F I S C A L   P O L I C Y   I N S T I T U T E

11 Park Place, Suite 701, New York, NY 10007   212-721-5624
One Lear Jet Lane, Latham, NY 12110   518-786-3156
www.fiscalpolicy.org

Testimony of
James A. Parrott
Deputy Director and Chief Economist
Fiscal Policy Institute

Before the

Joint Legislative Public Hearing On Economic Development

February 1, 2010

Good morning. My name is James Parrott, Deputy Director and Chief Economist of the Fiscal Policy Institute. Thank you for the opportunity to testify today.

The Great Recession has left New York with an unemployment crisis—850,000 New Yorkers are out of work, with two out of every five jobless for more than six months. One in six has been out of work for over a year. When you factor in discouraged workers and the underemployed, the unemployment rate nearly doubles.

New York's 750,000 jobs gap

New York State needs 750,000 jobs over the next five years to restore the 330,000 jobs lost so far in the recession and to keep up with growth in the labor force. Even were we to add those 750,000 jobs, it would bring the unemployment rate back to 5.5 percent—that's even higher than the 4.7 percent average rate for 2006 and 2007. This would mean an employment growth rate of 1.7 percent a year; an additional 150,000 jobs each year for five years. It's not unattainable—from 1995 to 2000, New York added 160,000 jobs a year, an amount that then represented two percent annual job growth. (See Appendix A)

Given this critical jobs need, it is important that the actions taken to balance the state budget not exacerbate the economic slump and increase unemployment. This is a severe national economic downturn—it is not caused by New York's budget policies as some have argued. In fact, many states, including several low-tax states in the Sunbelt, have experienced greater job declines than New York in this downturn. It is highly questionable if not ludicrous to think that New York can pull itself out of the recession by slashing its budget. The main determinant of the health of New York's economy is the national economy. Our most critical economic need is for sound macroeconomic policy actions at the national level to create and sustain jobs, including action to provide fiscal relief to state budgets to keep them from worsening local economies by cutting their budgets or raising taxes further.

A changing economy requires a solid foundation for growth

Our economy is changing in fundamental ways. It is not simply a matter of restoring the jobs that have been lost. New York needs to do more to nurture a large manufacturing base, but it has to be a high-productivity, high-tech oriented manufacturing base. Dynamic, internationally-competitive high-tech manufacturing requires advanced technical and professional services. New York's many colleges, universities, and research facilities give it a solid technological infrastructure that can provide the basis for innovative products and enterprises. The economy is finally moving toward greater efficiency in its use of energy and toward renewable energy sources. New York is well-positioned to lead this movement; it already has the advantage of ranking very high among states for its efficient natural resource use.

We need to keep in mind several key elements that contribute to creating a solid foundation for job and economic growth:

- Quality preK-12 education system for all
- Affordable and high quality public higher education
- Modern physical infrastructure and smart growth investments
- Conducive environment to attract and retain human capital and to encourage and support innovation.

Any economic development expert will tell you that this foundation for growth does not materialize automatically on its own. Nor has an unfettered market with a strait-jacketed government ever fostered a foundation for growth. A foundation for growth is created by forward-thinking leaders, and at a state level, by smart state and local government investments in human capital and physical infrastructure. Evidence abounds that arbitrary government spending caps in other states have undermined important economic foundations.

New York's high productivity economy

Economic development discussions, either explicitly or implicitly, employ differing conceptions of the factors affecting the "competitiveness," or economic vitality of a state or region. Our view is that "business cost" approaches that focus only on "costs" as opposed to the "value" of what is produced provide limited insight. In this regard, it is important to point out that New York has the highest value added per worker among the large states with diversified economies and, depending on how measured, the average New York worker is 15 to 37 percent more productive than the national average. In most sectors important to the New York economy, we rank first or second most productive among the 10 large, diversified industrial states. Value added represents total wages and profits. It is puzzling why this sort of data is not on the home page for the Empire State Development Corporation. (See Appendix B.)

Business cost or business climate measures that ignore the value side of the equation are of limited use. For example, one measure often cited by the Business Council of New York is the Milken Institute Cost-of-Doing Business Index. In the 2007 Milken index, New York ranks 2nd highest overall in the cost of doing business. However, this ranking is largely based on New York's high average wages (2nd highest in the country after Connecticut) and high office rents (highest among all states). But what does this tell us? New York's wages and salaries are high because the skills of the workforce and the productivity of our workers are both very high. Office rents are high because there are considerable economies from the dense concentration of activity in New York City. To be meaningful, costs should be related to the value of the production that the high costs make possible.

