New York City Independent Budget Office

Fiscal Brief

May 2011

Reestimating the Mayor's Plan:

An Analysis of the 2012 Executive Budget & Financial Plan Through 2015

When looked at broadly, the Mayor's Executive Budget for fiscal year 2012 largely follows the script first presented in his Preliminary Budget earlier this year: the elimination of more than 6,100 teaching positions, the closing of 20 fire companies, the reduction in subsidies to the city's library system, the cutting of 2,100 summer job slots for youth, and dozens of other measures aimed at reducing city-funded spending and helping to close a multibillion dollar budget gap. Much as in the preliminary plan there are no proposals for tax increases in the Executive Budget and a limited number of other efforts such as raising parking meter rates and increasing the cost of tennis and ball field permits to increase city revenues. The Mayor's approach to balancing the city's budget in 2012 lies heavily on the expenditure side of the city's ledger and underscores a message of fiscal austerity.

The drumbeat of austerity is likely to reverberate in budget plans in the near future as well. Despite the relative strength of the local economy, rising city expenditures coupled with expectations of reduced federal and state aid are likely to present the city with ongoing fiscal challenges over the next couple of years.

Based on IBO's latest economic forecast and revenue and expenditure reestimates under the Mayor's Executive Budget for 2012 and Financial Plan through 2015, the city will end the current fiscal year with a surplus of $3.15 billion, $64 million less than the Mayor's projection. With the assumption that the entire 2011 surplus will be used to prepay some of next year's expenses and that the Mayor's plan for about $1.2 billion in gap-closing measures will be approved—on top of $4.2 billion in previously announced actions for 2012—we estimate the city will end 2012 with a small surplus of $84 million. Looking ahead to 2013, we project the city faces a sizable budget shortfall of $4.1 billion (8.5 percent of city-generated revenues). Our 2013 gap estimate is $636 million less than the Mayor's, largely because of our higher tax revenue projection.

The Economy and Taxes

The U.S. and New York City economies have continued to expand despite ongoing impediments. Though IBO has lowered its forecast of economic growth in the current year, our outlook on the national economy generally remains the same as two months ago: in the absence of any serious shock, we expect continued solid growth through 2015, with real gross domestic product (GDP) growth peaking towards the end of 2012, and employment growth strongest in 2014 (all references to years in the economic forecast sections refer to calendar years). Similarly, we expect the local

Detailed Tables on IBO's Revenue and Expenditure Estimates @ www.ibo.nyc.ny.us

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economy to expand over the next four years, with the city adding 52,000 jobs in 2011—over three times more than the 2010 employment gains and slightly above our previous forecast—with even greater employment gains in subsequent years.

In its forecast accompanying the Executive Budget, the Mayor's Office of Management and Budget (OMB) projects slower U.S. and local economic growth than IBO over the next few years. Despite significant differences in the economic outlook, IBO's forecast of total tax revenue in the current fiscal year is very similar to OMB's. But for fiscal year 2012 and beyond, IBO forecasts more tax revenue than OMB—$319 million (0.8 percent) more in 2012, $786 million (1.9 percent) in 2013, $1.9 billion (4.4 percent) in 2014, and $2.6 billion (5.6 percent) in 2015.

U.S. Economy. Although U.S. GDP growth slowed to an annual rate of 1.8 percent in the first quarter of this year (initial estimate, U.S. Bureau of Economic Analysis), down from 3.1 percent in the fourth quarter of 2010, IBO expects growth to return to a faster pace for the remainder of 2011 and the rest of the forecast period. The effects of the 2008 and 2009 stimulus bills and other programs which had boosted spending in 2009 and 2010 have now largely run their course, although the 2 percentage point reduction in 2011 payroll taxes agreed to by the President and Congress last December will partially offset the winding down of the previous stimulus programs.

Although growth has slowed, IBO believes that conditions remain favorable for the current economic expansion to gain momentum. With surging profits and generally healthy balance sheets—due in part to the Federal Reserve's policy of keeping interest rates very low—businesses have the means to expand production by adding workers and investing in new equipment and facilities. Many small banks remain under stress, but larger depository institutions have become profitable again and are making credit more available. Consumer debt, particularly bank card debt, has fallen, enabling more households to satisfy pent-up demand for cars and other durable goods. Business and consumer confidence have been increasing and should reinforce one another in the coming months. In turn, increasing business confidence should boost business investment, which had fallen sharply in 2009 and 2010. Private nonresidential investment is expected to increase by 8.8 percent this year and 7.6 percent in 2012.

