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Testimony of George Sweeting
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To the New York City Council Committee on Finance
Regarding the Mayor's Executive Budget for 2023 and Financial Plan through 2026
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Good afternoon, Chair Brannan and members of the Finance Committee. I am George Sweeting, acting director of the New York City Independent Budget Office (IBO). Thank you for the opportunity to discuss our latest economic and tax revenue forecasts for the city and our analysis of the Mayor's Executive Budget.

The city's recovery from the short, but deep, pandemic-induced recession continues to surpass earlier expectations, including ours of three months ago. Thanks, in large part, to higher than anticipated personal income tax collections in April, we raised our total tax forecast for fiscal year 2022 to $68.0 billion, a 4.5 percent increase compared with our projection in March. In other positive news, recent upward revisions to employment data reveal that the city is on track to reach pre-pandemic employment by early calendar year 2024, more than a year earlier than we previously expected, and tourism—as you know an important driver to the city's economy—continues its rebound after a short-lived decline during the Omicron wave this winter.

Of course, not all news is good news. Recent high inflation has led the Federal Reserve to tighten monetary policy by shrinking its balance sheet and raising interest rates. The Fed now faces the difficult task of tamping down inflation without triggering a recession. And while we assume that the Fed will succeed at this delicate task, the expected slowdown in growth has caused us to lower our March tax revenue forecasts for fiscal years 2023 through 2026. With this adjustment, IBO's projection of annual average tax revenue growth during fiscal years 2022 to 2026 has been reduced from 2.4 percent to 2.2 percent.

The personal income tax, sales tax, and the property transfer taxes have been particularly strong this year, while property tax revenue fell. Although we forecast property tax revenue to bounce back in fiscal year 2023 as assessments recover much of the reductions the Department of Finance made in response to the pandemic; we forecast most other major tax sources to decline, with overall tax revenue falling to $67.6 billion in fiscal year 2023, a decline of 0.6 percent from 2022. Tax revenue growth is expected to resume in 2024, averaging 2.5 percent annually in fiscal years 2024 through 2026.

Despite reducing our tax revenue forecasts from our March outlook for 2023 though 2026, our revenue estimates are still higher in every year than those included with the Mayor's Executive Budget. We estimate $2.5 billion in additional tax revenue for this year. About $1.5 billion of that is due to unanticipated personal income tax collections received in April—mainly a windfall of extension payments that cannot be expected to recur in the future and that were made after the Mayor's Office of Management and Budget had completed its forecast. Without such a substantial bump in personal income tax extension payments in later years, our differences shrink. In 2023, we estimate $1.5 billion more in tax revenue than OMB, and from 2024 through 2026, we estimate an average of $1.6 billion more each year.

Based on our forecast of revenues and our reestimates of spending proposals included within the Executive Budget, we project the city will add $2.2 billion to the current fiscal year's surplus. This is over and above the $5.9 billion in prepayments and additions to reserves the Mayor has already budgeted for this year. If all the additional surplus funds we identified are applied as a prepayment for 2023 expenses, this would result in a surplus of $3.2 billion in 2023. After 2023, IBO estimates that expenses will exceed revenues, resulting in gaps of $3.1 billion, $2.6 billion and $3.0 billion for fiscal years 2024 through 2026, respectively—all lower than the gaps projected by the Mayor and considered manageable by historical standards, particularly after accounting for the $1.25 billion of unallocated reserve funds built into each of these years' budgets.

One factor contributing to these future-year gaps is IBO's estimate that the city is funding an increasing number of ongoing education programs with time-limited, federal Covid-19 stimulus aid. Based on reallocations made in the Executive Budget, IBO now estimates that the Department of Education will face a funding need reaching $1.1 billion for these programs in fiscal year 2026. This is $337 million more than our previous projection, before reallocations made in the Executve Budget. Other areas where IBO expects the Mayor will have to have to increase city funding over the current budget include: uniform overtime, particularly for police; charter school tuition; and to cover the cost of the city's recently expanded housing voucher program.

While these and other higher-than-budgeted costs are more than offset by our projections of greater tax revenues than estimated by the Mayor, several issues could disrupt the balance of the financial plan. One of the most pressing is that of collective bargaining settlements with the city's municipal unions.

As you know, nearly all the city's labor contracts are either already expired or are set to expire this calendar year. Prior to the Executive Budget, the labor reserve only included funding for 1.0 percent wage increases in the third year of new contracts. While the Mayor did include some new funding in the Executive Budget—$1.7 billion over the plan's five-year period to support half percent raises for each of the first two years of new contracts—it seems unlikely that the municipal unions will settle for that amount, particularly given the rate of inflation over the past year alone. By way of example, in the last collective bargaining round, civilian pay rose by 7.4 percent over 44 months. While the city's Office of Labor Relations and the municipal unions are expected to work together to find additional health care savings to offset some negotiated wage increases, it is nearly certain that labor costs will rise in the next years of financial plan.

Our economic forecast relies on the assumption that the Federal Reserve will succeed in its efforts to tame inflation by tightening monetary policy without causing a recession. However, this is far from certain and presents the greatest risk to IBO's economic forecast of continued modest growth over the entire forecast period. Rising interest rates combined with continued geopolitical tensions caused by Russia's invasion of Ukraine, soaring energy costs, and renewed supply chain disruptions, have already led to significant losses in equity markets. For New York City, these market disruptions threaten the near record profits earned by Wall Street in recent years—and the income taxes they generate, which helped sustain the city coffers during the pandemic.

Lastly, there is the pandemic and its impact on the city economy. A much-discussed survey by Partnership for New York City recently showed that nearly 80 percent of companies surveyed plan on using a hybrid model of work post-pandemic compared with 6 percent before 2020. This change in working habits could alter the composition of the city's business districts by decreasing the number of office workers who commute into the city on a daily basis, and reducing the demand for office space. It could also spur more out-migration of city residents who no longer need to reside within easy commuting distance of their workplace. While IBO's forecast does not anticipate dramatic changes in the demand for office space or the values of office properties in the near-term, largely due to the length of commercial leases, looking beyond the near-term forecast there is a much greater amount of uncertainty.