The Tax Foundation publishes a State Business Tax Climate Index. In a recent version of this index, New York ranks 48th out of 50 states (with a high ranking indicating "high taxes".) But what does this index really indicate about the economic competitiveness of states when it looks only at the tax side and not at the value side and where the four top finishers are Wyoming, South Dakota, Nevada, and Alaska? It does not seem that this index measures anything that provides much insight into the competitive position of states with economies similar to ours.[1]

New York's tax environment has not translated into uncompetitive rates of return for businesses operating here. A 2007 study by economist Don Boyd found that while businesses operating in New York City had higher federal-state-local tax rates than like businesses in six other neighboring and "competing" states, businesses operating elsewhere in New York State had the lowest federal-state-local tax burdens compared to the six other states (California, Connecticut, Florida, Massachusetts, New Jersey, and Texas).[2]

A new study by economists Peter Fisher and Alan Peters (University of Iowa and University of Sydney, respectively) looked at after-tax rates of return for representative firms in eight key technology-oriented industries operating in seven mainly Northeastern states (Maryland, North Carolina, New Jersey, New York, Ohio, Pennsylvania, and West Virginia). Fisher and Peters concluded: "the after-tax rates of return vary little among the states (with other factors held equal)." In fact, this study found that after-tax rates of return for New York-based operations were slightly above the median of all seven states in each of the eight technology industries examined.[3]

The Governor's economic development initiatives

The Governor is proposing to end the failed Empire Zones program and replace it with the Excelsior program that would offer credits for job creation, investment, and research and development in specified industries. Targeted industries include manufacturing, internet publishing, software development, scientific research and development, financial services (limited to data or customer service centers), and other industry "with significant potential for private sector economic growth and development in New York state."

The funding for tax credits would be much lower than that for the Empire Zone program, with a cap of $250 million. The Zones program is now costing the state about $600 million a year in lost taxes. Tax credits for new jobs under the Excelsior program would range from $2,500 to $10,000 per job created, with the level determined by various factors including wages, benefits, and location in a Census tract deemed to be distressed. The commissioner of economic development has considerable discretion in determining benefits. Benefits would be limited to five years, and beneficiaries would be required to document jobs created and investments and research undertaken. Recipient firms would be required to be in "substantial compliance with all worker protection and environmental laws and regulations." Firms that did meet their commitments would not have to pay back the amount of the credit received but would instead have the amount of the credit treated as income.

We feel the Excelsior program needs a stronger clawback policy. Firms that do not meet their obligations under the program should repay in full the amount of the credit received. The level of tax credits for newly-created jobs should be tied to strong job standards and the process to determine the level of benefits should be transparent.

Given the proliferation of business tax credits in New York in recent years—there are already 36 business tax credits, with 12 enacted in the last three years—any new legislation should be carefully considered and provide for regular evaluation and modification. The annual value of tax credits has skyrocketed from less than $200 million in 1994 to over $1.2 billion in 2008. Plus, there is an enormous amount of carry forward tax credits—well over $2 billion worth—that will offset future tax liability and lessen tax collections.

The Governor is also proposing a new Small Business Revolving Loan Fund, which was one of the top recommendations of the Governor's Small Business Task Force.[4] The loan fund is intended to improve access to credit for small businesses, particularly minority and women-owned businesses and others having difficulty accessing regular credit markets. Considering the current difficulties small businesses face in the credit market, this seems like a reasonable response.

Another new proposal is for the New Technology Seed Fund. This would fund institutions of higher education to develop marketable products, strengthen partnerships with the private sector, and advance the commercialization of new products. This proposal appears to be very similar to the purpose of the existing Technology Transfer Incentive Program operated by the New York State Foundation for Science, Technology and Innovation (NYSTAR.) There should be appropriate coordination between these two programs.

Economic development priorities

When the state invests in promoting technology development or in large projects (such as AMD/Global Foundries,) it should pursue some form of "equal exchange" that enables the state to share in the success of state-funded investments. This could, for example, take the form of equity or stock warrants.

