New York City Independent Budget Office **Fiscal Outlook**

December 2010

Budget Challenges Ahead:

While Tax Revenues Improve, Cuts In State Aid Could Widen Gaps

WHEN THE BLOOMBERG ADMINISTRATION PRESENTED ITS MOST RECENT BUDGET PLAN in November, surprisingly little mention was made of the local economy. The Mayor's revenue estimates stood almost virtually where they had been roughly five months earlier. Instead, the Bloomberg Administration pointed to rising pension costs and the expiration of federal stimulus funding as the primary challenges to keeping the city's budget in balance.

While rising pension costs and expiring stimulus aid indeed present challenges, IBO's latest economic forecast finds that job growth and rebounding business profits will lead to $525 million more in tax revenues in 2011 and $790 million more in 2012 than projected by the Mayor. IBO estimates the current fiscal year will end with a surplus of nearly $1.7 billion, taking into account the additional revenue along with our projection of somewhat higher expenses. We assume the additional revenue in 2011 will be used to help prepay some 2012 expenditures. As a result IBO estimates that under the Mayor's November 2010 Financial Plan, which assumes all his proposed spendng and revenue measures will occur but does not take into account the likelihood of significant cuts in state aid, the budget gap for 2012 will shrink to $1.1 billion.

Because of our higher revenue estimates, IBO's gap projections for the out-years are likewise substantially lower than the Mayor's. Our gap estimate for 2013 is $3.2 billion, $1.6 billion less than the Mayor's, and for 2014 our projection is $3.5 billion, $2.1 billion less.

But these shortfalls could also swell by $2 billion or more a year if the state deals with its own fiscal problems by reducing aid to the city and other localities.

Taxes & Revenue

U.S. Economy. The U.S. economy has been sending mixed signals in recent months, making the near-term outlook particularly uncertain. Measured by real gross domestic product (GDP), growth slowed over the spring and summer quarters from the more rapid pace of last fall and winter. Real GDP grew at an annual rate of 1.7 percent in the second quarter of 2010 and 2.5 percent in the third quarter. (All years in this section refer to calendar years.) Since the beginning of the year, private-sector employment has increased each month, but at an unsteady pace. The number of private-sector jobs added each month rose steeply at the beginning of the year and peaked in April, with 241,000 jobs added, before plummeting in May, to 51,000 jobs gained. Job growth gradually strengthened again from May through October, when 160,000 jobs were added, before dropping to a gain of 50,000 jobs in November. The government sector has been shedding jobs since the census field work was

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completed in May and fiscally weakened state and local governments have been forced to cut staff.

Despite these signs of weakness in the pace of recovery from the recent downturn, IBO does not expect the economy to fall back into a second recession. Still, on an annual basis, GDP growth in 2011 is forecast to be essentially the same as this year, 2.7 percent versus an estimated 2.8 percent in 2010, before picking up to 3.4 percent in 2012. Total employment is projected to grow more slowly than output, with year-over-year job losses in 2010 followed by modest growth of 0.8 percent and 1.2 percent, respectively, in 2011 and 2012. Unemployment will gradually edge upward in the coming months as workers who had stopped looking for work rejoin the labor force faster than jobs are created. With the economy having regained only about 8.5 percent of the 8.3 million jobs lost during the recession, the prerecession employment peak in the first quarter of 2008 is not expected to be reached until the second quarter of 2013. The unemployment rate is expected to remain above 9.0 percent till 2014, when employment growth has accelerated to 2.7 percent for the year.

A prolonged period of U.S. growth significantly below its potential rate has led to excess capacity and high unemployment, keeping inflation low even with substantial fiscal and monetary stimulus. With relatively slow growth in output, income, and, especially, employment in our forecast, inflation as measured by the consumer price index is expected to remain low: 1.6 percent this year, 1.4 percent in 2011, and 2.0 percent in 2012.