Despite the slow first quarter, IBO forecasts real GDP growth of 3.0 percent for the year, rising to 3.5 percent in 2012 and 3.4 percent in 2013. Consumer expenditures for durable goods, inventory investments, exports, and nonresidential fixed investment contributed most to real GDP growth in the first quarter, and should continue to lead growth in the remainder of the year. Employment growth will lag output growth because, as is typical, firms initially expand production by increasing hours worked by their current employees before seeking to hire new ones. IBO forecasts that employment will grow only 1.1 percent this year, before rising 2.3 percent in 2012, 2.6 percent in 2013, and 2.7 percent in 2014.

But the pace of job creation has already picked up. The nation has added an average of 233,000 jobs in each of the last three months, compared with a monthly average of 78,000 in 2010. The unemployment rate is expected to fall only gradually, however, since the expanding economy will draw more people into the labor market to look for work, increasing the number of unemployed workers even as employment increases. IBO projects U.S. unemployment rates of 8.9 percent in 2011, 8.3 percent in 2012, and 7.7 percent in 2013, which in the next few years will help to restrain inflationary pressures in the labor market.

Still, our forecast of inflation is the one component of IBO's macro forecast that has substantially changed due to the recent increases in the prices of oil and raw materials.

Total Revenue and Expenditure Projections
Dollars in millions

	2011	2012	2013	2014	2015	Average Change
Total Revenues	**$65,887**	**$66,309**	**$68,089**	**$70,495**	**$73,000**	**2.6%**
Total Taxes	*39,178*	*41,625*	*43,373*	*45,701*	*48,100*	*5.3%*
Total Expenditures	**65,887**	**66,225**	**72,220**	**73,825**	**75,845**	**3.6%**
IBO Surplus/(Gap) Projections	**–**	**$84**	**$(4,131)**	**$(3,330)**	**$(2,845)**	
Adjusted for Prepayments:						
Total Expenditures	*$66,380*	*$69,378*	*$72,220*	*$73,825*	*$75,845*	*3.4%*
City Funded Expenditures	*44,683*	*49,854*	*52,794*	*54,378*	*56,313*	*6.0%*

SOURCE: IBO

NOTES: IBO projects a surplus of $3.153 billion for 2011, $64 million below the Bloomberg Administration's forecast. The entire 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.

We have raised our inflation rate forecast to 2.1 percent for 2011, 2.0 percent in 2012, and 2.9 percent in 2013.

IBO's outlook for stronger economic growth for the remainder of 2011 and throughout 2012 is premised on the economy avoiding a number of pitfalls, any of which could derail the expansion. The most immediate risk to growth would be further sharp and sustained increases in oil prices caused by a disruption in oil supply due to political instability in the Middle East. Our forecast assumes oil prices average $105/barrel in 2011—if crude prices this year turn out to be only moderately higher, real GDP growth would probably slow but would remain positive. The still recovering financial markets are also at risk if the European Union proves unable to contain its sovereign debt crisis. Closer to home, there is also the risk that the slump in U.S. housing prices will be even deeper and more prolonged than we expect, thwarting a recovery of residential construction, undermining consumer confidence, and constraining consumer spending. The caustic debate over the federal budget is another threat to both consumer and business confidence.

The Local Economy. Payroll employment in New York City fell by nearly 135,000 from the third quarter of 2008 to the end of 2009. As of the first quarter of 2011, the city had recovered 64,000 jobs, nearly half of the previous losses. With regards to employment, the city has done better than the rest of the nation, its own history (including much more prolonged and severe downturns in 2001-2003, 1989-1992, and 1970-1976), and the expectations of local forecasters, both in terms of how well it weathered the recession and how quickly it has rebounded.

The damage inflicted by the crisis is more apparent when we look at wages rather than employment: led by a 27.0 percent plunge in the securities sector, real average wages in the city economy fell 12.2 percent over 2008 and 2009 (most of the decline was in 2009)—the worst drops on record. As with employment, a recovery is underway, and IBO estimates that overall real average wages outside the securities sector will be back above the 2007 level this year, though securities wages are not expected to regain their old peak until 2013.

