New York City Independent Budget Office

Fiscal Brief

May 2010

Analysis of Mayor Bloomberg's Executive Budget for 2011

THE FISCAL CHALLENGES FACING THE CITY are evident in the breadth of spending cuts proposed by the Mayor, from eliminating 6,400 teachers to closing city pools to shutting 50 senior centers. Large cuts to the city's library systems and cultural programs are also part of the plan for 2011. The number of HIV/AIDS case managers would be reduced while child welfare workers will have to handle larger caseloads.

As difficult as these and other proposed cuts may be, some New Yorkers braced themselves for even steeper reductions in anticipation of the Mayor's release of the Executive Budget earlier this month. In the prior budget plan the Mayor presented in January, he proposed $1.1 billion in measures by city agencies to reduce spending and raise revenue in 2011. These measures, the Mayor emphasized, did not take into account the effect of the estimated $1.3 billion in cuts to the city proposed by the Governor.

Although the state budget remains unresolved, the Mayor's Executive Budget for 2011 presumes significant cuts in aid to the city from Albany. Yet the Mayor's latest budget plan includes a surprisingly modest addition of about $175 million in agency actions—on top of the $1.1 billion proposed in January—to reduce the city's budget shortfall. At the same time, the Mayor's Executive Budget eliminates two tax increases proposed in the January plan that had been projected to generate nearly $220 million in revenue for 2011; restores funding next year for about 900 police officers, summer jobs for youth, and for some summer after-school programs previously slated for elimination; and provides $83 million in new city funding for the Health and Hospitals Corporation and nearly $6 million more for Governors Island in 2011. These changes are enabled in part by the availability of new funds from the Battery Park City Authority, by moving into the general fund dollars previously held aside in the city's labor reserve for future contract settlements, and by the assumption that Congress will extend the temporary increase in the federal share of Medicaid.

IBO's latest revenue forecast has risen a bit since our projection three months ago, largely because local economic growth and tax collections in 2010 have been somewhat stronger than previously expected. We now forecast taxes will total $38.3 billion in 2011, $1.9 billion more than our 2010 projection. IBO expects job growth to be modest this calendar year and next, with employment rising just 29,200 from the fourth quarter of 2009 to the fourth quarter of 2010 and then by another 30,800 by the fourth quarter of 2011. The pace is expected to pick up in 2012 through 2014, averaging 65,000 a year.

Based on our latest economic and revenue forecast and projections of city spending, IBO estimates that under the Mayor's Executive Budget the city will end the current fiscal year with a $3.4 billion surplus, $101 million more than anticipated by the Bloomberg Administration. The entire surplus

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Detailed Tables on IBO's Revenue and Expenditure Estimates

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will be used to close what would otherwise be a budget shortfall in 2011. With the use of the surplus to prepay some expenses, we expect 2011 will end with a modest surplus of $356 million.

Fiscal year 2012 still poses a significant fiscal challenge, although our projection of a $3.3 billion shortfall (7.2 percent of city-funded revenue) is $479 million less than the Mayor's estimate. Neither of these budget gap estimates reflects the elimination of $853 million in federal stimulus funds for schools in 2012. The Mayor has said the loss of these funds could force the city to cut about 14,000 teachers. There will likely be substantial pressure on the Mayor and City Council to fund these teachers with local dollars, which would add to the city's budget shortfall, if new federal or state resources are not forthcoming. In addition, the even deeper state budget shortfalls projected for 2012 could mean further cuts in state aid to the city.

TAXES AND THE ECONOMY

Recent economic news has not substantially altered the economic outlook IBO presented in its analysis of the Preliminary Budget. New data on output, consumer spending, and employment all confirm that the Great Recession has ended and that the nation's economy is moving toward self-sustaining growth. IBO projects continued if moderate growth throughout the calendar year and stronger growth in 2011 and 2012. (Note: Unless otherwise noted, all references to years in economic forecast sections refer to calendar years.) New York City has also begun to climb out of its own relatively short downturn, which has had an especially large impact on wages and salaries, and on the unemployment rate. IBO projects slow city employment growth through 2011 and faster growth thereafter, but city employment will not return to its predownturn levels until the third quarter of 2013. There are uncertainties to the economic outlook that put projected economic growth at risk.

