

## The Fiscal Monitors Assess The Budget

by {ga=gpasanen}

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Three official fiscal monitors have given New York City's adopted budget for fiscal year 2004 generally favorable reviews, but two private budget groups are rather harsh, giving the Mayor and City Council grades ranging from "B" to "F". City Comptroller William C. Thompson in a July report ( [pdf format](#) ) says the budget "charts a reasonable course toward current-year balance." The State Financial Control Board's July 24 staff report calls the budget "an achievement of no little note," and State Comptroller Alan G. Hevesi says in his July report on the city's finances that "the city has demonstrated its ability to manage the budget during difficult times."

On the other hand, the [Citizens Budget Commission](#) , a conservative nonpartisan civic organization, and [City Project](#) , a progressive nonpartisan public policy organization, attack several elements of the adopted budget, if from quite different perspectives. The commission's City Budget Report Card gives a "B" for the budget's transparency and timeliness, "C" for productivity, "D" for budgeting responsibly (i.e., too much spending), and "F" for tax policy (a high city tax burden "grows even higher"). City Project gives the adopted expenditure budget a "B", for saving essential services, and the revenue budget a "D-", for the "temporary and largely regressive nature of its revenues, and its over reliance on debt refinancing and funding shifts."

Looking ahead, the five new reports highlight several interconnected issues that will be crucial to budget discussions over the next year – issues such as future budget gaps, a squeeze on human service spending, and city tax burdens. The official monitors, for instance, worry about the large deficits beginning in fiscal year 2005 – approaching \$3 billion in 2005 and \$4 billion in 2006 and 2007. Although those gaps are significantly less than the \$7+ billion deficit the adopted budget filled, Thompson says the "city's options going forward are limited." The monitors cite problems like increasing mandated costs in non-service areas (pension, health insurance, and debt service in particular) and the Financial Control Board worries about the economic impact of increasing tax burdens.

### Notable Cuts In The Adopted Budget

The city's new \$43.9 billion budget for 2004 includes about \$3.2 billion in new taxes and fees and nearly \$900 million in cuts in basic municipal services. (Another \$1.2 billion includes new revenues, re-estimates in spending, staff reductions where the service impact is unclear, and cost-shifting to non-city sources). The budget also reflects a final surplus in fiscal year 2003 of \$1.3 billion (largely the result of the November 2002 increase in property taxes), which was used to pre-pay 2004 expenses.

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Several cuts are notable. Hevesi points out that city funding for the Department of Education has been reduced by \$495 million (“nearly the lowest level permitted under state law”) just as the new department faces higher state and federal educational standards.

The uniformed agencies’ budgets (police, fire, corrections, sanitation) are reduced by \$505 million, with the police force to be reduced by 2,100 in 2004.

Libraries take a big hit, with most now open only five days a week instead of six. The Administration for Children’s Services is also hit hard. Hevesi says that since fiscal year 2002, the agency has experienced the most cuts among social service agencies – both in percentage and absolute dollars: “Between July 2001 and April 2003, the city reduced planned funding in FY 2004 for child welfare services by \$54 million, and for child care by \$107 million...partially offset by an increase of \$19 million in community development block grant funds.” The results, among others, include cuts in child welfare contract agency payments, fewer beds, fewer child care slots, higher child care costs for parents, and cuts in crisis services. The mayoral/City Council negotiations in June restored only \$11.6 million in city funding for child welfare and \$10.9 million for child care.

### Future Spending

In the face of such substantial cuts in schools, libraries, and child welfare, it is sobering to see the projected spending priorities in the monitors’ reports. For example, the Hevesi report notes that although spending in 2004 actually grows by 8.2 percent, far above the rate of inflation, the great bulk of the increase is in areas such as pension, health insurance, and debt service costs. Pension costs are projected to grow by \$927 million (61 percent) in 2004 alone, and debt service by \$663 million (20 percent).

The pressure of such non-discretionary spending only increases over the longer term. The City Comptroller’s report shows how these expenditures (including Medicaid and legal claims on the city) are projected to grow by 51 percent (\$5.9 billion) over the next four years. Over the same four-year period, salaries and wages of the city’s workforce are projected to fall by 4.6 percent. City funding of public assistance is estimated to fall by 11.6 percent. And the city’s remaining \$11 billion OTPS (other-than-personal-service) budget – over half of which represents the city’s huge contracted-services budget – is projected to fall by just over one percent over the next four

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years.

The four-year projections in the adopted budget, according to the Thompson report, add up to a fiscal year 2007 city budget that looks like this:

- 2007 Expenditures \$49.5 billion
- 2007 Revenues 46.2 billion
- 2007 Budget Gap (\$3.2 billion)

However, the City Comptroller (like the other monitors) sees a lot of risks in the projections, and says the 2007 deficit could approach \$4 billion.