IBO forecasts continued expansion of the city economy in the remainder of 2011 and then through 2012 and beyond. Assuming the U.S. economic recovery is not interrupted by major shocks, New York City annual average employment is projected to grow by about 52,000 in 2011, 65,000 in 2012, and nearly 68,000 per year over 2013–2015.

Fully half of the city jobs gains in 2011 through 2015 are expected to come from education and health care services (averaging 19,000 jobs added per year, 29.7 percent of total employment growth) and business services (13,000 jobs added per year, 20.3 percent of total growth). The next largest growth category is leisure and hospitality, projected to add 8,500 jobs per year (13.1 percent of total employment growth).

The securities sector (3,500 jobs added on average per year) accounts for only 5.4 percent of IBO's projected city employment growth. But reports of the demise of Wall Street as a principal driver of the city economy are greatly exaggerated: even with its modest contributions to employment, the securities sector is projected to account for close to 40 percent of the city's aggregate *wage* growth over the next five years. This is twice the share of business services, and over four times the share of education and health services. (Note, however, that in the years prior to the recent crisis and during the crisis itself, securities was responsible for closer to 60 percent of aggregate New York City wage gains—and losses.)

New York Stock Exchange (NYSE) member firm profits swung from record losses to record gains during the financial crisis and its aftermath (2007 through 2009) and have since been slipping back towards more sustainable levels. IBO projects profits of about $17 billion in 2011, $14 billion in 2012, and roughly $12 billion per year in 2013–2015. These are largely a function of very low—though gradually increasing—interest expenses, with member firm revenues remaining far below their pre-crisis peaks. Note, however, that the revenues, expenses, and profits NYSE reported refer only to the broker/dealer operations of the member firms, including investment banking, trading, underwriting, and commissions. Not included are investment advising and asset management, which generate large and growing portions of the total incomes (and occasional losses) of Wall Street financial institutions.

The city's real estate markets have stabilized after a period of contraction during which prices—particularly for housing—did not fall as much here as in many other markets across the country. IBO anticipates slow growth in the median price for conventional homes in 2011 (1.2 percent) with gradual acceleration in 2012 (2.4 percent).

In the near term, IBO is not projecting significant sales or development of commercial office buildings, although just a few big transactions can shift the trend sharply. Our outlook for office rents is fairly flat over the forecast period, reflecting a vacancy rate that is still near 10 percent, only moderate projected employment growth in some key office-using industries such as financial services, and competition from new space that is expected to come online by the end of the forecast period.

The tourism industry remains a bright spot for the city economy. Surging growth in both hotel room rates and the number of rooms occupied suggest that rising fuel costs and airline fares have had little impact on travel to the city, or perhaps that these increases have been offset—at least for international travelers—by the relatively weak dollar.

However, despite a strong performance by local major department stores in the first three months of 2011, many industry analysts have expressed concern that the higher prices on gas may crowd out retail sales in the months ahead.

While this is, for the most part, a relatively strong forecast for the city economy, it does contain significant risks. We have already alluded to the risk of shocks to the overall U.S. economy. Another risk includes the possibility that state Medicaid reforms might translate into a substantial shakeout in health care sector employment. Moreover, new federal regulations on financial services are a wild-card in the forecast, and it is still too soon to tell how these will affect the structure and profitability of what remains the engine of the city's economy.

Tax Forecast. With the city's economic recovery now in its second year, tax revenue growth has been gradually accelerating, with the pace exceeding the outlook when the budget was adopted last summer. IBO now expects tax revenues to reach $39.2 billion in fiscal year 2011, an increase of 7.9 percent from 2010, and $1.2 billion (3.2 percent) higher than the amount assumed in the June 2010 Adopted Budget. But 2011 is also expected to mark the fastest tax revenue growth during this recovery. For 2012, tax revenues are expected to grow at a slower pace, increasing by 6.3 percent next year to $41.6 billion. Over the last three years of the financial plan, IBO projects tax revenue growth to average 4.9 percent annually, with revenues forecast to reach $48.1 billion in 2015. IBO's tax revenue forecast is slightly below (-$60 million) OMB's for 2011 and modestly higher for 2012 ($319 million). With IBO's more robust economic forecast, the difference in tax forecasts widens sharply in the last two years of the forecast period, reaching $2.6 billion in 2015.