IBO expects the drags on economic growth apparent in the second half of this year will continue well into 2011. Lingering effects of the financial crisis have resulted in lending standards that are still much tighter than two years ago, and many small businesses are having difficulty getting loans, making it difficult to expand and create jobs. Sales of foreclosed homes and short sales, combined with the enormous excess supply of housing units in many parts of the country, continue to put downward pressure on home prices, forcing households to focus on shoring up their balance sheets rather than consumption. With households spooked by still-falling home prices and high levels of unemployment, consumer confidence remains low, further constraining consumption, which is limping along at 1.7 percent growth this year, with only a 2.5 percent gain expected for next year.

The drags on recovery are expected to gradually weaken during 2011, enabling stronger growth going into 2012. The number of delinquent mortgages appears to have peaked this year and the number of mortgages in foreclosure should level off in early 2011. Meanwhile, the housing price declines have almost run their course, with the the market expected to hit bottom in mid-2011. These improvements should lighten housing's weight as a brake on growth. Businesses, which have enjoyed strong corporate profits this year and improving corporate balance sheets, are expected to accelerate investing and hiring by the end of 2011. (The investment incentives in the new tax bill should provide an additional spur.) With household debt burdens shrinking, employment slowly recovering, and personal income and consumer confidence picking up, household consumption is expected to pick up going into 2012.

Persistent sovereign debt problems in Europe could hamper economic growth there and depress demand for U.S. exports of goods and services, slowing the recovery here. If concerns about public-sector debt spread to this country, interest rates could rise sharply and constrain government spending and business investment at all levels.

IBO's outlook for economic growth is modestly more optimistic than some recent forecasts, particularly for 2012. Comparing our GDP forecast with that of a group of leading forecasters surveyed by the Philadelphia Federal Reserve Bank, IBO's forecast is 0.2 percentage points

Total Revenue and Expenditure Projections
Dollars in millions

	2011	2012	2013	2014	Average Change
Total Revenues	$65,099	$66,351	$68,789	$71,138	3.0%
Total Taxes	*38,735*	*40,772*	*43,002*	*44,880*	*5.0%*
Total Expenditures	65,099	67,488	71,985	74,590	4.6%
IBO Surplus / (Gap) Projections	**$(0)**	**$(1,137)**	**$(3,196)**	**$(3,452)**	
Adjusted for Prepayments and Discretionary Transfers:					
Total Expenditures	*$67,067*	*$69,166*	*$71,985*	*$74,590*	*3.6%*
City-Funded Expenditures	*$45,848*	*$48,974*	*$51,706*	*$53,903*	*5.5%*

SOURCE: IBO

NOTES: IBO projects a surplus of $1.678 billion for 2011, $517 million above the Bloomberg Administration's forecast. The surplus is used to prepay some 2012 expenditures, leaving 2011 with a balanced budget. Estimates exclude intra-city revenues and expenditures. City-funded expenditures exclude state, federal, and other categorical grants, and interfund agreement amounts. Figures may not add due to rounding.

above the median of the Philadelphia group for 2011 (2.7 percent versus 2.5 percent) and 0.5 percentage points above for 2012 (3.4 percent versus 2.9 percent.) Based on the Mayor's Office of Management and Budget (OMB) forecast that accompanied the November financial plan, there is a substantial difference between the Bloomberg Administration's and IBO's forecasts for GDP growth in 2011, with IBO forecasting 2.7 percent and OMB expecting 2.1 percent.

Note that IBO's forecast was completed before the terms of the just-enacted federal tax policy changes were announced. While IBO's forecast assumed extension of the Bush personal income tax rates, other aspects of the deal that provide additional fiscal stimulus—including the temporary payroll tax reduction—were not anticipated.

New York City Economy. Though the Great Recession began with the crisis in financial firms and markets, the employment downturn in New York City was shorter (five quarters, from the fourth quarter of 2008 through the fourth quarter of 2009) and less severe (a 4.2 percent or 160,800 jobs drop in employment from peak to trough) than in the nation as a whole. In terms of earnings and income, however, the city economy was hit much harder. In 2008 and 2009, real average wages in the city fell by 10.1 percent over two years, with a 9.0 percent decline in 2009 alone, with the average real wage declines particularly steep in the high-paying securities industry (24.6 percent over the two years). Because over a third of the aggregate compensation losses were borne by commuters, real average personal income of residents decreased by a smaller percentage—5.4 percent in 2009.

