Testimony before the City Council Finance Committee's hearing on the Mayor's Preliminary Budget for 2025

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Center for New York City Affairs

Thank you, Chair Brannan and members of the committee for the opportunity to present this testimony. I am George Sweeting, a senior fellow at The New School's Center for New York City Affairs.

I last testified before this committee on December 11th. The backdrop for this hearing is decidedly different from the backdrop then. While the budget picture has brightened, you and the Adams Administration still face significant challenges in the months ahead.

The $7.1 billion gap for Fiscal Year 2025 the mayor and his budget office projected in November has now been closed in the Preliminary Budget. The projected budget gaps in 2026 and 2027 also have shrunk by about 20 percent in the Preliminary Budget and now amount to around six percent of City funds revenues each of those years. These out-year gaps are similar in percentage terms to ones the City has dealt with in the past.

This turnaround is thanks to several factors: tax revenues exceeding the Office of Management and Budget's (OMB's) forecasts; savings from a budget-cutting plan that was partially implemented; slower than anticipated growth in the cost of providing shelter and services to asylum-seeking migrants; and the promise of additional assistance from Albany to help the City with those costs.

The revised outlook for tax revenues is due to better economic news than OMB had expected in November, when it used an economic forecast dating from last spring that anticipated slow or negative growth in calendar years 2023 and 2024 as the basis for its revenue projection.

Fears that the Federal Reserve's use of monetary policy to tame inflation would result in a recession have proved incorrect. Even with strong consumer demand, stronger than expected labor markets, and rising wages, inflation has slowed substantially while GDP growth has continued, particularly in the second half of 2023. The surprisingly strong GDP growth in the last two quarters of calendar year 2023 raised the annual GDP estimate for all of 2023 to 2.5 percent.

New York City's job growth in calendar year 2023 (measured fourth-quarter to fourth-quarter) was stronger than anticipated at 77,100 (1.7 percent), although significantly smaller than the nearly quarter-million jobs added in 2022. OMB is now forecasting a gain of 90,000 jobs in calendar 2024. Wage rates, personal income, and corporate profits are all also expected to bounce back from slow growth in 2023 to more moderate growth in calendar 2024. Tourism has been a particularly bright spot in the local economy and is expected to continue so, although geopolitical tension is a potential headwind.

These improvements in the city's economic condition come despite continuing evidence that many city residents have seen little of the benefits of the post-Covid recovery in overall employment and incomes. Unemployment in the city was 5.4 percent in December compared with 3.7 percent for the nation.

While the gap between Black and White unemployment rates in the city has shrunk somewhat in recent months, Black unemployment was three times higher than it was for whites at the end of December, and the Hispanic employment rate remains below the pre-pandemic level. While employment in some sectors has fully recovered pre-Covid levels, others, including many with low average wages such as retail and particularly leisure and hospitality, have yet to do so. The latter is actually continuing to shrink. Health care is one sector that has shown strong growth but must of the increase has been in the very low-paying home health care sector.

As emergency Covid relief programs have expired, poverty rates have increased dramatically. According to recent estimates from the Columbia University Center on Poverty and Social Policy, 23 percent of all New Yorkers and 25 percent of children lived in poverty at the end of 2022.

In short, we have a mixed bag of economic trends that are both hopeful and troubling. The same is true on the fiscal front.

OMB is now relying on an updated economic forecast that incorporates data from the second half of calendar 2023. The administration's current tax revenue projection is now essentially flat for Fiscal Year 2024 rather than the decline OMB forecast in November. Looking ahead, OMB is now forecasting 2.6 percent growth in revenues in Fiscal Year 2025, led by the personal and business income taxes.

On the other hand, high interest rates and a lagging housing supply are drags on the residential housing market. Meanwhile, high vacancy rates continue to plague commercial properties. As a result, the outlook for real estate transaction taxes has once again been reduced. OMB also expects property tax revenue to grow by only 1.6 percent, much slower than in the decade before the pandemic.

Recent forecasts from the city's Independent Budget Office and the Council's Finance Division project stronger revenue growth than OMB, with differences over 2024 and 2025 of $2.9 billion and $3.4 billion. respectively. Given the continued strength in key economic indicators and current collections, these estimates seem more likely than what OMB is forecasting.

Given this changed and mixed economic and fiscal outlook, what should you and the mayor be doing?

The mayor has responded by pulling back from much of the three-round budget-gap closing program he planned for in November. Only one of those rounds of cuts has now been fully implemented – and some of those cuts were reversed. Some but not all cuts once anticipated in the second round were canceled; $3 billion in cuts for Fiscal 2024 and 2025 remain part of the preliminary budget. The third round of cuts was canceled last month, save for reductions in migrant services spending.

As you contemplate your responses to these revised budget proposals, let me urge you to also keep in mind these two factors:

The first concerns the so-called "fiscal cliff" resulting from the expiration of federal Covid relief funds. the Preliminary Budget includes commitments of City funds to replace some, but far from all, of these funds, which have been used in, for example, early childhood education programs.

The second concerns the large and still-unaddressed costs of meeting new policies and mandates. The clock continues to tick down on a State mandate to reduce class sizes which will likely require hiring thousands of teachers. These costs will almost certainly start showing up in Fiscal Year 2026 – about 16 months from now. The preliminary budget does not reflect these costs.

City Council legislation also has expanded the eligibility for rental assistance from the City. The January budget added $442 million in new rental assistance spending for Fiscal Year 2024, but added nothing for 2025 through 2028. How this issue is resolved is, needless to say, of enormous importance to City taxpayers, and also to low-income tenants caught in the tightest residential housing market in modern memory.

Sustaining programs previously funded with Covid aid and meeting these mandates will require new budget resources, either by re-arranging budget priorities or securing more recurring revenues. And given the still uneven recovery from Covid, it is critical that resolving these issues while closing future budget gaps not be addressed with across-the-board cuts. Instead, the city will need a mix of carefully targeted cuts, smarter spending, and if necessary, tax increases starting with the ranks of individuals and institutions whose income and wealth have increased the most in recent years.

The Center for New York City Affairs has estimated that the personal income tax could be made more progressive while raising approximately $1 billion in new revenue by adding two new brackets at $1 million and $5 million, with rates of 4.2 percent and 4.4 percent, respectively. The City Comptroller offered a similar proposal last year. Under the State Constitution, colleges, universities, and hospitals are exempt from the City's property tax, although they rely on some City services. If it were necessary to raise revenue, the City could seek to amend the Constitution, or alternatively negotiate agreements with the institutions to have them pay a portion of what they would owe if not exempt. Such arrangements are common in other cities with large numbers of tax-exempt institutions. Preliminary results from analysis by the Center indicate that agreements similar to those Boston has with its non-profits could yield about $235 million annually for the city.

Thank you.