The growth in 2011 and 2012 is largely due to strength in the city's business and personal income taxes, with the former growing by more than 16 percent in each year and the latter growing by 8.8 percent this year and 9.5 percent next year. Revenue from the city's largest source, the real property tax, with built-in lags between market conditions and tax liabilities, is expected to grow more slowly than the income taxes, with growth fluctuating in a narrow band of 4 percent to 5 percent over the next few years. However, given the size of the property tax, even with slower growth it accounts for one-third of the $2.4 billion increase in taxes projected from 2011 to 2012.

Business Income Taxes. The city's three business income taxes—the general corporation tax (GCT), banking corporation tax (BCT), and the unincorporated business tax (UBT)—are collectively expected to yield $5.2 billion this fiscal year, an increase of 16.4 percent over 2010, reversing three straight years of declines during which they fell by a cumulative 25.1 percent. This return to tax revenue growth reflects the rebound in the broader city economy which has been gathering strength despite the still uneven recovery in the city's financial services industry. For 2011 the BCT has shown the most strength, growing by 31.9 percent, followed by the GCT (16.7 percent). In 2012, IBO expects business income tax revenue to reach $6.1 billion (up by 16.1 percent), with GCT growing the fastest (22.9 percent) from 2011 to 2012, followed by the UBT (15.3 percent) and then the BCT (5.0 percent).

These three taxes are quite volatile, with the BCT being the most volatile of the three. For 2013, IBO projects an overall increase of 3.2 percent for the business taxes, with the BCT expected to fall by -30.7 percent, largely wiping out the gain in BCT revenue projected for 2011 and 2012, while the GCT and UBT are each forecast to have double-digit growth from 2012 to 2013. Following 2013, IBO projects that the three taxes will collectively grow by an annual average of 8.9 percent in 2014 and 2015.

IBO's business income tax forecast for 2011 is nearly identical to OMB's, but there are more substantial differences after that. IBO's forecast is $339 million higher (5.9 percent) than OMB's for 2012, and $431 million higher (7.3 percent) in 2013; the gap reaches nearly $1.3 billion higher (20.9 percent) by 2015. The widening gap in the collective business income tax forecast appears to be mostly a function of differences in the outlook for the city's economy.

Personal Income Tax. IBO's forecast for personal income tax (PIT) revenue in 2011 is $7.5 billion, an increase of 8.8 percent from 2010, and growth is expected to accelerate further in 2012, with PIT revenue forecast to increase by 9.5 percent, reaching $8.2 billion.

The resumption of local economic growth in calendar year 2010 plus a change in the STAR program of state-funded tax relief are fueling the projected $603 million increase in PIT revenue from 2010 to 2011. Last summer the state Legislature reduced the STAR benefit for filers with incomes above $500,000, resulting in higher PIT burdens for affected taxpayers and an estimated $225 million in additional PIT receipts for the city. (However, the additional PIT revenues are exactly offset by the loss of state STAR aid, so there is no impact on the city's budget.) Beyond the change in STAR, the economic recovery has boosted taxpayers' liabilities, on average; as a result, the city is collecting more revenue from withholdings, estimated payments and final returns, refunding less.

An unexpected surge of estimated payments made in April, particularly by taxpayers filing for extensions, has provided an unexpected boost to 2011 receipts, leading IBO to increase our PIT forecast for 2011 by $205 million compared with the forecast we published in March.

With our forecast for accelerating local employment growth, IBO expects withholding collections to increase by 6.0 percent in 2012. The expected growth would be more brisk except that the lower profit outlook for Wall Street firms results in a lower forecast for growth in bonus compensation. IBO also expects strong gains in estimated payments and final returns in 2012.

IBO expects PIT revenue growth in 2013 through 2015 to be slower than in 2011 and 2012, averaging 6.7 percent each year. With the slower growth, PIT revenue is not projected to exceed its 2008 peak until 2014, when it is forecast to be nearly $9.0 billion.

IBO's forecast for 2011 is $157 million (2.1 percent) less than OMB's, with the difference due to IBO's expectation of less withholding and lower estimated payments receipts than OMB forecasts during the remainder of the fiscal year. With IBO's forecast of greater employment and personal income growth in calendar year 2011 relative to OMB's, our forecast of PIT growth in 2012 is greater, with the result that our 2012 and 2013 forecasts are very similar to OMB's. After 2013, IBO's more bullish economic forecast results in IBO's projections exceeding OMB's by $224 million (2.6 percent) in 2014 and $493 million (5.6 percent) in 2015.