New York's local Industrial Development Agencies (IDAs) are still in need of reform. Too often, IDAs have subsidized poorly-paid jobs that undermine economic development. IDA decision-making should be accountable and more transparent, and the program should require prevailing wage for construction projects and living wages for permanent jobs.

An extensive economics literature shows that prevailing wage in construction means more cost-effective construction, and more skilled and better-paid workers. A widely publicized critique of prevailing wage applied to New York IDAs assumed that labor productivity is the same for all construction, whether prevailing wage or not. That assumption flies in the face of considerable research by construction economists that shows that workers paid prevailing wages are much more productive and cost effective than workers paid lower wages.This is because prevailing wage workers receive years of intensive skill and safety training in real apprenticeship programs, they require less supervision and they save on materials and time because they do jobs right the first time. A classic study covering 14 years of highway construction nationwide found that states with higher construction wages had 11 percent lower total costs per mile of highway because of higher productivity and savings from less work done over. Industrial development authorities exist to enhance local economic development. Prevailing wage standards are a fundamental building block for a strong local, "high-road" economy based on high skills and high wages.

The state should have a general policy of linking taxpayer-funded economic development benefits to performance standards. The state should only subsidize companies that provide good jobs, opportunities for disadvantaged communities and are good environmental citizens.

IDAs now have authority to grant exemptions on a portion of the mortgage transfer tax that is dedicated to transit systems. Legislation submitted with the 2010-11 Executive Budget would restore funding for public transit by revoking the ability of IDAs to grant this exemption.

The Green Jobs/Green New York program will leverage Regional Greenhouse Gas Initiative (RGGI) funds to secure private financing to retrofit homes and businesses, creating jobs, reducing greenhouse emissions, and lowering New Yorkers' energy bills. About 30,000 retrofits will be done in the first year. We should ensure that green jobs are good jobs, with strong wage and labor standards.

New York's Investment Tax Credit (ITC) is so generous that many large corporations pay only a nominal amount in corporate income taxes. Many companies routinely can use only a portion of the ITC and end up paying the state's alternative minimum tax. But they are allowed to carry forward unused credits for up to ten years. For 2003, the total amount of ITC benefits carried forward was $1.6 billion. This means that large companies could stop reinvesting in New York altogether and would still be able to reduce their tax liability to the legal minimum or close to it for another decade.

At the same time, we have seen the emergence in New York in this decade of a gap between the growth in productivity and the growth in wages. The ITC could be changed to, in part, address this gap. The ITC should be modified to reduce the amount of credits provided without any requirement for job creation or retention, and increasing the amount of credits that can be earned through job creation and retention. For example, the five percent ITC could be linked to job growth and reduced in value in the first year along with increasing the value of the credit under the Employment Incentive Credit in subsequent years, with the credit directly linked to job retention and creation. The enhanced Employment Incentive Credit would replace the ability to carry forward ITC credits independent of employment levels.[5]

Leveling the playing field among businesses is good business

An important part of establishing a sound foundation for growth is having clear rules of the road that are fairly and evenly enforced. Over the past three years, New York has made important progress in enforcing compliance with labor standards and social insurance requirements. When some employers break the law, it not only hurts workers, but it creates unfair competition for law-abiding businesses, and it also shifts significant costs onto taxpayers. Part of the reason why workers comp premiums were so high in New York is that there was massive non-compliance.[6]

Workers comp reform included tougher penalties for businesses that broke the law by not carrying workers compensation insurance for every employee. The Workers Compensation Board has issued 4,000 stop work orders when it discovered firms that were in violation of the law.

By misclassifying workers as independent contractors or paying workers off the books, employers strip workers of the protections of the entire package of social insurance programs that helped lay the basis for a broad middle class in this country. Such workers lose coverage under workers' compensation, unemployment insurance, temporary disability insurance, and Social Security. Workers lose any paid time off, and lose access to any fringe benefits such as health insurance or pension. They also lose many employment rights, including the right to organize and form a union, and protections against discrimination. This scourge of employee misclassification afflicts an estimated 10 percent of New York's workers.

