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Testimony of
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Before the
New York City Council
Finance Committee

Oversight: An Examination of the November Financial Plan

New York City
December 6, 2010

Good afternoon, my name is James Parrott, Deputy Director and Chief Economist of the Fiscal Policy Institute (FPI). The Fiscal Policy Institute is a nonpartisan research and education organization that focuses on the broad range of tax, budget, economic and related public policy issues that affect the quality of life and the economic well-being of New York City and State residents. FPI regularly prepares reports on the state of the New York City economy and the economic condition of workers and their families, and on city budget and tax policy issues. Thank you for the opportunity to testify today.

I would like to make three broad points regarding the current New York City budget outlook:

1—Because the State budget has such a profound impact on the city budget, the escalating attacks on state spending and public employees, and the building pressure to make drastic cuts in the state budget pose a serious threat to the interests and well-being of all New York residents, including those of New York City;

2—The Great Recession might be over in a technical sense for the nation and New York City, but despite proportionately fewer payroll jobs lost in this recession, for most city residents the recession was every bit as bad as, or worse than, the two that preceded it, and the outlook is for a very gradual and drawn-out recovery during which unemployment remains very high; and

3—The City needs a more balanced approach to closing large budget gaps that involves looking at the revenue side of the budget and considering the hyper-concentration of income at the top in recent years with an eye toward restructuring the city's personal income tax to make it more progressive.

Fairly and effectively dealing with State budget gaps

The November financial plan has $1.5 billion in city budget cuts in the ninth round of such cuts over the past three years. Many areas of the City budget depend heavily on state funding. As a candidate, Governor-elect Cuomo proposed a state spending cap, a tax freeze, and a local property tax cap set at a fairly low level. The Governor-elect has yet to indicate the broad parameters of which cuts he will make to balance the state budget. Were the city's financial plan to factor in the magnitude of further cuts in local aid likely to be included in the State Executive Budget proposal due by February 1, there would be a substantially greater extent of cuts that invariably will further intensify the pressure on many vital areas of the city budget.

The state is indeed facing very large budget gaps in the next and succeeding years. Tax revenues have not yet recovered and the amount of federal fiscal relief to New York State will fall by roughly $5 billion. However, there are a host of misconceptions and misunderstandings regarding the driving forces behind the state budget gaps that have contributed to an atmosphere where many areas of state spending are under unprecedented attack and extreme proposals have been advanced that are harmful to the effective functioning of state and local government and certainly harmful to the well-being of most New Yorkers.

Unless there is a more thoughtful discussion of the underlying causes of state budget gaps and of how to more effectively bring recurring spending in line with recurring revenues while protecting essential government functions, changes in the state budget will result in a new order of magnitude of devastating cuts in the city budget next year. Given the direction things are going, there are likely to be significant further reductions in state aid to New York City schools, large cuts in Medicaid, reductions in funding for CUNY and in many areas of human services for child welfare, youth, seniors, and the working poor, among others. These cuts will further fray an already severely tattered safety net and will increase the hardships already brought to unprecedented levels by the Great Recession.

What is needed is an approach to state finances that:

1) Doesn't demonize public employees whose compensation, adjusted for the education and age of employees, is in line with their private sector counterparts;
2) Seeks to balance the budget without worsening unemployment and further complicating an extremely fragile recovery;
3) Maintains the essential public investments in human and physical infrastructure needed to support job growth, economic security, and rising living standards, and help more people get into and stay in the middle class;
4) Seeks shared sacrifice from all sectors of the state including Wall Street and the wealthy who have reaped most all of the economic gains in recent years; and
5) Restructures state and local finances and the taxes that fund state and local services and investments.

Let me say a little more on this last point. New York State's personal income tax is mildly progressive. Yet, the highly regressive effects of the sales tax and local property taxes mean that New York's overall combined state and local tax burden is regressive. Thus, low- and middle-income families pay a higher share of their incomes in state and local taxes than what wealthier families pay. To address this regressivity and to deal with the widespread and growing concerns about burdensome local property taxes, New York State needs to revamp the fiscal relations between the state and local governments.