While the recession's shock to the city's economy was most evident in income declines, the contraction of economic activity (output) was much less than in the last two recessions (1990-1991, 2002-2003), and this may have positioned the city for its—so far—relatively robust recovery. By the end of 2010, IBO expects employment in the city to have risen by 52,000 (1.4 percent) from the nadir reached in the fourth quarter of 2009. This means that in one year the city will have recovered nearly a third of the jobs lost during the downturn, including 43 percent of the private-sector jobs previously lost. But the jobs now being added tend to be in different industries than the jobs lost. Financial and business services employment fell by a combined 85,500 during the downturn but is expected to regain only 10,300 through the end of 2010. The leading job growth sectors during 2010 have instead been education and health care, leisure and hospitality, personal services, and wholesale and retail trade.

IBO forecasts continued growth in the city economy in 2011, but at a somewhat weaker pace due to the flagging recovery at the national level. From the fourth quarter of 2010 to the fourth quarter of 2011, total employment is expected to increase by 41,700 (1.1 percent), with private employment up by 45,400 (1.4 percent). The city will benefit from the ongoing role of health care services as a buffer against business cycle shocks, the continuing spending flowing into the economy from tourism, a partially revived financial sector, and the firming of the local real estate market—albeit with sales volume at less than half of the precrisis peak.

Job gains will be spread over most of the city economy, with only manufacturing, transportation, utilities, and government showing net declines and the largest number of jobs added in education and health services (+18,700), leisure and hospitality (+7,200), and trade (+6,000). However, the employment increases are not expected to make much of a dent in the city's high unemployment rate, which is projected to rise from 9.7 percent in 2010 to 10.1 percent in 2011 as New Yorkers enter (or reenter) the labor market faster than they can all be absorbed. With the city's high-wage industries largely on the sidelines of employment growth through the first two years of the recovery, real per capita personal income is projected to increase by a modest 2.4 percent in 2010 and again in 2011.

The wild card in the local forecast is banking and securities. After swinging from record losses in 2007–2008 to a record gain in 2009, Wall Street profits are expected to decline to relatively moderate levels—$24.6 billion in 2010 and $13.6 billion in 2011. Gradually rising interest expenses and expected weakness in proprietary trading will hold down net revenue, which we have forecast without any special assumptions pertaining to new financial regulations—many of which are yet to be written. The uncertainty about regulatory impacts makes us cautious about recognizing any upside in our profit growth projections.

IBO forecasts fourth quarter-to-fourth quarter job growth of about 52,700 (1.4 percent) per year over the 2012-2014 period—growth well below the big gains of the late 1990s and a bit below the most recent precrisis pace. The growth would enable the city to regain its third quarter, 2008 employment peak by the second quarter of 2012, a full year before national employment is expected to climb back to its prerecession level. The pace of job creation in the financial sector will pick up after 2011 and average 5,800 per year, igniting a strong and sustained expansion in professional and business services employment (14,300 per year on average). Education and health care services will on average add 14,200 per year in this period.

Job growth in the out-years will enable labor markets to eventually reabsorb many, but not all, of the city's unemployed. The unemployment rate in the city is expected to recede to 6.6 percent by 2014 and not drop much further in subsequent years, still well above the precrisis (2005-2008) lows. With more residents employed and with more jobs being added in higher wage sectors, real per capita personal income growth will pick up, averaging 4.5 percent from 2012–2014. This will be accompanied by steady growth in real estate sales volume, but at a fraction of the rate during the real estate boom.

IBO's local economic forecast is more optimistic than OMB's forecast in the November plan, particularly in the outlook for 2011. As in OMB's U.S. forecast, growth slows considerably next year with little job growth expected and weaker nominal personal income growth (2.6 percent) compared to IBO's 4.0 percent expected increase.

There are two major risks to IBO's local forecast. The first is Wall Street, where we expect the profits of New York Stock Exchange member firms to fall further to $12.3 billion in 2012 and around $11.0 billion per year thereafter. But it will take years for the new financial regulations to roll out and for the banks, hedge funds, and other businesses to adapt to them, and the potential effect on Wall Street profits is unknown. The health care sector also is beset by unknowns. For decades nothing—neither crisis nor recession nor reimbursement reforms—has stopped its expansion. But New York State is now facing unprecedented fiscal stress, which might decrease state health care funding. Federal health care reform adds an additional layer of longer-term uncertainty, with some elements suggesting greater effective demand for health care services and others greater restraint on supply.

