ECONOMIC CRISIS: MINIMIZING RISKS WHILE MAXIMIZING OUR STATE'S POTENTIAL

The Fiscal Policy Institute's Vision for Re-Building New York

May 27, 2020

COVID-19 created an unprecedented public health crisis and subsequent economic downturn which leaves New York with and extraordinary fiscal challenge. Before the pandemic, the state already faced a budget gap of $6.1 billion and now the deficit is projected to be at least $13 billion and maybe higher.

Governor Cuomo suggested the state needs to make $10.1 billion more in cuts in addition to the previously adopted savings plan and new resource changes totaling over $3 billion to balance this year's budget. Appropriately, the governor looks to federal assistance but remarkably continues to eschew smart state-level action to mitigate harm and raise the necessary revenue.

There is no single, immediate solution to these fiscal challenges with The Boston Consulting Group projecting budget gaps through 2024 of $61 billion. To begin, New York State government must urgently address problems of immediate liquidity, pandemic recovery, and long-term revenue sustainability. Improving New York's fiscal health will require bold innovation and the recognition that the pandemic which not only deepened an existing budget shortfall, the crisis also exposed already existing stress points caused by years of austerity budgeting.

The danger is that continuing to cling to an austerity model will only set our state back further. Firing public employees and cutting aid to essential programs that everyday New Yorkers rely on to make it through the day only makes it harder to regain solid financial footing. Hard times will only become harder if our first response is to choke off revenue to hospitals, schools, small businesses, and first responders - all the people and services that foster our ability to live, grow, prosper, and raise families.

FPI recommends three vital components of an effective post-COVID economic and fiscal recovery policy:

1. **Federal Assistance to States.** The state aid outlined in the three federal relief packages provides New York with around $7.5 billion of COVID-related emergency funding. This is welcome, but it is not nearly enough to address the state's revenue shortfall. It is expected that the next federal stimulus package will include aid to states to help states take care of the budget problems due to the sudden stop in economic activity. New York's

leadership, together with the state's congressional delegation, should work to maximize aid for state and local operations.

2. **Borrowing from the New York Federal Reserve Bank's Municipal Liquidity Facility (MLF).** The Fed's MLF is a new and potentially valuable policy tool. New York State government and other eligible entities need to examine whether and how to use the facility to secure short term funding to bridge the gap in revenues instead of resorting to severe and harmful cost-cutting measures. It is not clear now what governance, oversight, and disclosure mechanisms will be in place. New York's policy community should remain informed of the latest developments related to the facility operation. Making use of the MLF would help reduce budget volatility over a short to medium-term planning horizon and stabilize public sector incomes and employment.

3. **Generating New Revenues from the Ultra-Rich**. New York has a substantial untapped capacity to raise revenue, and that is urgently needed right now. Wealthy New Yorkers can pay their fair share of taxes to make it possible for our schools, health care system and other public services to continue as needed. Expanding tax revenues responsibly would be complementary to the federal response, and would add a substantial measure of sustainability, flexibility, and control over the specificities of funding distribution and application. As the state attempts to adjust to a new COVID revenue reality, it will need to make smart decisions, and raising revenues must be part of the equation.

As part of this year's budget, decided on April 1, several measurement dates were established—April 30, June 30, and December 31—when the Division of Budget will determine how to adjust spending based on projected revenues. After each measurement date, the legislature has ten days to develop its plan to respond to the governor's proposals. New York's Assembly and Senate have an excellent opportunity to mitigate the proposed devastating cuts to our schools, healthcare systems, and human service programs by developing a joint plan that raises additional revenues and leverages the Fed's MLF.

Federal Government's State Aid

The recently proposed HEROES Act in the U.S. House of Representatives would provide New York State with approximately $34 billion in funding. It would also provide additional funding to local governments and increase the state's FMAP by a cumulative 14 percentage points. The FMAP increase would result in New York receiving a much needed $11 billion in total additional Medicaid funds through June of 2021. There is no question that New York needs and deserves these funds from the federal government. We must continue to push our state's congressional delegation to secure these funds promptly. The U.S. Senate is the next crucial step in this process, and we need to insist that adequate funding for state and local governments be included in the final package.