Several steps are needed. New York should significantly enhance the property tax circuit breaker administered through the personal income tax to provide meaningful property tax relief to those households in upstate New York communities and the downstate suburbs, including renters around the state and in the city, truly burdened by a high level of property taxation relative to their incomes. The state should aid communities with low property wealth and proportionately high Medicaid usage by increasing the state share of Medicaid costs. This will lessen pressure on the property tax in those communities that have a limited property tax base. The STAR program very inefficiently and ineffectively provides real property tax relief and the resources currently devoted to that program should be redirected to help fund the expanded circuit breaker and Medicaid relief to poorer communities. New York State should make its personal income tax structure more progressive through higher rates at the top—before the enactment of the 2009-2011 temporary income tax surcharge, New York families with $50,000 in income paid the same marginal tax rate as families with $500,000 or $50 million in income. Finally, the state should seek to close corporate tax loopholes and curb the excessive growth in the $5 billion annual cost of state business tax expenditures.

The lingering effects of the Great Recession and high unemployment

Much has been made of the fact that New York City has suffered a smaller payroll job decline (5.2 percent) in this recession than the nation as a whole (7.2 percent). And that the city's job decline during this Great Recession was less than the 6 percent job loss suffered from 2001 to 2003, or the nearly 10 percent job decline from 1989 to 1992.

Despite this comparatively less horrendous degree of job loss, we have suffered a tremendous degree of job loss, as well as a much steeper wage loss and more prevalent long-term unemployment than during the previous two recessions in New York City.[1]

- To a much greater degree than during the two prior recessions, job losses have been concentrated among city residents as opposed to commuters.

- Unemployment soared as the recession swept across the city, doubling from early 2008 to 10 percent at the end of 2009.

- Total wages declined much more than in prior recessions, and among non-managerial/non-professional workers, real weekly earnings fell by 4.3 percent from 2007 to 2010. Professional and managerial workers on the other hand, increased by 9.5 percent.[2]

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[1] For an in-depth look at the effects of the Great Recession in New York City, see Fiscal Policy Institute, *The Great Recession Lingers in New York City and Its Neighborhoods*, September 2010. http://fiscalpolicy.org/FPI_Presentation_RecessionLingersInNYC_Sept%202010.pdf.
[2] FPI analysis of the Current Population Survey.

- Unemployment has been felt very unevenly across the city, with poor neighborhoods experiencing the highest unemployment rates and unemployment being much higher for blacks and Hispanics.[3]

- When discouraged workers and the under-employed are factored in, the city's underemployment rate was 16.2 percent during the first half of 2010, much higher than the official published unemployment rate of 9.8 percent. This means that 700,000 New Yorkers are unemployed, under-employed or so discouraged about the prospects of finding work that they have given up looking.

Not surprisingly, poverty usually rises during economic downturns. Family income from wages drops when people lose their jobs or have their hours cut back. The recession pushed an additional 100,000 New Yorkers into poverty in 2009 as the city's poverty rate (as measured by the official Current Population Survey) rose from 20.1 percent in 2008 to 21.3 percent in 2009, according to FPI estimates.[4] Last year, 1.8 million city residents lived below the poverty threshold, and half of that number had incomes below 50 percent of the poverty threshold.

There has been a sharp disconnect between the fortunes of Wall Street and Main Street New York City during this Great Recession.[5] New York City's job losses have been heavily concentrated in moderate- and middle-income paying sectors largely populated by city residents. The brunt of job loss has occurred in construction, manufacturing, trade and transportation, administrative and building services, and in the government sector.

In fact, there has been a steeper decline in local government employment in New York City over the past two years than there has been in total private employment. New York City local government employment has dropped by 16,600 or 3.6 percent over the past two years, compared to a 2.3 percent decline in total private employment in New York City.[6] And of course, the November financial plan calls for the reduction of an additional ten thousand city employees.

The recession has been very uneven in its impact on different communities within the city. Unemployment rates increased much more for blacks and Hispanics than for white non-Hispanics. Many of the city agencies that have experienced job cuts and those targeted for

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[3] FPI, *New York City in the Great Recession: Divergent Fates by Neighborhood and Race and Ethnicity*, December 2009.

[4] According to the American Community Survey (ACS), which is also used to gauge poverty trends, the increase in poverty in 2009 was less than 0.5 percent. However, due to differences in the timing for the ACS compared to the CPS, the CPS provides a much better window into the effects of the recent recession on poverty and family incomes in New York City than does the ACS. The ACS reported for 2009 is the compilation of monthly surveys, each of which asks respondents for their income over the prior twelve months. The March CPS (formally known as the CPS Annual Social and Economic Supplement) asks respondents for their income for calendar year 2009. Thus, the ACS is reflecting incomes spanning the period from January 2008 to November 2009, with a midpoint of December 2008, while the CPS is reflecting incomes for 2009. Considering that the recession did not begin in earnest in New York City until August 2008, the 2009 CPS provides a clearer sense of the effects of the recession during 2009 than the ACS surveys for 2009.