### Tax Burdens

The conventional political wisdom at the moment is that the large tax increases in the 2004 budget preclude any new taxes as the city begins to fill these out-year budget gaps. If this view persists, especially in the face of the huge non-discretionary spending increases, the pressures to cut core city services are likely to be severe. In this context, it is interesting that both the City and State Comptrollers at least begin analyses of the actual tax burdens now facing individuals and businesses. The results of these studies – and two others -- provide initial important data.

The new personal income tax surcharge is a three-year tax increase, in effect from January 1, 2003 to December 30, 2005. According to the State Comptroller, it will produce \$644 million in 2004. Who pays? Only singles with adjusted gross income of \$100,000 and couples with income over \$150,000. For those earning over \$500,000, their effective city income tax rate (taxes paid divided by income) rises from 3.65 percent to 4.45 percent. This is a progressive change in tax rates. But the State Comptroller report puts the increase in the larger context of recent federal tax reductions. Those paying the new city surcharge are net winners:

- Couples earning \$200,000 will net \$3,066: They will pay \$1,252 more in city income taxes, but \$4,318 less in federal taxes.
- Couples earning \$600,000 will net \$14,937: They will pay \$4,418 more in city income taxes,

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but \$19,355 less in federal taxes.

Incidentally, those couples that make \$100,000 and \$150,000 – who won't pay the surcharge – are getting \$1,442 and \$2,534 reductions in federal taxes, respectively. The State Financial Control Board's July report ignores this larger context and warns that if the three-year income tax surcharge is not allowed to expire in 2005, it "could well have counterproductive consequences for the economy and for the city's ability to balance its budget in the long run."

The tax burden imposed by the new property tax rate increase is much harder to determine. In broad terms, according to the State Comptroller, half of the \$1.7 billion increase is paid by commercial and utility properties, 35 percent by condo, coop and rental properties, and the balance by one-, two-, and three-family homeowners (so-called class 1). Factoring in the November 2002 18.5 percent rate increase and assessment increases, the State Comptroller says, "the average real property tax bill for class 1 homeowners has increased to \$2,490, which is \$591 (or 31.1 percent) higher than in FY 2002." Since class 1 homeowners have long been protected by a number of technical details in the property tax law – resulting in lower effective tax rates than in surrounding counties – and since the November increase was the first average rate increase in 11 years, further analysis is necessary to understand the full consequences of this hefty homeowner tax increase.

The City Comptroller's report is interesting also for an ambitious attempt to measure tax burdens in New York City. One dense chart (p. 19) shows four measures of actual and projected tax burden over the 1992 to 2007 period. The measures:

- Taxes per capita
- Taxes per worker
- Taxes as a fraction of gross city product
- Taxes as a fraction of personal income

The report notes that from 1992 to 2001, all four measures grew slowly or declined, "very likely due to the tax cuts in the 1990's." In 2002 they all fell, because of the recession and 9/11. Not surprisingly, they all show rises in 2003 and especially in 2004.

To take only the most common measure – taxes as a fraction of personal income, the measure

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which Rudy Giuliani used regularly to mark his success in reducing taxes – city residents paid an average of 10 cents for every dollar earned during the early 1980s, then 8.5 cents in city taxes for every dollar earned in 1991 and 7.5 cents in 2001, an average annual decline of 1.3 percent. The new taxes will increase this rate by six percent in 2003 and seven percent in 2004.

So what to make of this? On this most common measure, it looks as if in 2004 city residents will have roughly the same tax burden they had from 1991 to 1993, another period suffering from recession and big budget gaps.

What may be different now is the effect of the property tax increase. After 11 years of a frozen average property tax rate, the sudden 18.5 percent increase has exposed how incredibly complex and inequitable the city's property tax system is. The Citizens Budget Commission report card, for instance, says that the property tax burden on commercial properties is three times that on single-family homeowners. A new report from the [New York Public Interest Research Group](#) illustrates the inequitable impact of assessment practices on class 1 homeowners. Another new study, by the Independent Budget Office ([in pdf format](#)), shows how the new tax on absentee landlords will have an unfair impact on poorer neighborhoods. Renters and certain coop and condo owners also get a bad deal, as shown in earlier [Independent Budget Office](#) reports and an earlier [Gotham Gazette finance column](#).

The official monitors suggest that at least in the short run the city is in reasonable budget shape. That gives decision-makers some time to examine more closely charges from the political right and the political left that the new taxes are excessive and/or unfair. A comprehensive look at the property tax is the natural place to begin. Budget balance also gives them some time to determine more accurately how several substantial budget cuts affect children in schools, libraries, and the various human service agencies designed to serve them.

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