Revenue Outlook

In 2011, with the city's recovery well underway, tax revenue is expected to total $38.7 billion—a gain of 6.7 percent over the 2010 total. But with the strength of the city's economic recovery expected to moderate during calendar year 2011, IBO expects tax revenue growth to slow to 5.2 percent in fiscal year 2012 with tax revenue totaling $40.7 billion. Steady but unspectacular growth in output, employment, and profits are projected thereafter and revenue growth is expected to average 4.9 percent in 2013 and 2014, reaching $44.8 billion by 2014. Because OMB's local economic forecast assumes a more substantial slowdown in the city's recovery—particularly in calendar year 2011—IBO's tax revenue forecast exceeds OMB's in each year of the financial plan. The difference is $525 million for the current fiscal year, $790 million for 2012, and then averages about $2 billion in 2013 and 2014.

IBO's current tax outlook is somewhat more optimistic for 2011 and 2012 than we projected last spring—collections are now expected to be $454 million higher this year and $324 million next year. This reflects strong collections activity in the first months of the fiscal year as well as our somewhat more optimistic near-term economic forecast. In contrast, our outlook for the two subsequent years (2013 and 2014) is for slower tax revenue growth than we forecast last spring.

Compared with the recovery from the 2001-2003 recession IBO forecasts a slower local economic recovery and, therefore, much slower tax revenue growth as the city recovers from the most recent downturn. Fiscal year 2011 is expected to be the first full fiscal year of job growth since 2008. During fiscal year 2005, which was the comparable first full fiscal year of employment growth following the 2001-2003 recession, tax revenues grew by 11.2 percent, roughly two-thirds faster than the 6.7 percent increase IBO expects for this year. Similarly, our outlook for 2012 tax revenue growth—5.2 percent—is only about half the 10.2 percent growth seen in 2006. (Note that in both periods, 2005–2006 and 2011–2012, tax increases enacted to cope with the proximate recessions were already fully in effect.)

More than two-thirds of the revenue gain in 2011 comes from the business and personal income taxes, which tend to be highly sensitive to current economic conditions. With local employment, incomes, and profits rising during calendar year 2010, income tax collections have been recovering from the hits they took in fiscal years 2009 and 2010. For next fiscal year (2012), the expected slowdown in the local economy's recovery means that the income taxes will account for a smaller share of the year-over-year gain (46.1 percent), while the more stable property tax's contribution grows to 36.2 percent, up from 25.8 percent in 2011.

Business Income Taxes. After three years in which city business income tax revenues fell by over $1.5 billion, a decline of 25.1 percent from their 2007 peak, these taxes are expected to rebound sharply in the current fiscal year. IBO expects revenue to grow by $946 million (an increase of 21.0 percent) in the current fiscal year to nearly $5.5 billion. This growth reflects the relatively strong recovery in the city economy and the sharp jump in overall corporate profits in calendar year 2010, as well as the surge on Wall Street in 2009 that continued into the first quarter of calendar year 2010.

Collections in the first quarter of this fiscal year are already up 52.0 percent over the same period in the prior year. The first quarter leap is mostly due to a huge increase in bank corporation tax (BCT) revenue. BCT revenue was $483 million—the strongest quarter on record. First quarter general corporation tax (GCT) and unincorporated business tax (UBT) revenues were also up over a year ago. This is the first time all three taxes have grown since the first quarter of 2008. For 2011 as a whole, IBO projects increases of $416 million (21.1 percent) in the GCT, $334 million (34.5 percent) in the BCT, and $196 million (12.5 percent) in the UBT.

Beginning with 2012, IBO forecasts more moderate year-over-year increases in business tax revenue—4.8 percent in 2012—bringing the projected total revenue to $5.7 billion. Revenue growth in 2013 and 2014 is expected to average 6.1 percent, with business income tax revenues totaling $6.4 billion in 2014. Business income tax revenues will finally exceed the 2007 peak ($6.0 billion) in 2013.