U.S. Economy. Real (inflation-adjusted) gross domestic product (GDP) grew at an annual rate of 3.2 percent in the first quarter of 2010—the second quarter of solid growth— and real personal consumption expenditures increased by 3.6 percent. The nation gained 290,000 jobs in April and 230,000 jobs in March—the largest consecutive monthly job gains since early 2006, and by the end of April, the economy had regained roughly 573,000 of the 8.4 million jobs lost from peak to trough (a decline of 6.1 percent from December 2007 to December 2009). The uptick in the unemployment rate from 9.7 percent in March to 9.9 percent in April reflected encouraged workers drawn back into an improved labor market rather than continued declines in the number working. IBO expects the nation's output to grow slowly through the end of the year and then accelerate, with real GDP growth of 2.9 percent in 2010, 3.9 percent in 2011, and 5.1 percent in 2012.

U.S. employment growth is projected to be slow but steady this year and then accelerate, reaching an annual rate of 1.6 percent in 2011 and 3.1 percent in 2012, with total employment regaining its prerecession peak in the first quarter of 2013. IBO expects the unemployment rate to peak at 10.2 percent later this year and to decline gradually over the next few years. But annual personal income growth is projected to climb from 2.2 percent in 2010 to 4.5 percent in 2011 and then 6.5 percent in 2012, as more people start working again and wages are ultimately bid up. Consumer prices fell last year, and excess productive capacity and high unemployment are expected to continue to dampen inflationary pressures even as the national economy grows.

While the likelihood of a slide back into recession seems low at this stage, expansion will require a real boost in demand, and obstacles to that happening remain. Within the U.S., low wages have kept corporate costs down and profits up, but they also are constraining household spending. Unemployment remains alarmingly high, and the ranks of the long-term unemployed

Total Revenue and Expenditure Projections
Dollars in millions

	2010	2011	2012	2013	2014	Average Change
Total Revenues	$63,590	$63,598	$65,508	$68,784	$71,584	3.0%
Total Taxes	*36,407*	*38,274*	*40,421*	*43,418*	*45,766*	*5.9%*
Total Expenditures	63,590	63,242	68,813	71,368	73,948	3.8%
IBO Surplus / (Gap) Projections	**-**	**$356**	**$(3,304)**	**$(2,583)**	**$(2,364)**	
Adjusted for Prepayments and Discretionary Transfers:						
Total Expenditures	*$65,856*	*$66,615*	*$68,813*	*$71,368*	*$73,948*	*2.9%*
City-Funded Expenditures	*44,435*	*46,502*	*48,927*	*51,310*	*53,482*	*4.7%*

SOURCE: IBO

NOTES: IBO projects a surplus of $3.373 billion for 2010, $101 million above the Bloomberg Administration's forecast. The surplus is used to prepay some 2011 expenditures, leaving 2010 with a balanced budget. Estimates exclude intra-city revenues and expenditures. Figures may not add due to rounding. City-funded expenditures exclude state, federal and other categorical grants, and interfund agreement amounts.

are not shrinking. Resolving sovereign debt problems in Europe could slow economic growth in some countries and depress demand for U.S. exports, thus slowing down the recovery. If concerns about public-sector debt spread to this country, it could greatly increase interest rates and constrain possible future stimulus spending by the federal government.

Local Economy. By most measures, New York City's economy has begun the long climb back from what turned out to be a painfully sharp but unexpectedly short downturn. In contrast to the 1989–1992 and 2001–2003 downturns, which each continued well over a year after the national economy began to recover, the city's economic turnaround is now coinciding with the nation's economic recovery. After contracting for three quarters, real output has been expanding in the city since the middle of 2009. The employment decline lasted longer—through the end of 2009—but payroll jobs have now also started to slowly pick up.

Total job losses in the city were relatively less deep than in the nation as a whole. From the third quarter of 2008 through the fourth quarter of 2009, total seasonally adjusted payroll employment fell by 160,800 (4.2 percent). The largest losses during this period were 46,200 jobs in professional and business services (a 7.6 percent decline), 35,800 jobs in finance and insurance (10.4 percent), 29,000 jobs in trade (6.5 percent), 18,200 construction jobs (13.6 percent), and 15,300 manufacturing jobs (16.0 percent). As has been the case in previous recessions, these losses were partially offset by continued growth in education and health services (17,800 jobs, up by 2.5 percent).