In establishing an inter-agency Task Force on Employee Misclassification in September 2007, then Governor Eliot Spitzer characterized the problem as "rampant" and an "epidemic". Governor Spitzer said the Task Force would "protect worker rights while leveling the playing field for law abiding employers so they are not at a competitive disadvantage to employers who refuse to play by the rules as they exploit hard working New Yorkers."[7]

In her testimony before the State Senate Labor Committee on January 13, 2010, Jennifer Brand, the Executive Director of the Task Force reported on enforcement efforts from September 2007 through the end of 2009. Over this period, the Task Force identified 31,500 misclassified workers, uncovered $390 million in unreported wages, and more than $11 million in unemployment insurance taxes due. Investigators found that employers owed more than $14 million in unpaid wages and overtime.[8]

In a related vein, it is encouraging that the Governor is proposing to add over 300 tax audit staff to better ensure that all New York taxpayers are complying with our tax laws.

Only the state can create a foundation for broadly shared, sustainable growth

CFED, a national economic development organization, argues that "measuring the standard of living and working in a state and how well the state is building foundations for future growth is just as important as how hospitable that state is to businesses." In the preface to its Development Report Card for the States, CFED writes:

> Economic development is a complicated thing, but fundamentally, it should strive to serve the needs of everyone in a community. It certainly includes providing an environment in which companies can thrive, but that should not be the exclusive goal. … [B]ecause at the end of the day, businesses share the same needs as their employees, suppliers, and customers. Both businesses and individuals benefit from dependable infrastructure, good schools, a healthy environment, a good quality of life, accountable and transparent government, financial security for households, and a lack of strong divisions across, for instance, class and race." [9]

The Executive and the Legislature should work together to develop a compelling and long-term economic strategy that incorporates a comprehensive workforce development strategy. As part of this process, which should start with an objective assessment of the state's key economic resources – human, environmental, financial, educational, and technological – the state's economic and workforce development agencies should seek local input in crafting recommendations that fit strengths and needs o each region in the state.

The Fiscal Policy Institute's *One New York: an Agenda for Shared Prosperity* elaborates many details of this programmatic framework.[10] In addition to arguing for a coherent and coordinated economic development strategy, *One New York* outlines proposals to revitalize upstate cities, reverse "sprawl without growth", and advances a comprehensive reform of the state-local fiscal relationship in New York geared to reducing he pressure on the property tax.

Endnotes

[1] The Public Policy Institute of New York State calculates something it calls the "New York State Cost Gap" that is supposed to represent the extent to which the "government-related costs of living and doing business in New York" exceed the national average. However, forty percent of the "cost gap" stems from personal income taxes, yet PPI fails to adjust New York's income tax burden for the portion paid by commuters. According to Division of the Budget estimates, non-residents paid 16.3 percent of New York State personal income taxes in 2004. New York State Division of the Budget, *Executive Budget 2007-2008, Economic and Revenue Outlook*, February 2007, p. 254. http://publications.budget.state.ny.us/fy0708app3/fy0708appd3.pdf

[2] Donald J. Boyd, "A Simulation of Business Taxes in New York City and Other Locations," Final Technical Report, Prepared for the Citizens Budget Commission, June 2, 2007.

[3] Peter Fisher and Alan Peters, "How Taxes and Economic Development Incentives Affect Returns on New Manufacturing Investment in Pennsylvania and Surrounding States," in *Growing Pennsylvania's High-Tech Economy: Choosing Effective Investments*, by Greg LeRoy, with Leigh McIlvaine, Peter Fisher, Alan Peters, Doug Hoffer, Stephen Herzenberg, Mark Price, Merrill Goozner and Philip Mattera. Washington, D.C.: Good Jobs First, January 2010, pp.9-16.

[4] *Report and Recommendations, New York State Small Business Task Force*, December 2007, William Grinker, Chair.

[5] One example of this suggested approach is Assembly bill A05323, sponsored by Assemblyperson Ortiz.

[6] Fiscal Policy Institute, "New York State Workers Compensation: How Big is the Coverage Shortfall?" January 25, 2007.