IBO's business income tax forecasts exceed OMB's by hundreds of millions of dollars each year. The differences range from $462 million in the current year, to $380 million for 2012 and $597 million for 2014. One factor contributing to the large difference in 2011 is how the extraordinary collections so far this year were handled. IBO has largely incorporated them into our forecast while OMB made only a small upward revision to the adopted budget forecast.

Personal Income Tax. IBO expects revenue from the city's tax on personal income (PIT) to total $7.6 billion in the current fiscal year (an increase of 10.4 percent) and grow at a somewhat slower rate for 2012 (8.8 percent) when revenue of $8.2 billion is expected. Strong revenue gains are expected to continue in 2013 and then weaken somewhat in 2014; in the latter year revenue is forecast to be $9.6 billion.

The resumption of employment and income growth during calendar year 2010, the reversal of a steep two-year decline in capital gains realizations (about 70 percent nationwide over calendar years 2008 and 2009), and the expectation that robust securities industry profits will yield an increase in year-end bonuses are all fueling PIT revenue growth in the current fiscal year.

Another factor boosting 2011 collections is the elimination of the state's school tax reduction (STAR) program's PIT benefit for taxpayers with incomes above $500,000. Cutting back on STAR benefits saves the state money, but it has no effect on the overall city budget because the reduction in the state's STAR grant to the city is exactly offset by a boost to PIT revenue, which the Bloomberg Administration estimates will be $156 million in 2011.

Underlying PIT revenue growth for 2012 is actually less robust than the numbers suggest because half of the increase is due to a technical adjustment in accounting for the state's processing of the city's tax. IBO's forecast for personal income growth in the city for calendar year 2011 is slightly lower than for 2010, and we are also projecting further declines in Wall Street profits and the bonus pool. As a result, PIT withholding, estimated payments, and final settlements all grow more slowly in fiscal year 2012 than in the current year.

Forecasting PIT revenues this fall was made more challenging by uncertainty surrounding the fate of the Bush-era tax cuts in Washington. With basic PIT rates and preferential rates for capital gains and dividends now extended for two years, the incentive for taxpayers to alter their timing in recognizing capital gains and other discretionary income has been postponed.

IBO's forecast for PIT revenues exceeds OMB's for each year from 2011 through 2014, although the differences are minor in 2011 and 2012. For 2013 and 2014 the differences exceed $500 million each year.

Real Property Tax. IBO expects property tax revenue to total $16.8 billion this year. Thanks to long lags between changes in market values and when those changes are reflected in property tax bills, the city's property tax revenue is expected to grow next year by 4.3 percent, reaching $17.4 billion, although market value growth has slowed and even fallen in some areas. With the pipeline of lagged market value changes largely exhausted by 2013, revenue growth slows to an average of 2.8 percent in the 2013 and 2014. By 2014, property tax revenue is expected to be $18.5 billion. While IBO's forecast of property tax revenues for 2011 and 2012 are similar to OMB's, for 2013 and 2014, IBO's forecast exceeds OMB's by $385 million and $709 million, respectively.

With the collapse of the housing bubble, the total market value of class 1 properties (mostly one-, two-, and three-family houses) declined by 8.6 percent from 2008 through 2011 and is expected to fall by another 1.2 percent for the 2012 assessment roll. However, because limits on assessment increases when market values were rising left many houses still under-assessed relative to the their target assessment, billable assessed value (which is the basis for the property tax) has been rising—by 13.5 percent from 2008 to 2011—and is expected to grow by 2.7 percent in 2012. Assuming that the city keeps the overall property tax rate constant for 2012, this means that many class 1 homeowners will see higher tax bills.

For apartment buildings and condo apartments (class 2), total market values and total billable assessments are expected to grow in 2012 by 3.7 percent and 3.9 percent, respectively, and then slow somewhat in 2013 and 2014, with market value rising at an average of 3.4 percent and growth in billable assessments averaging 2.2 percent over the two years.