Federal Reserve's Lending Facility

The Fed's new municipal liquidity facility (MLF) has been authorized to support up to $500 billion in lending to states, cities with over 250,000, counties with more than 500,000 residents as well as multistate entities, e.g. Port Authority of N.Y. and N.J. Under the setup, bond, tax, and tax and revenue anticipation notes are eligible as determined by the Fed on a case-by-case basis, granted their maturities are under three years. The borrowing limit is 20 percent of the revenue of the applicable state, city, or county government in the 2017 fiscal year. During the fiscal year 2017, the state collected over $71 billion from taxes and fees. The facility is scheduled to stop purchases of eligible notes on December 31, 2020.

The MLF is an innovative way of bringing the nation's main monetary policy-maker closer to fiscal policy at the state and local levels.

Revenue Raising Options

The importance of raising state revenues cannot be overstated. New York has the most significant income inequality of any state in the nation. We are home to over 100 billionaires with a net worth of approximately half a trillion dollars. In a state where so few have so much, and so many have so little, it would be unconscionable to cut services to the many while asking nothing of the wealthiest few. Raising taxes in a time of urgent need has many historical precedents in New York. In times of economic and fiscal crisis:

- Franklin D. Roosevelt and following him Herbert Lehman raised taxes on the wealthy to raise revenue post-Great Depression;

- Nelson Rockefeller raised taxes on the wealthy by three percentage points during the "Eisenhower Recession" of 1958-59;

- Nelson Rockefeller raised taxes on the wealthy by 4.9 percentage points during the recession of 1961;

- Speaker Silver and Majority Leader Bruno and their houses raised taxes on the wealthy after 9/11 by 1.1 percent in 2003 over Governor Pataki's veto;

- Governor Paterson raised taxes on the wealthy after the financial collapse in 2009 with the first "Millionaires Tax."

Every time New York came back stronger.

Over the years, the two-percent cap has become Governor Cuomo's trademark budget policy principle, meant to signal strict adherence to fiscal discipline. The two percent cap was not working before the COVID-19 crisis, and it surely is the wrong policy today. Unforced austerity does not represent good governance at a time when so many needs are going unmet. We should abandon the two percent state spending cap and seek to raise additional revenue in a variety of ways.

Enhance the Millionaires Tax

For the past several years, the New York State Assembly majority proposed making the personal income tax code permanently more progressive by creating additional brackets for taxpayers earning more than a million dollars annually. The top rate of 8.82 percent would begin at $1 million in annual revenue. This rate would increase by half a percentage point for those earning more than $5 million, by another half a percentage point for those earning more than $10 million, and the top rate would be 10.32 percent for those earning more than $100 million annually. If enacted, the proposal would deliver over $2 billion annually in new revenue.

Fiscal Estimate for Additional Revenue Generated from the Millionaires Tax in 2020 (Proposal 1)

Proposed Personal Income Tax Brackets for all Filing Statuses	Current Law Tax Rates	Proposed Tax Rates	Additional Revenue from State Residents	Additional Revenue from Non-Residents	Total Additional Revenue
$500k to $1 million	6.85%	6.85%	$ -	$ -	$ -
$1 million to $5 million	6.85%/8.82%*	8.82%	$ 727,000,000	$ 196,000,000	$ 923,000,000
$5 million to $10 million	8.82%	9.32%	$ 138,000,000	$ 25,000,000	$ 162,000,000
$10 million to $100 million	8.82%	9.82%	$ 621,000,000	$ 98,000,000	$ 718,000,000
Above $100 million	8.82%	10.32%	$ 225,000,000	$ 11,000,000	$ 236,000,000
Total			$ 1,711,000,000	$ 329,000,000	$ 2,040,000,000

*Under current law, the top bracket of 8.82 percent begins at $1,077,550 for single filers, $1,616,450 for head of household filers, and $2,155,350 for married taxpayers filing jointly. The tax rate for the second highest bracket under current law is 6.85 percent.