Real Property Tax. IBO's and OMB's property tax revenue forecast for 2011 are virtually identical at $16.8 billion. Typically by this point in the budget process, the property tax forecast for the upcoming fiscal year is essentially set because the tax assessments that will be the basis for next year's tax bills have been largely completed, but that is not true this year. Due to continuing uncertainty about the final assessment roll, especially with regard to Class 2 (apartment buildings) assessments, IBO only made modest revisions to our forecast for 2012. We now forecast 2012 property tax revenue to grow by 4.8 percent to $17.6 billion—up from $17.5 billion in our March forecast—mainly due to changes in the timing of lien sale revenue.

This spring has brought unusual scrutiny to the Department of Finance's (DOF) assessment procedures. DOF has announced a number of actions—including caps of 10 percent and 50 percent on market value increases in Class 2—that it plans to take to address the problems uncovered so far regarding 2012 assessments of coops and condos, particularly in Queens. However, there remains considerable uncertainty about how the proposed caps would affect assessments in 2013 and beyond. Moreover, the recent difficulties have led to proposals for more significant changes to the property tax system. One thing seems more certain: the assessment problems make it likely that tax commission appeals on Class 4 (commercial) properties will be unusually high.

Looking beyond 2012, we forecast property tax revenue to grow to $18.4 billion in 2013 (4.1 percent), $19.1 billion in 2014 (4.0 percent), and $19.9 billion in 2015 (4.2 percent). IBO's forecast for growth in Class 1 (one-, two-, and three-family homes) taxable assessed value will average 2.5 percent a year from 2013 to 2015. For Class 2, taxable assessed value growth is now expected to be 3.6 percent in 2013, weaker than the average annual growth of 4.5 percent projected for 2014 and 2015. With a slower pace of employment growth and some lingering weakness in demand for office space, particularly among financial services firms, the projected Class 4 taxable assessment growth averages 3.9 percent in 2013 through

2015, relatively low compared with the 6.5 percent average annual growth in Class 4 assessments for 2008 through 2011.

Although IBO and OMB have very similar forecasts for 2011 and 2012, more significant differences emerge beginning in 2013, when the difference is $159 million (0.9 percent), followed by wider differences of $460 million (2.5 percent) in 2014 and $841 million (4.4 percent) in 2015.

Transfer Taxes. The city's real estate markets continue to see gradual recovery. After peaking in 2007 and declining for three straight years, revenues this year from the real property transfer tax (RPTT) and mortgage recording tax (MRT) continue to run well ahead of their 2010 levels. IBO projects that RPTT revenues will total $734 million in 2011, an increase of 19.4 percent over 2010, while MRT revenues will reach $421 million, an increase of 14.9 percent. Forecast revenues for the two taxes are down slightly—1.2 percent in the case of the RPTT, and 4.1 percent for the MRT—compared with IBO's March 2011 forecast.

The commercial real estate market has not been as strong in the second half of fiscal year 2011 as it was in the first half. The commercial market received a boost in the first half of 2011 from a few very large transactions, and in general from concern over an impending increase in the capital gains tax that was eventually postponed until 2013.

For the period 2011–2015, IBO projects an average annual growth rate of 6.9 percent for the RPTT and 13.8 percent for the MRT. The strong growth in MRT reflects a gradual improvement in the availability of credit for purchase and refinancing, combined with interest rates that are expected to remain relatively low by historic standards, although significantly above the record lows of the past year. By 2015, RPTT revenues are forecast to reach $959 million and MRT revenues $705 million. The projected sum of the two taxes, $1.7 billion, is just over half the record amount of $3.3 billion collected in 2007.

OMB projects average annual growth from 2011–2015 of 7.1 percent for RPTT and 13.2 percent for MRT. The main difference in our out-year forecasts is that we forecast continuous growth in both taxes, while OMB forecasts a slight dip in RPTT in 2013.

Sales Tax. IBO projects strong growth of general sales tax collections in 2011, reflecting gains in employment and personal income, and the strength of the city's tourism industry. IBO projects that sales tax receipts will reach $5.6 billion in 2011—10.4 percent ($525 million) greater than 2010 revenue. After 2011, revenue growth returns to rates similar to the long-term average. IBO forecasts sales tax revenue of $5.8 billion in 2012 and $6.0 billion in 2013.