Although this has not been the city's worst modern recession in terms of job losses, it has been the worst in terms of wage losses—not just in finance but throughout the local private economy. Wall Street's record profits in 2009 have overshadowed an unprecedented plunge last year in real average wages (including bonuses) in the city's securities industry. But the wage declines across the rest of the city's private economy were also exceptionally broad and deep. The estimated 4.8 percent real average wage loss outside of securities in 2009 dwarfed the 1.0 percent drop in 2002 and 2.2 percent fall in 1993. Overall, average wages declined last year in 70 of the 88 private industries (defined by two-digit North American Industry Classification Systems categories), collectively representing over 80 percent of the city's private-sector jobs.

Real estate has weathered the recession better in New York City than in many other parts of the country. Declines in property values from predownturn peaks have been less steep, and residential foreclosure rates and commercial vacancy rates have each risen but remain much lower than in most other U.S. cities. Construction activity virtually ground to a halt, but abandonment has not been widespread. Real estate markets now seem to have stabilized, setting the stage for renewed expansion, though the timing remains uncertain.

IBO projects city employment to increase by just 29,200 from the fourth quarter of 2009 to the fourth quarter of 2010, and then by another 30,800 to the fourth quarter of 2011. The projected pace picks up in 2012 and fourth quarter-to-fourth quarter growth is expected to average about 65,000 per year for 2012–2014. At this rate, the city will regain its previous employment peak by the third quarter of 2013. But with the number of people entering the labor market expected to outpace increases in the number working, the city's unemployment rate is forecast to stay near 10 percent for over two years (from the third quarter of 2009 through the third quarter of 2011). Even after that, the city's unemployment rate is not expected to come down as far as the national rate, and the city's projected rate at the end of 2014 (6.5 percent) will still be nearly two percentage points higher than it was at the beginning of 2008.

Wall Street profits continued to come in strong in the first quarter of 2010, but they are projected to abate later in the year. IBO forecasts $29.0 billion for 2010 and, for subsequent years, more modest levels in the $14 billion per year range. But securities wages are projected to regain only a small portion of their declines in 2010 and do not appear poised to return to the breakneck growth exhibited prior to the crisis.

There are considerable uncertainties to the local forecast. To close its massive budget gaps, will New York State resort to some combination steeper cuts and larger tax increases than those already factored into our forecast? Will the fallout from sovereign debt crises overseas impart new destabilizing shocks to U.S. financial markets and institutions? How will the revenue and payroll of the securities industry be affected by new regulatory standards and taxes? New York City has a particularly strong stake in how all these uncertainties are resolved.

Baseline Tax Revenue. New York City's total tax revenue will increase in fiscal year 2010 for the first time in several years thanks to the resumption of economic growth in the nation and the city, and new revenue from sales tax increases and business tax changes enacted last year. After remaining flat in 2008 and declining 7.2 percent last year, total tax revenue is forecast to increase 4.5 percent ($1.6 billion) this year and 5.2 percent ($1.9 billion) next year, reaching $38.3 billion in 2011. Our latest forecast for 2010 and 2011 is higher than our outlook in March, largely because both local economic growth and tax collections to date in 2010 have been somewhat stronger than previously expected. With the city's economic expansion expected to accelerate, IBO projects that tax collections will rise at an average annual rate of 6.1 percent from 2011 through 2014.

Increases in the sales tax and a package of business tax reforms account for roughly half of the projected increase in tax receipts from 2009 to 2010. Collections of the personal income tax and real property tax have also increased substantially over last year, though receipts of the real estate transfer taxes and the business income taxes are lower than in 2009. Apart from the property tax, all of these taxes are sensitive to economic conditions, and receipts from each plummeted in the last year or two. With the economic recovery expected to continue during 2011, revenue growth for these cyclically sensitive taxes generally will be strong, accounting for two-thirds of the $1.9 billion increase in total tax revenue next year. After 2011, with growth continuing, the economically sensitive taxes account for even larger shares of revenue growth.

The Bloomberg Administration has withdrawn its earlier proposals to expand the sales and mortgage recording tax bases. The baseline projections of tax revenue in the Executive Budget and IBO's own estimates do incorporate the effects of a proposed increase in New York State's cigarette tax, which is expected to reduce cigarette sales and decrease collections of the city's own cigarette and sales taxes by a total of $19 million annually.

