OFFICE OF THE STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

The Financial Industry Crisis – Impact on the New York State Budget

September 2008

The Financial Industry Crisis

Over the past year, financial firms have written off hundreds of billions of dollars in bad debt, which has resulted in a loss of confidence and a destabilization of the financial markets. Recent weeks have witnessed historic developments, with the collapse of Lehman Brothers and the sale of Merrill Lynch, as well as government intervention with Fannie Mae, Freddie Mac and AIG, in addition to Washington Mutual. These events have been followed by negotiations for a federal program to remove troubled financial assets from the financial system.

In addition to the Federal Reserve and the U.S. Treasury, the Common Retirement Fund and the New York State Insurance Department have acted to restore stability in the financial markets. As sole trustee of the Common Retirement Fund, the Comptroller quickly halted the use of several Common Retirement Fund-owned equities for use by short-sellers to relieve the mounting downward pressure on the stock prices of financial services companies. Speculative selling of financial firms has put downward pressure on the entire stock market and threatened to drive our national economy deeper into decline. This action removed some of the fuel that fed this speculative fire.

Impact on the New York State Budget

The situation remains fluid, but it is clear that the implications for the national, State and local economies will be substantial. The nation, including New York State and New York City, was already experiencing slower economic activity, and current developments will further impact the State and City economies. Consumers, already under pressure from higher energy and food prices, will now have to weather the effects of this financial institution crisis.

In response to the housing and credit crisis, in May 2008, the New York State Division of the Budget lowered current year revenue projections by $3.1 billion from the Executive Budget proposal and by an additional $1 billion in July 2008, and further revenue reductions are likely. The Governor and the Legislature have been proactive and, through August, have reduced agency spending by 10 percent and taken other steps to address the situation.

As the State's Chief Fiscal Officer, the Comptroller maintains a close watch over the impact of all economic events for New York State and its local governments, including New York City. The recent Monthly Report of State Funds released by the Office of State Comptroller for the month of August indicated that while General Fund revenues were only $50 million less than expected by the State's revised July Financial Plan, business taxes were nearly $167 million less than expected through August and were down $366 million from last year. Although personal income tax collections exceeded expectations by $104 million through August, collections are likely to erode as the impact of the Wall Street crisis is reflected in job losses and lower bonus payments. These lower than projected collections in tax revenues were accompanied by lower than expected General Fund spending of $532.5 million, primarily for local assistance payments.

Preliminary tax revenue collections to date for the month of September show a slight decline in tax revenues for all governmental funds. While collections in the personal income tax showed small growth compared to September 2007, other taxes, including the sales tax and business taxes, show an absolute decline of approximately $154 million on a year-to-year basis for the month. These numbers will be finalized over the next few weeks.

In comparison, total personal income tax collections for the first six months of the fiscal year are $2.7 billion above 2007, softening the loss of approximately $506 million in business tax collections over the same time period. The relatively small increase in personal income tax collections on a year-to-year basis for the months of July, August and September ($260 million) is now beginning to be overshadowed by the drop in business and in consumer taxes, indicating a turning point in the State financial picture as the events in the financial system begin to impact New York's fiscal plan.

As of August 2008, non-farm employment in New York State totaled 8.8 million jobs. Although the number of jobs in August was greater than a year earlier, job losses are expected to mount as the year progresses. The unemployment rate rose in August to 5.6 percent—more than a full percentage point higher than one year earlier.

Prior to the developments of the past few weeks, the securities industry was expected to lose approximately 25,000 jobs as a result of the losses reported by the financial industry earlier in the year. The recent events of the past few weeks, if not mitigated, could raise this number to approximate the 40,000 jobs lost in the 2001-2003 period. The implications go far beyond the securities industry itself since each job lost on Wall Street could result in as many as three jobs lost elsewhere within the State, from lawyers to restaurant owners, with the highest concentrated job loss in New York City. These estimates are as of September 29, and could decrease or increase, depending upon market volatility and federal actions.

Similarly, the contraction in the Wall Street bonus pool could rival the 50 percent decline incurred after the tragedy of September 11, 2001. In 2007, the bonus pool totaled $33.2 billion. A 50 percent decline would reduce bonuses to the 2003 level of approximately $16 billion.

The impact on State and City coffers will be significant in the short term as the financial markets continue to restructure and consolidate. The Office of the State Comptroller's preliminary review, based on estimates as of September 29, indicate that the tax revenue loss could approach $3.5 billion through March 2010, with particular risk to the SFY 2009-10 Financial Plan. Most of the revenue loss will come in the form of lower personal income tax collections, but, on a percentage basis, the decline in business tax collections could be greater. These numbers will be finalized once all September tax revenue numbers have been received and reviewed.

The situation remains fluid and serious. Nevertheless, it should be remembered that New Yorkers have navigated through difficult situations in the past. New York State and New York City, under the leadership of Governor Paterson and Mayor Bloomberg, with the support of the State Legislature and City Council must work together to ensure the fiscal stability of the State and the City.