[5] James A. Parrott, "New York City: A Tale of Two Recessions," *Challenge*, May/June 2010.

[6] New York State Labor Department non-agricultural employment data, seasonally adjusted by Fiscal Policy Institute.

further reductions employ large percentages of blacks and Hispanics. Black and Hispanic unemployment has not declined over the past year, and for the third quarter of 2010 unemployment for white non-Hispanics was 5.2 percent, but for Hispanics it was 12.8 percent, two-and-a-half times that for whites, and for blacks unemployment was 15.5 percent, three times the white non-Hispanic rate.

Meanwhile, Wall Street chalked up record profits in 2009—three times the previous record and more than the combined profits of the four years of the housing bubble from 2003 to 2007 (see attached Chart 1). The State Comptroller estimates that the 2009 level of profitability translated into $20 billion in bonus payments to New York City-based Wall Street employees. Through the first three quarters of 2010, while Wall Street profits are much less than in 2009, for the full year 2010 profits are likely to rank among the four or five most profitable years ever.

While New York City's job growth during the first several months of 2010 surpassed the nation's growth pace, it is not clear how long job growth locally can outperform the nation in the absence of a more broadly based recovery. One of the most telling indicators of the local labor market is the weekly data on initial unemployment claims which indicates the extent to which people continue to lose jobs. Here we are more than two years since the recession began and initial unemployment claims in New York City are still averaging 10,000 a week, 25 percent greater than before the recession.

It is appropriate to ask how our safety net is performing during this downturn. Over the decades various programs have been put in place to cushion the effects of involuntary job, earnings and benefits loss during downturns. The record is very mixed.

- Food stamp rolls have been the most responsive, increasing by 56 percent since December 2007.

- Medicaid rolls have also grown considerably which is fortunate since one million New Yorkers statewide lost employer-provided health insurance in 2009.

- While an average of 120,000 city residents received unemployment insurance a month during 2009, that number has declined in 2010. The number unemployed averaged 400,000 for most of 2009. Moreover, unemployment compensation provides a benefit of half of the recipient's wages up to a maximum weekly benefit of $405, a maximum that has not been raised in 12 years even though the cost of living has increased by 40 percent over that time period.

- Most discouraging is the fact that the temporary cash assistance program has not responded at all to dramatically higher levels of hardship; there has been no significant increase in the number of people receiving temporary assistance over the past two years.

It is clear that unemployment will stay very high for the foreseeable future in New York City and that the safety net will be challenged more than ever before. Poverty very likely will increase even more in 2010, and like 2009, much of that increase will occur among those in "deep poverty," less than half of the poverty threshold income level.

The City needs to be a lot more aggressive in responding to the hardships posed by the lingering recession. This will require different approaches when it comes to the budget rather than cutting programs serving those in need and those that provide essential supports to the working poor. It is long overdue for the city to re-think its "work first" approach to public assistance, particularly given the prospect of relatively slow job growth in the context of very high unemployment levels with much of that of long duration. We also need to re-think labor market and economic policies—like living wage and minimum wage—that have kept wages so low that many more people are working but not able to rise out of poverty.

More balanced approach needed to balance the City budget

It is critical that the City balance its budget in a way that does not unduly burden neighborhoods that are reeling, and will be reeling further, from the effects of the recession for some time to come. The City needs to look at the revenue side of the equation as well. Since 2002, when the City has sought to increase revenues to stave off more devastating budget reductions, it has largely turned to regressive taxes—the 2002 18.5 percent increase in the property tax and the 2009 12.5 percent increase in the city's sales tax rate have accounted for most of the higher taxes. The City's personal income tax was increased in a progressive manner on a temporary basis from 2003 to 2005. These changes have contributed to the overall regressive nature of how the local tax burden is shared in New York City.