For the current year, IBO's revenue forecasts exceed those of the Mayor's Office of Management and Budget (OMB) by only $107 million—a 0.3 percent difference. The difference widens to $324 million (0.9 percent) in 2011, mostly due to IBO's higher forecasts of revenue from the unincorporated business and transfer taxes. After 2011, the difference grows substantially, due to faster rates of economic growth in IBO's forecast for the local economy, resulting in relatively higher rates of growth of business and personal income tax revenues.

Business Income Taxes. The plunge that began in 2008 in revenue from the city's three business income taxes—the general corporation tax (GCT), the unincorporated business tax (UBT), and the banking corporation tax (BCT)—is continuing into 2010. After falling $809 million (13.5 percent) from 2007 to 2009, collections are forecast to further decrease by $656 million (12.6 percent) in 2010, to $4.5 billion, with declines across all three taxes. The declines result from the huge losses of securities firms in calendar year 2008 plus the contraction that battered the whole city economy and continued to pull down nonfinancial corporate profits and proprietors' income in calendar year 2009.

With the dramatic reversal of fortune on Wall Street in calendar year 2009 and employment, overall profits, and incomes turning positive this calendar year, business income tax revenue is projected to start growing again in fiscal year 2011, by 8.1 percent. IBO forecasts GCT and UBT increases of 17.4 percent and 14.6 percent, respectively, partially offset by a further drop of 20.4 percent in the BCT. As the economy's recovery picks up steam, all three taxes will grow, and combined business tax revenue will increase from $4.9 billion in 2011 to $5.6 billion in 2012—a 14.2 percent increase.

The projected annual growth of business income tax revenue averages 14.0 percent from 2011 to 2014. The growth rates for these years are solid but far below the growth achieved coming out of the last recession, when annual growth from 2003 to 2007 averaged 27.4 percent. Though projected revenue growth is not extraordinarily fast, IBO's business tax forecast—which is very close to OMB's for 2010 and 2011—rapidly diverges from OMB's forecast after next year; it is $220 million higher for 2012 and over $1.2 billion higher in 2014.

Personal Income Tax. IBO forecasts a 5.2 percent ($344 million) increase in personal income tax (PIT) collections in 2010, to $6.9 billion. The increase is being driven in large part by the projected decline of refunds—roughly one-fourth the level in 2009—due to fewer taxpayers having overpaid their calendar year 2009 liabilities and a sharp decline in the average refund for those who did overpay. The 2010 forecast for withholding, $5.7 billion, is virtually the same as 2009, as the effects of declines in the number of city residents employed during the first half of 2010 is expected to be offset by an increase in bonus compensation on Wall Street and rising employment in the second half of the year.

With the resumption of employment and income growth in the city, IBO forecasts a robust 9.5 percent increase in PIT revenue for 2011—to $7.6 billion. Economic growth is expected to generally increase residents' tax liabilities in calendar year 2010 relative to the previous year, though the steep decline forecast for Wall Street profits will constrain bonus compensation. Another factor expected to drive 2011 PIT revenue growth is a one-time boost in personal income—and in quarterly estimated payments—from many investors and homeowners realizing capital gains before preferential federal tax rates expire at the end of calendar year 2010.

IBO's 2011 forecast is essentially the same as OMB's, and the difference in the 2012 forecast is not much larger, when IBO projects $8.0 billion in PIT collections—5.6 percent growth over 2011. For the final two years of the forecast period, when the economy achieves its fastest growth, IBO projects annual growth averaging 9.4 percent—strong but hardly unprecedented. With IBO's forecast of

PIT growth in 2013 and 2014 more than twice that of OMB, by 2014 our PIT forecast is $900 million above the Mayor's.

Transfer Taxes. Despite some recovery in real estate markets and wider access to financing, the collapse of the real property transfer tax (RPTT) and the mortgage recording tax (MRT)—collectively known as the transfer taxes—that began in 2008 has continued into the current year. IBO projects that combined revenues from the transfer taxes will be $1.0 billion in 2010, a decline of 20.9 percent from 2009 and a drop of 69.8 percent from the 2007 peak of $3.3 billion. The MRT has been particularly weak, and with $373 million forecast for 2010, this would be the first year that MRT revenues drop below $400 million since 1998. The RPTT forecast is $622 million, the lowest level since 2003.

