CITIZENS BUDGET COMMISSION

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TESTIMONY SUBMITTED TO THE NYC CITY COUNCIL FINANCE COMMITTEE
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Good afternoon. I am Maria Doulis, Director of City Studies at the Citizens Budget Commission (CBC). The CBC is a nonpartisan, nonprofit organization devoted to influencing constructive change in the finances and services of New York City and New York State government.

Thank you for the opportunity to testify today on the Executive Budget for Fiscal Year 2013. I would like to stress two points to members of the Council as they consider and amend the Mayor's proposed budget. First, the economic climate has changed dramatically, and budget practices must adapt. The traditional "budget dance" of Council restorations of proposed Mayoral cuts is no longer appropriate; the Council should instead focus on structural changes to municipal finances that will make budgeting easier in future years. Second, while some important changes require action through state legislation or collective bargaining, the City Council can move promptly on one front: phasing out the unusual practice of reimbursing retired municipal workers for their Medicare Part B premiums.

What's different?

The City has recovered the jobs lost in the recession, and private employment has surpassed the previous historical peak. While this is good news, it is important to note the jobs gained are not the same jobs that were lost. The heaviest job losses were on Wall Street, but the industries adding the most jobs are professional services, tourism-reliant trades (retail and hospitality) and health care services. The average wage in each of these sectors is markedly lower than in the securities industry. Retail, hospitality and health care jobs have average wages between $28,000 and $48,000; professional services and information industries average more than $100,000, but are still below the $360,000 average securities wage. As Wall Street continues to transform under federal regulations, its employment and profitability levels are unlikely to reach pre-recession levels – and this has important implications for City revenues.

Wall Street's record profitability over the last decade led to extraordinary growth in tax revenues for the City. Taxes grew 6.6 percent a year from fiscal years 2002 to 2012, compared to 2.7 percent a year in the decade prior. Even during the recession, economic activity exceeded budget assumptions, and the City customarily ended each fiscal year with a multi-billion dollar tax surplus, as high as $5.3 billion in fiscal year 2007.

Strong revenue growth allowed the City to pay for rapidly-growing costs and to make expansive investments in its workforce, services and infrastructure. From fiscal years 2002 to 2010, the city workforce grew by 26,000 positions. Labor contracts were negotiated that increased wages 26 percent for civilian employees, 32 percent for teachers and 42 percent for uniformed employees. Pension benefits were enhanced and health insurance costs began to grow more rapidly, combining for a total of $12.8 billion and 20 percent of the budget in fiscal year 2012. More than $80 billion in capital commitments were made, and the outstanding debt financing them grew to $100 billion.

But the City cannot rely on fast-growing revenues and large surpluses going forward. In sharp contrast to previous years, total tax revenues are not higher than anticipated: only $39 million more has been recognized to date in

fiscal year 2012. Even if greater collections are recognized in the next few weeks, the tax surplus will not reach the order of magnitude of previous years. More importantly, tax revenue growth over the financial plan will be modest – 4 to 5 percent annually, according to forecasts by the Office of Management and Budget and the Independent Budget Office.

How is this addressed in the financial plan?

The Executive Budget benefits from prior revenue and expenditure actions taken by the Mayor and the Council. First, the budget includes $2.5 billion in revenues from increases to property, sales and hotel taxes enacted at the onset of the recession. Second, 11 rounds of agency cost-cutting will produce more than $6 billion in savings in fiscal year 2013. The program-to-eliminate the gap has been an important restraint on expenditures; combined with a three-year wage freeze assumed in the financial plan, it will help limit growth in city expenditures to 2.7 percent a year.

Despite the significance of these efforts, they are not sufficient to balance the budget; over the financial plan period, total spending growth will outstrip revenue growth by one percent a year on average. Driving spending increases are large items like health insurance and debt service, which will continue to grow at a rapid pace – 9.4 and 7.2 percent a year, respectively. Rather than tackle these items, the Executive Budget relies on $3.6 billion in "one-shot" resources to close the fiscal year 2013 gap: $1.6 billion from fiscal year 2012 that includes $455 million from the CityTime settlement (which are more properly used to pay down the debt incurred to pay for the project); $1 billion in new revenues from the sale of taxi medallions (which appears to be more and more uncertain); and a $1 billion withdrawal from the Retiree Health Benefits Trust Fund (RHBT).

The Mayor and the Council took an important positive step in 2006 by creating the RHBT to begin to address the City's $90 billion unfunded liability for retiree health benefits. Unfortunately, the financial plan proposes depleting the RHBT by withdrawing $1 billion each year in fiscal years 2013 and 2014. These withdrawals are short-sighted; they provide temporary budget relief while increasing the long-term liability.

What should be done?

One-shots only delay the tough choices ahead. In the adopted budget, the Council should:

1. *Sustain the three-year wage freeze*. All major labor contracts will be expired by the end of the current fiscal year, and no reserve exists to pay any wage increases for the 2010-2012 round of bargaining. A wage freeze is not unreasonable; municipal wage increases exceeded inflation over the past decade, particularly during the recession, when many employees received four percent raises. Much of the State workforce has agreed to a similar freeze. The Council should support the Mayor's bargaining position and a quick resolution of expired contracts; failure to do so is a serious risk to the budget. Even wage increases no greater than the rate of inflation would open the budget gap by $5 billion in fiscal year 2014.

2. *Tie depletion of the RHBT fund to health insurance reforms, most importantly, phasing out the reimbursement of Medicare Part B premiums.* New York City is uniquely generous in paying the full premium cost of health insurance for its employees, retirees and their families – and especially in reimbursing the cost of Medicare Part B premiums for retirees over age 65. The Council should use its

authority to phase out the reimbursement through local legislation; this step alone would save $280 million in fiscal year 2013 and grow to $380 million by fiscal year 2016.

3. *Support the Mayor in seeking premium-sharing arrangements for employees and retirees*. If employee contributions of 10 percent for single coverage and 25 percent for family coverage were implemented, the City would save $700 million a year and would still be more generous than the State and many other large cities.

   Premium contributions for retirees under age 65 should be phased in over the course of the financial plan. A 50 percent contribution toward the premium cost would save more than $700 million a year and go a long way toward reducing the City's unfunded liability.

4. *Reexamine the level and nature of capital investments*. As debt service continues to grow, more than $40 billion in capital spending is planned over the next five years. Little is known about how priorities in the capital budget are established and how projects are evaluated. For example, the capital plan calls for $1.5 billion in economic development projects over the fiscal years 2012–2015 period, but no cost-benefit analysis is available to explain or justify them. In contrast, state-of-good-repair needs are persistently unmet: the most recent Asset Information Management System (AIMS) report shows that only 52 percent will be funded in fiscal years 2013 to 2016. Growth in capital commitments should be restrained, greater scrutiny should be placed on capital projects, and clear criteria should be established for prioritizing projects based on condition, need, or return on investment.

The City's economic recovery is underway, but that will not solve the City's financial dilemma. The Council has an important role to play in the budgeting process that should not be limited to debate over restorations and member items at the margins; rather, it should focus attention on the important structural changes needed to place the City on firmer footing.

Thank you.