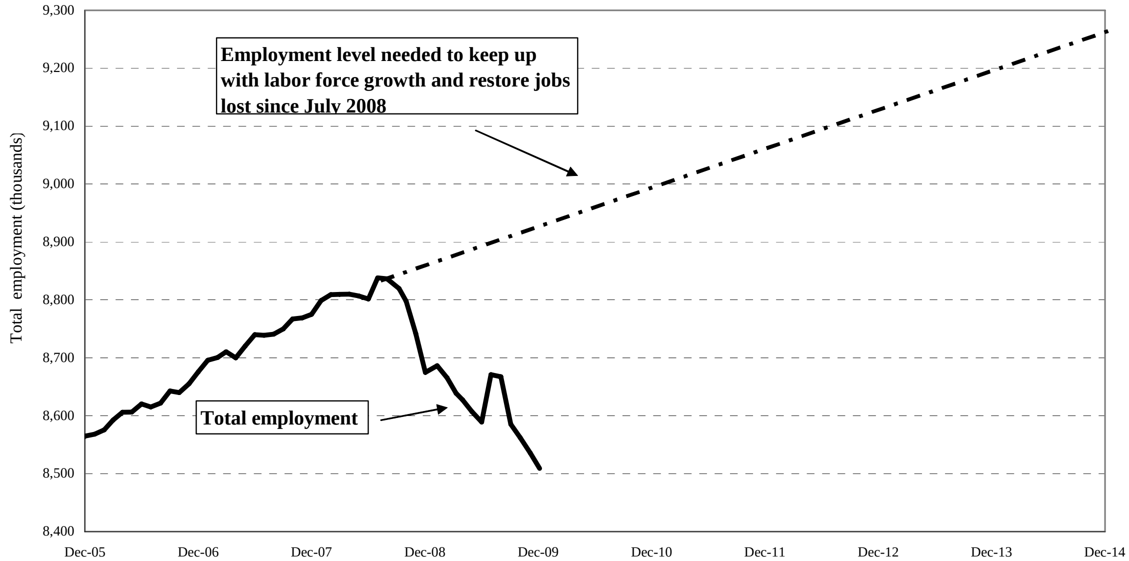
[7] New York State Office of the Governor, "Governor Spitzer Signs Executive Order to Prevent Employee Misclassification," Press Release, September 7, 2007.

[8] Testimony of Jennifer S. Brand, Executive Director of the New York State Joint Enforcement Task Force on Employee Misclassification, New York State Senate Labor Committee, "Employee Misclassification in New York's Underground Economy," January 13, 2010.

[9] CFED, "Economic Development: Of the People, By the People, For the People," http://www.cfed.org/focus.m?parentid=2346&siteid=2346&id=2406.

[10] See FPI, *One New York, An Agenda for Shared Prosperity*, pp. 16-32.

Appendix A: New York will need to add over 750,000 jobs over the next five years to restore jobs lost in the recession and to keep up with labor force growth.



Source: FPI analysis of Current Employment Statistics and Local and Area Unemployment Statistics.

Appendix B

Almost all New York sectors have a strong productivity edge - compared to the national average, and compared to other large states

	Real value added per employee, 2007		Ratio of NY value added per employee to US total	New York's rank among 10 largest states
	U.S.	New York		
Private industries	**$66,799**	**$91,456**	**1.37**	1
Agriculture, forestry, fishing, and hunting	$117,507	$79,586	0.68	9
Mining	$113,318	$47,837	0.42	7
Utilities	$370,331	$380,994	1.03	5
Construction	$30,659	$36,599	1.19	1
Manufacturing	$108,332	$110,020	1.02	4
Wholesale trade	$104,606	$114,610	1.10	1
Retail trade	$46,819	$52,885	1.13	2
Transp. & warehousing, excl. USPS	$64,150	$53,881	0.84	10
Information	$206,051	$307,378	1.49	1
Finance and insurance	$114,006	$261,377	2.29	1
Real estate, rental, and leasing	$176,167	$275,237	1.56	1
Professional and technical services	$73,802	$90,521	1.23	1
Management of companies and enterprises	$91,345	$146,673	1.61	1
Administrative and waste services	$30,177	$40,727	1.35	1
Educational services	$23,344	$27,693	1.19	1
Health care and social assistance	$42,309	$42,762	1.01	2
Arts, entertainment, and recreation	$27,877	$31,055	1.11	4
Accommodation and food services	$24,399	$31,918	1.31	1
Other services, except government	$23,055	$27,307	1.18	1
Government	$49,799	$53,690	1.08	2
Total private excluding finance and insurance, and real estate	**$57,415**	**$66,002**	**1.15**	1
All industries	$116,597	$145,146	1.24	1

Sources: Bureau of Economic Analysis (BEA) Real GDP by States (2000 USD Chained), 2006-2007 (June 2008); BEA employment data, 2006-2007 (SA25N, June 2008)