There are indications that the residential real estate market is improving. Sales volume for one- to three-family houses outside of Manhattan during January through March of this year increased by 9 percent compared to the same period a year ago. The median sales prices inched up to $446,000. The Manhattan coop and condo market had a strong performance during the quarter compared with the same period last year. Median apartment sales prices fell by around 8 percent, to roughly $800,000, but the number of transactions was up 80 percent.

The weakness of the commercial real estate sector continues to pull down transfer tax revenues. But there are signs of an uptick in commercial real estate. From January through March this year there were six sales valued at over $100 million, compared with only two such sales from July through December in 2009.

IBO projects strong growth in transfer tax revenues beginning in 2011. The 2011 forecast is $688 million for the RPTT (10.6 percent growth over 2010) and $494 million for the MRT (32.4 percent growth). Average annual growth rates from 2011 through 2014 are 9.1 percent for the MRT and 14.5 percent for the RPTT, but even by 2014 combined revenue of the transfer taxes is less than half 2007 collections.

Real Property Tax. As New York City's largest tax, the real property tax (RPT) is projected to account for $16.1 billion of collections this year—44.3 percent of all tax revenue. IBO has slightly lowered its RPT forecast for 2011 from March to $16.8 billion, due primarily to a downward revision in the estimates of the final assessment roll for apartment buildings (Class 2) and commercial and industrial (Class 4) properties; these revisions have also led to modest declines in the forecasts for 2012 and beyond. There is little difference between the IBO and OMB property tax forecasts through 2012, although for 2013 and 2014 IBO's forecasts are somewhat higher.

While the RPT is forecast to grow each year, in contrast to the other major taxes the rate of growth slows throughout the forecast period, from 12.4 percent this year to 2.3 percent in 2014. Because the RPT adjusts billable assessed value—the base for the tax—to changes in market value only slowly, assessments and revenue initially continue to increase even with weak or no growth in market values. While Class 1 market value is expected to decline 4.4 percent on the 2012 roll and remain flat the following year, total assessed values will increase throughout the forecast period because much of the class remains assessed below the target assessment ratio (assessment divided by market value) of 6 percent. Market values of Class 2 and Class 4 properties are expected to increase slowly from 2012 on.

General Sales Tax. Revenue from the city's general sales tax is projected to reach $5.0 billion this year, $407 million (8.9 percent) more than 2009 collections. Sales tax collections increased this year only because the city enacted (with state approval) a partial repeal of the clothing tax exemption, an extension of the tax to electricity and gas sales, and a 0.5 percentage point increase in the tax rate; these reforms are boosting 2010 revenue by an estimated $650 million.

IBO expects sales tax revenue to grow by 4.6 percent in 2011, to $5.0 billion as the economy strengthens and disposable income growth resumes. From 2011 to 2014, projected sales tax growth averages 6.0 percent a year. The IBO and OMB sales tax forecasts for 2010 are almost the same, but after this year IBO's forecasts are 1.7 percent to 4.4 percent greater than OMB's forecasts through 2014.

EXPENDITURES

Based on the Mayor's plan, IBO estimates that total spending will decline from $63.6 billion this year to $63.2 billion in 2011 and then rise to $68.8 billion in 2012. The decline in 2011 is partly the result of the use of this year's $3.4 billion surplus to prepay some 2011 expenditures. When adjusted for the use of the 2010 surplus, city-funded spending to meet 2011 needs is $46.5 billion—$2.1 billion higher than this year's spending.

Spending Growth and Savings. As for much of the past decade, growth in city spending is being driven by a few key areas. Debt service for the city's capital needs is among the fastest growing expenditures. Debt service, after adjusting for the use of prior-year surpluses to make prepayments, is expected to grow from $5.1 billion in 2010 to $6.3 billion in 2012 and increase at an average annual rate of 7.5 percent throughout the 2010–2014 period.