An expected uptick in job and personal income growth and the strong performance of the city's tourism industry will contribute to growth in sales tax collections. In 2011, IBO expects New York City personal income to grow 7.5 percent and for the city's employers to add over 52,000 jobs. Revenue growth this year is also helped by improvements in household balance sheets and the rise in consumer confidence, which have contributed to consumers' willingness to spend. In addition, the city continues to receive large inflows of business and leisure tourists; a record 48.7 million visited the city in calendar year 2010. Tourists not only pay sales tax on their purchases in stores and restaurants, they also pay sales tax on their hotel rooms—in addition to a separate tax on hotel occupancy.

After 2011, sales tax revenue is expected to grow at a slower rate as the surge of post-recession consumer spending recedes and revenue growth normalizes to the long-term average rate. Rising gas prices may also put pressure on sales tax revenue growth, as many retail industry analysts have expressed concern that higher gas prices may crowd out consumer spending on other goods and services in the months ahead.

IBO's sales tax forecast is 0.8 percent ($46 million) above OMB's for 2011 and is virtually identical for 2012. Beginning in 2013, IBO's forecast again exceeds OMB's, by $63 million in 2013 and $76 million 2014.

Hotel Tax. Driven by strong tourism and improving economic conditions nationally, IBO projects an increase in hotel occupancy tax revenue this year. After 2011, hotel tax revenue is forecast to decline over two years due to the expiration of a temporary increase in the hotel tax rate. But the revenue declines will be relatively modest because increasing demand for hotel rooms is expected to offset much of the impact of the lower tax rate.

For 2011, IBO forecasts hotel occupancy tax revenue of $427 million—growth of 17.7 percent from 2010 revenue of $363 million. The strong revenue growth projected for this year is based on year-to-date collections—which through March are 18.5 percent greater than during the comparable period in 2010—and evidence that business and leisure travel to New York City remains strong. The number of room nights sold in New York City hotels this past January, a popular month for tourism, was 1.8 million—8.2 percent higher than January 2010. Moreover, average daily room rates for January rose by 6.7 percent, from $208 in 2010 to $222 in 2011. Evidence of rising hotel room rates despite an increase in the supply of rooms—6,200 rooms were added to the city's inventory in calendar year 2010—suggest that demand for hotel rooms has increased. The increase in demand for hotel rooms is especially notable given that airline fares have increased, driven by rising fuel costs.

We expect increases in tourism and the demand for hotel rooms to continue beyond the current year, fueled by accelerating employment and personal income growth nationwide. The strength of tourism will in large part counter the effects of the expiration of the temporary tax increase on November 30, 2011, when the rate reverts to 5.0 percent from 5.875 percent. Because the rate reduction will affect revenue in part of 2012 and all of 2013, it will decrease collections in both years. IBO projects hotel tax revenue to decline $4 million (1.0 percent) in 2012 and $13 million (3.0 percent) in 2013. In 2014, business travel and tourism are expected to push revenues back up to $427 million, the same level as 2011. One risk to the forecast is that economic difficulties in Europe and Japan, two major sources of vacation and business travelers, will reduce the flow of visitors to the U.S.

IBO's 2011 hotel tax forecast exceeds OMB's by $9 million. The differences after the current year are larger—$25 million in 2012 and $39 million in 2013—in part because IBO forecasts stronger U.S. economic growth than OMB.

Expenditures

Although city tax revenues are expected to increase by $2.4 billion next year, the growth is not sufficient to cover rising costs. In response, the Mayor has proposed $233 million in gap-closing actions in the Executive Budget; if these additional gap closers are adopted, gap-closing measures over the course of 10 budget plans would total $5.4 billion. If not for the use of an expected $3.2 billion surplus in 2011 to prepay some 2012 expenses, other cost-cutting or revenue-raising measures would be necessary.

IBO projects that total spending in 2012 will be $66.2 billion, about $500 million more than the Bloomberg Administration's estimate. When we adjust our 2012 estimate to account for the use of the 2011 surplus to prepay some of next year's expenses, total spending to meet 2012 needs is $69.4 billion, an increase of 4.5 percent from the current year.

