-Local fiscal relationship

3. Creating shared prosperity

Contact FPI if you're interested in contributing to, or staying informed about, this agenda-setting project.