FIG. 1 Sources: New York State Department of Taxation and Finance: Personal Income Tax Filers Summary Datasets through tax year 2016, Table 3; New York State Division of the Budget: FY 2020 Economic and Revenue Outlook; Fiscal Policy Institute staff estimates.

Because of New York's substantial budget needs, FPI proposes a more robust version using the same brackets as above, but with the rates that focus at the top of the distribution at 9.62, 10.32, 11.32, and 11.82 percent respectively to obtain $4.5 billion in new revenue. For comparison, in California, the top relevant state income tax rate is 13.3 percent that applies to incomes above around $1.2 million.

Fiscal Estimate for Additional Revenue Generated from the Millionaires Tax in 2020 (Proposal 2)

Proposed Personal Income Tax Brackets for all Filing Statuses	Current Law Tax Rates	Proposed Tax Rates	Additional Revenue from State Residents	Additional Revenue from Non-Residents	Total Additional Revenue
$500k to $1 million	6.85%	6.85%	$ -	$ -	$ -
$1 million to $5 million	6.85%/8.82%*	9.62%	$ 1,405,000,000	$ 365,000,000	$ 1,770,000,000
$5 million to $10 million	8.82%	10.32%	$ 413,000,000	$ 75,000,000	$ 487,000,000
$10 million to $100 million	8.82%	11.32%	$ 1,552,000,000	$ 244,000,000	$ 1,796,000,000
Above $100 million	8.82%	11.82%	$ 450,000,000	$ 22,000,000	$ 472,000,000
Total			$ 3,820,000,000	$ 707,000,000	$ 4,530,000,000

*Under current law, the top bracket of 8.82 percent begins at $1,077,550 for single filers, $1,616,450 for head of household filers, and $2,155,350 for married taxpayers filing jointly. The tax rate for the second highest bracket under current law is 6.85 percent.

FIG. 2 Sources: New York State Department of Taxation and Finance: Personal Income Tax Filers Summary Datasets through tax year 2016, Table 3; New York State Division of the Budget: FY 2020 Economic and Revenue Outlook; Fiscal Policy Institute staff estimates.

Enact a Pied-à-Terre Tax

The state of New York can generate additional revenue and make a step toward addressing its housing crisis by taxing luxury homeowners' residential property that they do not use as a primary residence. In addition to raising revenues, this tax will improve the housing market resource allocation function by discouraging the inefficient utilization of housing that takes place when homes are left unused. Recent data from the New York City Housing and Vacancy Survey shows the number of residences held vacant by their owners has increased by 16 percent

Proposed Pied-à-Terre Marginal Tax Rates

If the Market Value of the Property is:	The Tax will be:
Over $5,000,000 but not over $6,000,000	$0 plus 0.5% of exxcess over $5,000,000
Over $6,000,000 but not over $10,000,000	$5,000 plus 1% of excess over $6,000,000
Over $10,000,000 but not over $15,000,000	$45,000 plus 1.5% of excess over $10,000,000
Over $15,000,000 but not over $20,000,000	$120,000 plus 2% of excess over $15,000,000
Over $20,000,000 but not over $25,000,000	$220,000 plus 3% of excess over $20,000,000
Over $25,000,000	$370,000 plus 4% of excess over $25,000,000

FIG. 3 Source: Fiscal Policy Institute, March 2019, The Pied-à-Terre Tax: An International Review and Evaluation for New York

in the last three years reported. In 2017, almost 75,000 units were held vacant for occasional, seasonal, or recreational use. This represents 2.2 percent of the total number of housing units in

New York City, and the combined market value of these homes is many millions of dollars and, therefore, a potential source of revenue that has gone ignored by the state. Governor Cuomo and the Legislature expressed support for this tax last year.

The new pied-à-terre tax on—often empty— second homes valued at $5 million and above can be expected to yield approximately half a billion dollars in new revenue. This is roughly in line with other recent projections.

Tax the True Economic Income of the Wealthiest New Yorkers (Mark-to-Market)

Over 100 billionaires in New York State have a combined net worth of over half a trillion dollars. These individuals have reaped the lion's share of income gains over the past few decades, and since the Great Recession saw their wealth double. Yet, New York's billionaires typically pay a lower share of their income in taxes than do average New Yorkers. New York should extend its tax system to ensure fairness of income taxation.