As Chart 2 indicates, relative to household income levels, the wealthiest one percent of the population in New York City pays a lower share of its income in local income, sales and property tax than less fortunate New Yorkers.[7] While the wealthiest one percent pay about half of the city personal income tax, what is often overlooked is the fact that they receive 45 percent of all income, and their incomes nearly tripled (+188 percent) from 2002 to 2007. On the other hand, the increase in the total incomes of the bottom 70 percent of New York City's population, basically those people in households with incomes under $50,000, experienced a collective gain in incomes of 21 percent from 2002 to 2007, barely keeping pace with inflation over that period. The top 1 percent pays much smaller shares of their income in sales and property tax than do less wealthy New Yorkers.

The City could go a long way to redressing this regressive picture by reforming its personal income tax structure to moderately increase tax rates at the top and increase tax credits for low- and moderate-income households to lighten tax burdens among those with the least income. Income tax reform along these lines, which would require Albany approval, could generate roughly $1 billion annually. The exact amount depends on the how taxes were increased at the top, and the configuration of changes to the City's three tax credits that provide relief to low-income households (the earned income tax credit, the child and dependent care credit and the New York City household credit.)

[7] The estimates on tax burden by income group are based on 2007 data on the city personal income tax, together with estimates from the Institute on Taxation and Economic Policy regarding the incidence of New York sales and property taxes. These estimates do not include the impact of water and sewer fees that are also regressive in their incidence and have nearly doubled since 2002.

Another revenue option that should be carefully examined is eliminating the “carried interest” exemption on the City’s Unincorporated Business Tax (UBT).[8] This is a loophole that costs New York City upwards of $100 million yearly and results in the perverse result that the city’s truly small businesses are asked to pay a higher effective UBT tax rate than hedge funds that generate hundreds of millions of dollars in fees for their principals. Hedge funds and private equity funds have grown tremendously in recent years and constitute a growing “shadow” banking sector in the U.S. The UBT helps to maintain a level playing field among large businesses across the various sectors of the city’s dynamic commercial and financial economy. In 2004, 92 percent of UBT taxes were paid by business owners with over $250,000 in profit. The UBT taxes the business income of highly profitable companies that happen to be organized as partnerships and limited liability companies. Should the carried interest exemption be eliminated, the additional tax liability will be moderated by the very generous 23 percent credit for UBT tax payments against New York City personal income tax liability.

No one wants to pay higher taxes. The city and state tax burden is high in New York City. However, we need to keep in mind that the ***value added*** by the production of goods and services in New York City is extraordinarily high, and that this per worker productivity advantage relative to the U.S. average holds almost across the board. Excluding the finance and real estate sectors, the average value added per worker in New York City’s private sector is 36 percent higher than the national average.[9] New York City’s dense concentration of economic activity—which also requires an extensive publicly-funded infrastructure and a high level of public services—is the main reason for this impressive productivity advantage.

The recession has taken a heavy toll on the livelihoods of hundreds of thousands of New Yorkers, and the adverse effects in further wage and job loss will persist for several months, if not years, to come. Adequately funded health, education, youth, and other social service-oriented public services are essential to maintain the quality of life for average New Yorkers. It is quite reasonable to ask those who have benefitted so greatly from the city’s robust economy to share some of the burden of balancing New York City’s budget.

Thank you for the opportunity to testify today.

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[8] For a thorough examination of this proposal, see Fiscal Policy Institute, *Re-thinking the New York City business Tax Treatment of Private Equity Fund and Hedge Fund “Carried Interest”*, April 15, 2008. http://www.fiscalpolicy.org/FPI_RethinkingTaxTreatmentOfCarriedInterest.pdf.

[9] See Figure 9, Fiscal Policy Institute, New York City: A Tale of Two Recessions, November 29, 2009, p. 11. http://www.fiscalpolicy.org/FPI_NewYorkCitysTwoRecessions_20091119.pdf.