The total market value of commercial properties (class 4) is expected to increase by only 2.0 percent on the 2012 assessment roll—far below the 9.7 percent annual growth it had averaged from 2006 to 2009. Nevertheless, because of the pipeline of deferred assessment increases from the boom period that are still being phased in, billable assessment growth for 2012 is expected to be 4.9 percent. The 2012 assessment roll is the last that will include deferred assessment changes from the height of the boom, and as a result IBO expects class 4 billable growth in 2013 and 2014 to average 2.4 percent annually.

Transfer Taxes. With the city's property markets more stable and IBO's forecast for slow growth in property values and sales volume, the city's two taxes on real property transactions are expected to continue their recovery in 2012. However, even with stronger growth thereafter, combined revenue in 2014 from the real property transfer tax (RPTT) and the mortgage recording tax (MRT) is expected to total less than half their $3.3 billion peak in 2007.

IBO's forecast for RPTT revenue in 2011 is $675 million growing to $695 million in 2012, and $870 million by 2014 (average annual growth of 8.8 percent in 2012 through 2014). These forecasts reflect some downward revisions from our outlook last spring, primarily due to weaker than expected collections so far this year. Sales activity was expected to fall with the expiration of the federal home buyer tax credit, but the drop-off has been steeper than anticipated.

Even with very low interest rates, mortgage tax collections have been slow to recover as the impact of the end of the housing boom has been magnified by the tightening of lending standards in the aftermath of the financial crisis. Revenue this year is expected to be $400 million (up by 9.2 percent from 2010) with more robust growth in 2012, with revenue increasing by 21.3 percent to $485 million. Strong growth is expected to continue through 2014 when revenue reaches $680 million.

Sales Tax. IBO projects that the city's general sales tax collections will reach $5.2 billion in 2011, a 3.3 percent increase over 2010. Recent earnings by retail and tourist-related businesses have been growing due to a rise in spending by locals and visitors alike that is stronger than expected given the tepid economic growth since the end of the recession. The record Wall Street profits in 2009 followed by continued strength in 2010 are generating an increase in the average bonus compensation of employees, whose purchasing power accounts for significant shares of local spending and tax revenue. There are also a few minor tax policy changes that will produce small boosts to sales tax revenues in 2011 and beyond. For example, a tax on hotel room remarketers enacted on September 1, 2010 should add $11 million to New York City coffers in 2011 and the same amount in 2012.

For 2012, IBO projects sales tax revenue of $5.5 billion, an increase of 5.8 percent. IBO's forecast of somewhat faster sales tax revenue growth in 2012 and beyond is closely associated with our projections of personal income growth, the growth of sectors of the local economy that cater to tourists, and national indicators pointing to growing consumer confidence. Personal income growth in New York City is expected to continue accelerating through calendar year 2012, peaking at 5.7 percent that year. Consumer spending on taxable goods is expected to grow slightly faster than the rise in disposable income due to improving consumer credit conditions and increasing consumer confidence. The consumer confidence index is expected to rise from 52.9 in 2010 to 88.3 in 2013—still well below the reading of 2006 and 2007. Additionally, stronger U.S. economic growth should help sustain domestic business and vacation travel to New York over the next two years. The outlook for international travel to the city is less clear as the Euro zone continues to cope with the successive bailouts of European Union member countries, thereby driving down the value of the Euro with respect to the dollar.

IBO's forecast for 2011 is just $58 million (1.1 percent) below OMB's forecast, but beginning in 2012 IBO's forecasts are significantly above OMB's with differences of $151 million in 2012 and over $200 million in both 2013 and 2014.

Spending and Savings

Despite nine rounds of agency spending cuts and revenue initiatives over the past two years to help close budget shortfalls, including $585 million for the current fiscal year and $1.0 billion next year proposed by the Mayor in November, growth in total spending (city, state, and federal dollars) will continue to exceed total revenue growth. Based on the Mayor's November 2010 Financial Plan, IBO projects total spending will grow from $65.1 billion in 2011 to $67.5 billion in 2012. Spending is expected to reach $74.6 billion by 2014.

Looking just at city-funded spending, IBO projects that expenditures will grow from $45.8 billion in 2011 to $48.9 billion in 2012, adjusting for the use of surpluses, and reach $53.9 billion in 2014. Based on our projections, average annual city-funded spending growth in 2011 through 2014 would exceed tax growth by a relatively modest half a percentage point.