Much as in past years, a large share of the growing costs are confined to a few areas of the budget: pensions and health and other fringe benefits for municipal workers and debt service on the money borrowed for capital projects such as housing construction and purchasing fire trucks. Spending on pensions is projected to increase by $1.4 billion to $8.3 billion in 2012, a jump in part due to expected changes in actuarial assumptions, including a reduction in assumed earnings on investments to 7.5 percent from 8.0 percent. Pension contributions are expected to grow far more modestly over the rest of the financial plan period and reach $8.6 billion in 2015—a projection that assumes the Mayor's plan for reduced pension benefits for new employees (except uniform services) goes into effect in 2013.

Growth in spending on health and other benefits for city workers (excluding education department staff) is expected to rise more sharply and steadily than city pension contributions. Health and other benefit costs are expected to rise from $4.3 billion in 2011 (including funds drawn from the Retiree Health Benefits Trust Fund) to $4.5 billion in 2012 and reach $5.7 billion in 2015.

Debt service is another of the fastest growing portions of the city budget as borrowing continues for capital projects and the city's amount of debt outstanding rises. Spending on debt service is projected to increase by nearly $900 million next year and total $5.9 billion (adjusted for the use of prior-year surpluses to prepay these expenses). In 2015, debt service is expected to reach $7.3 billion.

City spending is also growing to make up for expiring federal aid and less-than-expected state aid. For example, the relatively small overall increase in the education department's budget for 2012 of $362 million to total $19.2 billion is driven by city-funded spending. The city's share of school spending is anticipated to rise by about $1.5 billion next year, in large part to replace more than $850 million in expiring stimulus funds and other declines in federal assistance while state education aid remains essentially flat.

The large increase in city-funds for schools also creates a level of fiscal dissonance since education spending is also the source of one of the most controversial cuts in the Mayor's budget proposals—the elimination of more than

6,100 teaching positions, including 4,278 through layoffs. A significant share of the additional funds is absorbed by a few areas in the school system's budget. Spending on charter schools and contracts with schools for special education and for some foster care students is expected to rise to by $390 million to almost $1.5 billion in 2012. The cost of pre-K for special education students is also growing substantially next year, rising $165 million to $1.1 billion. The cost of pupil transportation is growing at a fast pace as well, rising $105 million to $1.1 billion in 2012.

Spending Cuts and Revenue Raisers. The Executive Budget includes $233 million in new measures to reduce city-funded spending and increases the total of such initiatives for 2012 to $5.4 billion. Among the new cost-cutting proposals is an expanded voluntary attrition program at the parks department that would reduce staffing by 655 and save $29.1 million—a similar program did not meet its goals and the Bloomberg Administration had to add money to the parks' budget in 2011. Another cost savings measure, expanding a proposal first announced in November, would affect 2,560 homeless families with no more than three children. Groups of families would share kitchens and bathrooms, saving $4.5 million in city funds in 2012 and $9.1 million in future years. The Bloomberg Administration also proposes to limit its planned increase in assistance to the fiscally ailing public hospital system: after planning to increase the city's unrestricted aid from $5 million in 2010 to $32 million in 2012, the Executive Budget reduces the subsidy to $19.5 million in 2012–2015.

There are also a few new efforts to increase city-generated revenues. The Department of Buildings, for example, would increase the application filing fee for alterations to raise an additional $4.4 million and the expansion of the number of red-light cameras is expected to bring in an additional $6.5 million in revenue.

Strained Services and Restorations. The successive rounds of budget cuts are taking a toll on city service delivery, and the most recent Mayor's Management Report presents a number of indications of this strain. Hours of home care services provided by the Department for the Aging fell by 29 percent to 392,481 during the first four months of fiscal year 2011, a direct result of budget cuts. Many branch libraries are now open for fewer hours and days, most notably in Brooklyn where branch hours fell from an average of 44.0 in July–October 2010 to 35.5 in July–October 2011. Public library officials say that with the cuts now proposed for 2012, 40 branches would close. The number of New Yorkers participating in adult education and English for Speakers of Other Languages programs declined by 31 percent to 4,415 during July–October 2011 compared with the same period in 2010.