Growth in spending on pensions and fringe benefits for city workers also outpaces most other city expenditures. The city's pension contributions are projected to grow from $6.6 billion in 2010 to $7.8 billion in 2012, and rise at an average annual rate of 4.9 percent from 2010 through 2014. Pension fund investment losses of 5.4 percent and 18.3 percent in 2008 and 2009, respectively, account for much of the need to boost city contributions. The Mayor has also placed $600 million in reserve for 2011 for potential changes in methodological assumptions used by the city's actuary. Increased spending on health insurance and other fringe benefits (not including the education department) is expected to rise from $4.1 billion this year to $4.6 billion in 2012, adjusted for prepayments, and rise at an annual average rate of 6.2 percent from 2010 through 2014.

Growth in city spending has been moderated by a series of cost cutting actions that began in April 2007. The Executive Budget for 2011 includes a $1.3 billion Program to Eliminate the Gap, or PEG, about $175 million more than proposed in January. The Mayor's latest plan includes the elimination of nearly 11,000 jobs, about 6,000 through layoffs and 5,000 through attrition. Over 60 percent of these job cuts are in the Department of Education, including 6,400 teachers. The Mayor has linked job cuts in education to the Governor's proposed reduction in school aid to the city (see next column). Although these school job cuts are part of the Mayor's headcount reduction plan, they do not help close the city's budget gap since they are the result of a state aid cut—there would be an effect on the city's gap-closing efforts only if we chose to fund the jobs with city dollars.

Many of the reductions in city-funded spending proposed in the Executive Budget were also included in the January plan, such as reductions in the subsidy to libraries ($31.2 million), a cutback in the number of subsidized child care slots ($9 million), the replacement of fewer firefighters who leave the force ($7.9 million), eliminating nearly a third of the job-training slots in the parks department for public assistance recipients ($3.9 million), and cutting the number of case managers for people HIV/AIDS ($4.2 million). There are also new proposals such as the elimination of city funds for adult literacy (saving $4.6 million) and the closing of 50 senior centers ($4.2 million). The savings from some of these cuts grows in subsequent years.

Restorations and New Spending. Despite the need to reduce projected city spending for 2011, the Executive Budget reverses a few previously proposed cuts and identifies some new spending needs. The Mayor eliminated his plan to reduce the police force by about 900 officers through attrition (reversing a savings estimated at $55.4 million in 2011) and he restored city funds for summer jobs for youth ($999,000) and some summer after-school programs ($600,000).

The new spending proposed in the Executive Budget is driven by several different factors. For example, spending at the Department of Homeless Services is increasing because of the recognition of a growing number of homeless adults, which increases projected shelter costs by $19 million in 2011, as well as the expected elimination of state funds for this population, requiring an additional $62 million in city funds next year. The closing of St. Vincent's Medical Center has led the fire department to plan to deploy additional ambulances at a cost of $2.2 million to replace those no longer operated by the hospital. The city's takeover of Governors Island is increasing city-funded operating costs by $5.7 million, and will total $12.4 million in 2011.

A large new expenditure results from the Mayor's plan to aid the fiscally ailing Health and Hospitals Corporation. The city's aid would come in part by leveraging additional federal Medicaid funds. The city's share of the aid plan costs $83 million in 2011 and grows to $300 million in 2013. These new funds are not counted under the state cap that limits growth in city Medicaid spending to 3 percent annually. As a result, overall city Medicaid spending is projected to grow by $1.6 billion, from $5.3 billion this year to $6.9 billion in 2014.

The Mayor's plan is being aided by some one-time actions generating new revenue or making city funds available for new purposes. The source of new revenue is the Battery Park City Joint Purpose Fund, which is providing the city with $134 million in 2010 and $66 million in 2011. Funds held in the city's labor reserve in anticipation of future settlements with municipal unions are being pulled into the city's general fund, part of an effort to pressure the unions to make concessions in exchange for wage increases. For the next round of collective bargaining, there is now no money in reserve for the first two years of contract settlements, and then 1.25 percent in reserve for the ensuing two years. This provides $190 million in 2010, growing to $952 million in 2011, for other uses. In addition to this change, the Executive Budget reestimates the amount of funds needed in the reserve. The reestimate results in $213 million in 2010, $268 million in 2011, and $766 million in 2012–2014 being transferred to the city's general fund.