Under the existing tax code, taxpayers who earn income not through employment but through ownership of assets are taxed only on their realized gains upon sale of their assets. This offers them an incentive to time their realization of gains or losses through the sale with a purpose to minimize their tax liabilities. Working people do not have such a chance. To ensure fairness of our income tax, the state should mark assets to market regularly and apply taxes accordingly. Research finds that wealthy taxpayers realize and pay tax on less than half of their economic gains over their lifetimes, meaning that more than half of the economic income of the super-rich effectively escapes income taxation.

This is a wholly untapped new source of income tax and, with taxpayers with less than $1 billion in assets excluded, can yield substantial new revenue. The projection assumes asset appreciation in the long term historical mean growth rate of seven percent per annum and the current applicable top income tax rate of 8.82 percent. Additionally, the estimate approximates the lookback by a 10-year period over which the value of all assets has, on average, doubled, to generate 10-year annual tax payments on historical gains. By taxing such gains as income at the current top tax rate is expected to generate $5.5 billion. If the top tax rate is increased to 11.82 percent, as proposed in the enhanced millionaire tax, this mark-to-market tax on unrealized capital gains would be expected to generate $7.4 billion

Reinstate the Stock Transfer Tax

New York State already has a stock transfer tax (STT), specified in Secs. 270-281-a of the state tax law. Currently, however, that tax is rebated instantly and completely to the stockbrokers who pay it. Rather than rebating this tax completely, New York State should temporarily reinstate the tax rather than rebate it.

Enacted in 1905, the STT levies a negligible tax on each sale of stock worth over $20, at the rate of one-quarter of one percent of the value. While this small fee amounts to fractions of pennies on the dollar, the revenue gains for New York State would be significant and sorely needed—today, and it would amount to nearly $13 billion per year.

The tax was fully collected until 1981. Then the state began rebating the tax in 1979 (at 30 percent), 1980 (at 60 percent) and in 1981 (at 100 percent). The tax has never been taken off the books; it is currently tallied, assessed, collected, and then handed right back to the brokers who paid it in the form of a 100 percent rebate.

Consideration should also be given to tying the underlying tax rate to a person's trading volume: the lower the trading volume, the lower the tax. This would discourage speculation and lessen the frenzied volatility that caused many of Wall Street's problems in recent decades.

Sophisticated stock markets already have a stock transfer tax in place as a revenue stream. The United Kingdom, Switzerland, Taiwan, and Hong Kong all have financial transaction taxes on the books that have not impacted the level of trading in any significant way.

Instead of rebating all of the stock transfer tax right after it is paid, FPI suggests that the state temporarily retain the full amount (during our economic downturn), which would result in a significant amount in revenue to address our yawning multi-year budget gap. As a further step, the state should consider broadening the application of the tax to other asset classes, including bonds and derivatives, which would generate additional billions in new revenue.

Conclusion

COVID-19 created a public health emergency that required urgent, additional spending from the state and federal governments. At the same time, it brought the economy to a sudden halt, which resulted in immediate and ongoing hardship and losses in revenue. It is becoming patently clear: it is impossible and senseless to try to cut our way out of this fiscal downturn as continued policy of austerity will invariably hurt our communities even more. We cannot rebuild and come back stronger by losing teachers, nurses, aides, and the services that people and communities rely on for everyday support. It is true, New York needs continued federal assistance to recover. Nevertheless, we, as a state, must do our part and fully exploit every opportunity to protect the people and services that make our state run.

Recommendations

- **Federal Assistance to States.**
- **Borrowing from the New York Federal Reserve Bank's Municipal Liquidity Facility (MLF).**
- **Generating New Revenues from the Ultra-Rich**. We should abandon the two percent state spending cap and seek to raise additional revenue in a variety of ways:
    - Enhance the Millionaires Tax
    - Enact a Pied-à-Terre Tax
    - Tax the True Economic Income of the Wealthiest New Yorkers (Mark-to-Market)
    - Reinstate the Stock Transfer Tax

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