Some programs facing cuts under the Mayor's previous plans are being restored in his Executive Budget. One proposed restoration is for services aimed at preventing children from going into foster care. The $40.9 million restoration of proposed cuts and previously implemented cuts is accomplished largely with federal funds—only $1 million of city dollars are used. While the Executive Budget restores $10.4 million in city funding for 248 HIV/AIDS case managers, it offsets this with other cuts to AIDS services such as reduced reimbursements to providers of supportive housing. And the proposal to provide about $29 million in city funds ($40 million in total) to restore 15,000 child care slots that had been slated for elimination has raised concerns because some child care advocates contend the slots are being shifted to a program that offers children a less enriching experience.

Capital Spending. The new Capital Commitment Plan reduces expected capital spending this year to $12.1 billion, $1.7 billion less than previously planned. Much of the reduced 2011 spending is shifted into 2012 and later years. In 2011–2014, capital spending is now expected to total $35.7 billion, up $2.5 billion from the previous commitment plan for this same period. About $650 million of the increase comes from city funds and the rest is from other sources.

Likewise, the new Ten-Year Capital Strategy (2012–2021) is growing, largely due to the expectation of more state funds. The new strategy totals $54.1 billion, $7.1 billion more than the preliminary plan published in February. About $5.1 billion of the increase is due to the Mayor's expectation of additional state funds for capital spending by the city. Among the projects in the 10-year strategy are a new $594 million jail on Rikers Island, $205 million for tree planting, and $127 million for buying new ambulances.

The education department has also released a new version of its proposed amendment to the five-year school construction plan. The new version anticipates $11.1 billion for school construction, $600 million less than under the current plan. Under the new amendment, the total number of new seats to be created would fall by 5 percent to 28,866. Community School District 8 would lose all its planned new seats and district 20 would lose 1,100 new seats (38 percent fewer than in the current plan) while district 28 would see an increase of 341 (an 82 percent increase).

Game Changers? Continuing budget pressures in Albany and Washington could have a substantial effect on New York City's own fiscal position. With the state still facing multibillion dollar shortfalls, aid from Albany could fall well below expectations. In Washington, the fallout from efforts to reduce federal spending is just beginning to take shape. The President's budget for the upcoming federal fiscal year proposed significant reductions to such longtime urban aid programs as the community development and community services block grants. The potential for more and deeper cuts on the federal and state level cannot be dismissed.

Another factor that could substantially affect the city's budget is settlements with municipal labor unions. By early in 2012, labor agreements with all of the city's largest unions will expire. Some such as those with District Council 37 and the United Federation of Teachers ended many months ago. The Mayor has not included any funding in his budget plan for the current round of negotiations (although there is funding in the labor reserve for the next round of settlements). The Bloomberg Administration is counting on productivity to offset any raises in the current round of negotiations, a position that has proven difficult to maintain in the past, particularly when productivity would have to be achieved retroactively. Each 1 percent increase in salary not paid for with labor savings would cost the city $291 million, including additional pension costs.

There are a number of international factors that could also have major effects on our economic and tax revenue forecasts. Rising oil prices, fueled by continued political instability in the Middle East, could take a toll on the city's tourism industry, as domestic and international travelers curtail their vacation and business plans due to increased driving and airline costs. High gas prices could also squeeze consumer spending and crimp sales by the city's retailers. A deepening sovereign debt crisis in Europe could reverberate through the international economy with implications for the national and local economies.

Domestic issues, including housing, financial regulation, and health care reform, pose risks to the U.S. and local recoveries. If the U.S. housing slump is longer or deeper than expected, it could also constrain consumer spending and weaken economic growth. New financial regulations under the Dodd-Frank act may have long-term implications for Wall Street profitability and compensation—and local tax revenues. The implementation of national health care reform may have consequences as well for an industry that has increased jobs in the city right through several past recessions.

A Question of Balance

Although IBO's budget gap projections for 2013–2015 are lower than those of the Bloomberg Administration, they still pose significant challenges for the Mayor and the City Council. We project a shortfall of $4.1 billion for 2013, a fiscal year that begins in just a little more than a year. The Mayor has balanced the 2012 budget with a large number of budget cuts as well as with the use of a surplus from 2011 of more than $3 billion. At this time we do not project a surplus nearly that large for 2012 and help from Albany or Washington seems very unlikely. So the 2013 budget must mostly be balanced with measures to cut costs or raise local revenues. As the cuts mount it may become increasingly difficult to maintain levels of service expected by the public. Whether the budget can continue to be balanced with a focus on just the spending side of the city's ledger is a key question facing the Mayor and Council.

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