School Spending Flat Overall. The gyrations in the Department of Education's budget are particularly sharp. Overall the Executive Budget calls for spending $18.4 billion in 2011, virtually unchanged from the current estimates for 2010 despite an expected enrollment increase of 23,000 (2.2 percent). The Executive Budget is $920 million (4.8 percent) lower than had been planned for 2011 when this year's budget was adopted last June. City funds would increase on a year-over-year basis by $520 million, although the increase is $114 million less than anticipated last June. The Mayor's budget projects a $377 million (12.8

percent) year-over-year drop in federal funds for 2011, in part because the state shifted some federal stimulus dollars from the 2011–2012 school year to 2009–2010 to minimize cuts this year.

The Mayor has built into his latest budget plan the education aid cuts in the Governor's Executive Budget that amount to $493 million, and as a result, overall state funds are now projected to fall $635 million short of what was planned for 2011 as of last June and $102 million (1.3 percent) from 2010 on a year-over-year basis. Because state aid is predominately targeted at classroom instruction—58 percent of classroom instruction costs (including the associated fringe benefits) are funded using state aid—the effect of these cuts will fall heavily on school budgets. The classroom instruction budget (including fringe benefits for teachers) would fall by $297 million (3.0 percent) from 2010 to 2011; excluding an increase in funding for special education instruction mandated by state and federal law, the decline in general education classroom instruction is actually $338 million (4.5 percent). The Mayor's Executive Budget addresses this cut by eliminating 6,400 teacher positions (historical retirement trends suggests that roughly 4,600 would be through layoffs). The Mayor has said that if the state budget impasse is resolved early enough and with at least some more education aid, then at least some of the teacher reduction could be averted.

Not all areas of the school budget are shrinking. Spending for nonpublic school expenses, which includes payments to charter schools (fueled by enrollment growth of 9,400 or 30.8 percent), contracts for prekindergarten special education programs, contracts for students attending special education schools that are not part of the public system, and tuition for foster children attending schools outside the city, continues to be the fastest growing part of the education department budget, increasing by $275 million (15.2 percent) next year.

Capital Spending. The five-year capital commitment plan through 2014 released in conjunction with the Executive Budget totals $46.1 billion. When compared with the years covered under the prior commitment plan, 2010–2013, planned commitments have increased by $774 million to $39.9 billion over that period. Planned commitments for 2011 have grown by $2.1 billion or 27.6 percent, although a large portion of this increase is the result of commitments originally planned for 2010 being pushed into 2011.

"X" Factors. A number of factors could significantly affect the Mayor's budget plan for 2011. One factor, of course, is the continuing uncertainty around the state budget, which is about 50 days late as this report is being issued. Given the stalemate in Albany, it is very unclear what level of state aid to expect for the city's coming fiscal year.

Another uncertainty in the Mayor's budget plan is the assumption that Congress will extend the temporary increase in the federal share of Medicaid for another two quarters. The Executive Budget includes additional federal payments of $279 million for 2011, $61 million in 2012, and $269 million in 2013 in anticipation of the extension.

With no money reserved for the first two years of the next round of labor contract settlements, the Mayor has said any raises must be paid for with productivity or givebacks. While the unions have agreed to concessions in prior rounds, it is far from assured that a wage settlement will be fully funded by givebacks. Each 1 percent wage increase for all municipal employees costs about $300 million in city funds.

There are also some considerable economic uncertainties. Albany's efforts to close its huge budget gaps could affect the local economy. The debt crisis overseas could destabilize U.S. financial markets and institutions. And new regulatory standards and taxes could make the securities industry less profitable, with implications for local wages and revenues.

TROUBLE AHEAD, BUDGETS IN RED

Despite eight rounds of budget cuts since April 2007 and estimates of rising tax revenues, IBO projects that the city faces a $3.3 billion budget shortfall for 2012, 7.2 percent of city-funded revenues. While our estimate is nearly $500 million less than the Mayor's it still poses a significant challenge—a challenge that does not take into account two other important factors.

Beginning in 2012, the city will no longer have federal stimulus funds for education. The Mayor has said the loss of this $853 million could result in the elimination of 14,000 teachers. If federal or state funds are not available to replace the stimulus funds, there is a strong likelihood that there will be significant pressure on the city to find the necessary dollars locally.

The state's budget difficulties may also continue to pose problems for the city. With the state facing an estimated shortfall of $15 billion next year, further cuts in state aid to the city for fiscal year 2012 are likely. This would force the Mayor and City Council to grapple with pressure to maintain services with city resources and increase the level of revenues generated locally.

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