Driving Spending Up. As in the past few years, spending on just a few items in the budget are largely responsible for expected expenditure growth. Debt service, the interest and principal the city pays on money it borrows for capital projects such as school construction or bridge repair, is rising steadily. City contributions for pensions for municipal workers and the cost of fringe benefits such as health insurance for these workers are also growing. The city is also expected to see a big jump in Medicaid expenditures with the expiration of federal stimulus funds that helped reduce the local share of these costs.

Conversely, we project that under the Mayor's budget plan, spending on many city programs will be flat and a number of agencies will see declines in spending from 2011 to 2012—and throughout the 2011-2014 plan period. Police, fire, and sanitation would have declining budgets in 2012, as would children's services, homeless services, and other social services.

Debt service is projected to rise from $5.4 billion this year to $6.2 billion in 2012, when adjusted for payments used to move budget surpluses from one year to the next. Debt service will continue to increase throughout the forecast period and total nearly $7.0 billion in 2014.

This growth in debt service results, in part, from a growing capital plan. The city's current Capital Commitment Plan for 2011-2014 is $35.1 billion, an increase of $6.5 billion since the plan released in May for the same four-year period. This increase does not include the additional spending recently proposed by the Department of Education for school construction and expansion of technology initiatives. These plan changes would add $4.6 billion in capital spending over 2011-2014. Following the release of both the financial plan and the amendment to the school construction plan, the Bloomberg Administration asked agencies to revise their 10-year capital strategies with the goal of reducing spending by 20 percent.

Pension contributions along with health insurance and other fringe benefits for city workers have been a consistent source of spending growth over much of the last decade. While this remains true under the Mayor's latest financial plan, there is an unusual twist in 2011: the Bloomberg Administration lowered its estimate of this year's pension costs by $600 million. As of the Executive Budget for 2011 (May 2010), a total of $600 million annually had been added for 2011 through 2014 in anticipation of changes in methodological assumptions used by the city's actuary. These changes will not occur this year and so $600 million less is needed. But the Mayor has now added an additional $400 million annually for these changes in 2012–2014. Under the current plan, pension costs are now expected to be $6.9 billion this year and then jump to $8.2 billion in 2012. Pension contributions would then level off, reaching $8.3 billion by 2014.

The cost of health insurance and other fringe benefits are projected to rise throughout the financial-plan period. Fringe benefit expenditures (excluding the education department) are expected to total $4.3 billion in 2011 and $4.6 billion next year, when adjusted for the use of retiree health benefit funds. Spending on fringe benefits is projected to reach $5.3 billion in 2014.

Earlier this decade Medicaid had also been a fast-rising expense. That growth slowed in 2006 when the state passed a cap on annual growth rates to ease the burden on localities. In the wake of the recession the federal government temporarily assumed a larger share of Medicaid costs. But the temporary federal change is expiring and the city is looking at a jump in Medicaid spending from $5.6 billion in 2011 to $6.2 billion in 2012. Medicaid is expected to cost the city $6.9 billion in 2014.

Layoffs and Other Spending Cuts. To help bring city spending into line with the projected revenues, the Bloomberg Administration has proposed $585 million in city agency initiatives for 2011 and $1.0 billion more for

2012. Much of the savings come from the elimination of about 9,500 municipal jobs, including nearly 5,500 through layoffs. The education department would absorb the largest share of the proposed cuts, although many other agencies also face reductions. A number of agency actions would help close the projected budget shortfall by bringing in additional revenue.

For the current year, the $215 million reduction in city funding for the education department will not come from the classroom. The reduction in city dollars is largely being offset by $159 million in federal education job bill funds and $51 million in state special education summer school dollars.

But the proposed education department cut of $350 million in 2012 would fall squarely on general education classrooms. According to the Mayor, savings would come from the elimination of nearly 5,800 teaching positions. The bulk of these positions, nearly 4,300, would be eliminated through layoffs and the remainder by not filling the positions of teachers who leave the system.