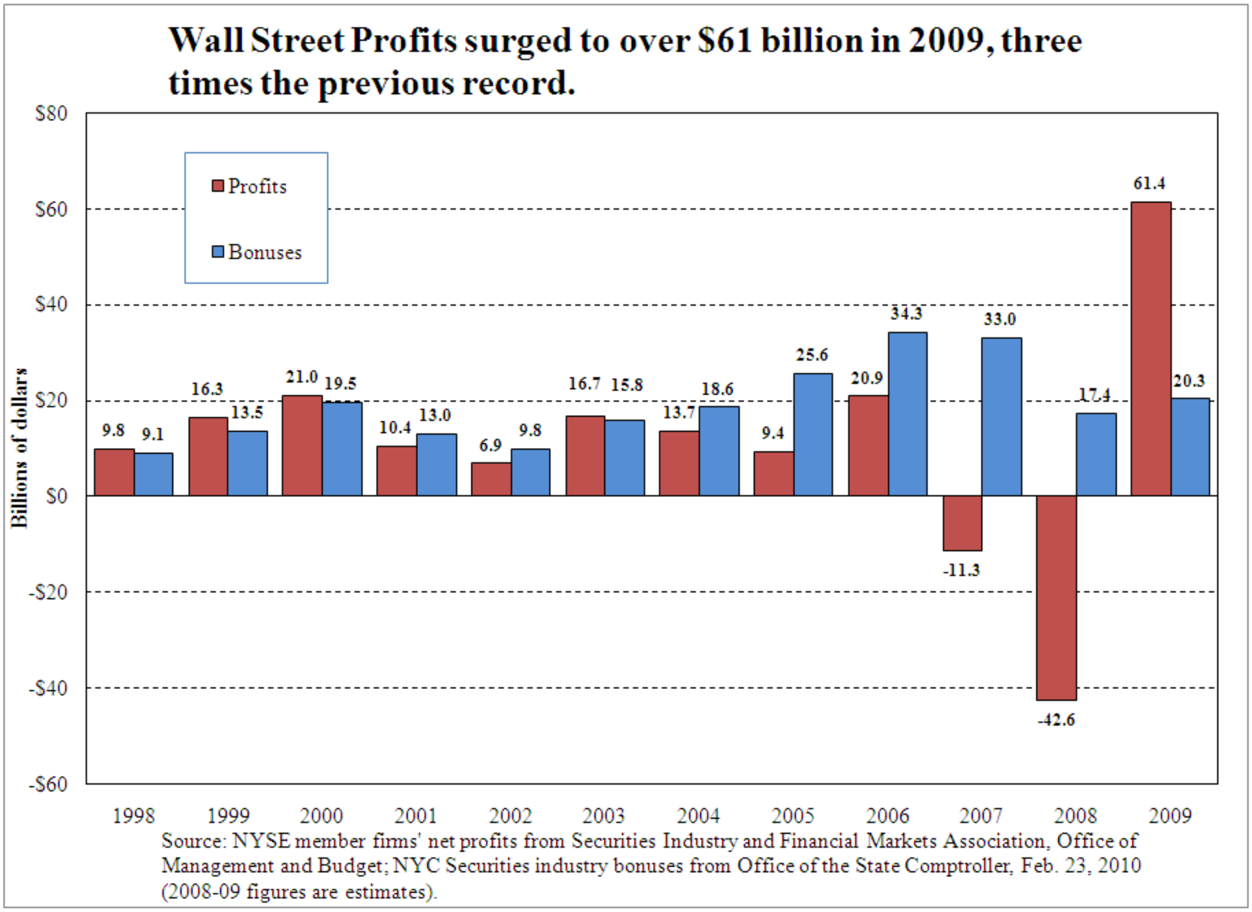
Wall Street Profits surged to over $61 billion in 2009, three times the previous record.
Profits
Bonuses
Billions of dollars
$80
$60
$40
$20
$0
-$20
-$40
-$60
9.8
9.1
16.3
13.5
21.0
19.5
10.4
13.0
6.9
9.8
16.7
15.8
13.7
18.6
9.4
25.6
20.9
34.3
-11.3
33.0
-42.6
17.4
61.4
20.3
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
Source: NYSE member firms' net profits from Securities Industry and Financial Markets Association, Office of Management and Budget; NYC Securities industry bonuses from Office of the State Comptroller, Feb. 23, 2010 (2008-09 figures are estimates).

CHART 1


Income group shares of total city income and total city taxes, New York City, 2007
50%
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
Share of total adjusted gross income
Share of total city tax burden
1.0%
1.2%
3.5%
3.6%
7.0%
8.2%
12.0%
14.8%
17.8%
22.9%
13.8%
15.4%
44.9%
33.8%
Lowest 20% (Up to $9,213)
Second 20% ($9,214 to $21,012)
Middle 20% ($21,013 to $37,457)
Fourth 20% ($37,458 to $67,298)
Next 15% ($67,299 to $167,402)
Next 4% ($167,403 to $642,704)
Top 1% ($642,705 and above)
Household income groups

CHART 2