While roughly two-thirds of the proposed reductions in staffing would be in the schools, a number of other agencies also face significant staff cutbacks. The police department would lose 350 civilians through attrition this year, generating savings that grow from $13.8 million in 2011 to about $30 million annually in subsequent years. Some of the work currently done by these civilians may have to be performed by police officers. As of June there were already roughly 730 fully trained police officers doing jobs that could be filled by civilian employees.

The parks department would lose the equivalent of about 400 positions by reducing seasonal staff, delaying some hiring, and cutting the work year to nine months for nearly 1,470 employees. Together these steps save $35.1 million per year beginning in 2012.

The Administration for Children's Services is slated to lose 294 child welfare positions this year, 80 of them supervisory or other managerial roles. The job eliminations include 37 positions that have been funded by the City Council in recent years.

Among some of the other proposals to reduce spending is the shutting of 20 unspecified firehouse companies during the night, when calls are less frequent, to save $15 million (20 firehouses are already scheduled to close entirely in 2012) and the city's subsidy for the public libraries is to be cut by $16.7 million (5.4 percent) this year and $19.7 million (8.0 percent) in 2012.

Protecting children's services, keeping firehouses open, and preserving library funding have been among the City Council's priorities in the recent past and it is possible that these services will be at least partially restored in negotiations with the Bloomberg Administration.

A number of proposed agency measures would garner additional revenue. Among the actions expected to increase revenues are hikes in parking meter rates ($24.2 million in additional revenue in 2012), higher copayments for city-subsidized child care ($13 million), and raising the cost of memberships at city-run recreation centers and permits for tennis courts and ball fields ($6.3 million). The police department would raise $3.5 million in 2012 by charging a fee to cover the cost of directing traffic at sports events, though not at events raising money for charity. And even as the finance department eliminates the jobs of 129 workers, it plans to hire 61 new staff members to increase revenue from tax audits by $20 million in 2012.

Reasons for Concern

Perhaps the greatest risk to the city's fiscal balance at this moment is the budget precipice upon which Albany teeters. Current estimates show the state facing a budget shortfall of at least $9 billion for the upcoming fiscal year. Governor-elect Andrew Cuomo has stated repeatedly that he intends to make substantial cuts in state spending. With the lion's share of the state's general fund budget going to aid to localities, New York City may shoulder a significant portion of any cuts in state aid. The November financial plan does not reflect a major loss in state aid, but Budget Director Mark Page said at a recent City Council hearing that the city faces a loss next year of $2 billion or more in revenue from Albany. This year's budget includes $11.4 billion in aid from Albany, about 18 percent of the city's revenue.

With labor contracts having expired for the largest municipal unions, potential settlements could pose an added cost to the city. While the Mayor has stated that any raises would have to be offset with givebacks, similar efforts have proven difficult to achieve—particularly when some of the givebacks would have to achieve retroactive savings. There are no funds in reserve in the city budget to cover potential raises for workers in the current round of negotiations. Each 1 percent increase would cost the city about $290 million.

There are two issues that could substantially affect IBO's local economic outlook and by extension lower our tax revenue projections. The implementation of new financial regulations is just getting underway and it is difficult to know how deeply these changes may cut into Wall Street profits. IBO's projections assume some falloff in profits over the next couple of years, but steeper declines could result. Also uncertain is the continued growth in health care jobs. Health care employment grew through this recession, as it did in downturns past. But Albany's fiscal problems may well lead to significant cuts to state health care funding, which may in turn affect health care jobs locally. It is also unclear what federal health care reform may mean for local employment. Some parts of the bill may stimulate demand for health services and, therefore, increase jobs but other measures may limit reimbursements for some types of care.

Out of the Woods?

New York City fared far better during the recent recession than many, including IBO, expected it would. Still, successive rounds of spending reductions and revenue increases were needed over the past two years to keep the city budget balanced. Based on the Mayor's latest financial plan and our current revenue and spending projections, the city's budget shortfalls have shrunk considerably and the gap for the upcoming fiscal year appears manageable compared with past challenges.

Despite these efforts, the city's fiscal future is far from certain. The greatest threat may be due north: to address its own fiscal imbalance Albany may substantially cut state aid to the city and other localities. In effect, the state would be driving some of its problems down the Thruway and parking them at City Hall.

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