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Testimony of
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New York State Commission on MTA Financing

New York City
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Chairman Ravitch and distinguished members of the Commission: I applaud Governor Paterson for establishing this commission with the charge to recommend how to best put the capital and operating finances of the Metropolitan Transportation Authority on a fiscally sound and stable footing. Nearly thirty years ago in the wake of the mid-1970s state and city fiscal crisis, the New York City subway system and the regional commuter lines had fallen into such a serious state of disrepair that the economic revival of downstate was put in jeopardy. Then, our elected leaders, guided by the enlightened vision of Chairman Ravitch when he was the Chairman of the MTA, embarked on an ambitious series of five-year capital plans to restore the operating efficiency of the transit system. And within a few years, a series of dedicated revenues were put in place to provide a firm financial foundation to rebuild, modernize, operate and maintain our transit infrastructure.

The dedicated revenues were not sufficient to achieve all this; capital and operating subsidies from New York State and New York City were needed, along with federal capital funds. Through the first three five-year capital plans, sufficient subsidies were provided out of the general tax revenues of the State and the City to enable the MTA to get the job done. But in the mid-1990s, this funding commitment broke down and the MTA was pushed toward the fiscal train wreck we are witnessing today. Beginning in the mid-1990s, the Governor and the Mayor sharply curtailed those subsidies at the same time they sought tax cut after tax cut. The all-too-painful result was that the MTA was forced to borrow ever-increasing amounts to pay for capital spending, thus saddling the operating budget with an ever-increasing debt service burden. The State Comptroller's office and the City's Independent Budget Office, among others, have documented this destructive tale.[1]

[1] New York City Independent Budget Office, "MTA Wants More Public Subsidies, But How Much Does It Get Now?" Inside the Budget Number 158, August 14, 2008; New York State Comptroller, "Metropolitan Transportation Authority Proposed 2008-2013 Capital Program," Report 11-2008, March 2008.

The debt service burden on the operating budget has already reached $1.5 billion and will rise to $2 billion in 2011. As a percentage of total revenues, debt service will increase from 15 percent to 19 percent in 2011.[2]

Using federal government data on New York's gross domestic product, we have documented the productivity edge held by the state economy in comparison to other states across most of the major sectors of the economy. This productivity edge is largely attributable to the downstate economy and results in large measure from the highly dense concentration of business activity made possible by our transit system. In the leading business sectors concentrated in Manhattan, value added per employee ranges from 27 percent to 89 percent above national averages.[3] Commercial real estate values in Manhattan are the highest in the country precisely because location here makes possible very high value-added operations. Our extensive mass transit system is literally the foundation for our high value economy. If we do not maintain it properly and keep it running smoothly, we will jeopardize our economic base.

We should also recognize that we are in a new economic era with respect to energy prices. While the price of a barrel of oil has receded from its high of $140 this past summer, the rapid growth in China, India and other large industrializing economies clearly means that, barring a deep global recession, we likely will never again see oil prices under the $80 a barrel level that was passed just a year ago.[4] In a world with permanently higher prices for the oil and gas that fuel our nation's transportation system, downstate New York is well-positioned by virtue of our extensive transit system. Although higher oil prices are causing painful economic dislocations, New York will be better able to adjust to the new economics of energy than most other U.S. metropolitan economies because it is far easier to improve and build on our extensive mass transit system than to create one from scratch or to work from a much less extensive foundation.

As the Commission considers various alternative revenue sources to repair and stabilize MTA finances, we offer four principles we believe should factor into your deliberations:

1—The core responsibility for transit funding rests with users and beneficiaries. The fares paid by MTA transit users already cover a greater share of operating budgets than elsewhere in the U.S., and while they should be periodically raised, those increases should be modest. The critical need is for increases in non-fare revenues and state and local subsidies. Most of the existing dedicated tax revenues reflect the principle that beneficiaries of mass transit have a major funding responsibility. Businesses clearly benefit from the dense concentration transit makes possible, as do real estate values. These taxes include the surcharge on the corporate income tax in the Metropolitan Transit District, and the real estate transaction taxes. Car and truck owners and drivers also benefit since mass transit helps get potential drivers out of their vehicles and off the road, easing congestion for the remaining drivers. Portions of the Petroleum Business Tax and

[2] MTA 2009 Preliminary Budget, July Financial Plan 2009-2012, July 2008.

[3] The leading sectors concentrated in Manhattan include: finance and insurance, management of companies, real estate, information, administrative and business services, and professional and technical services. Fiscal Policy Institute (FPI), *The State of Working New York 2007: Encouraging Recent Gains but Troubling Long-Term Trends*, September 2007, pp. 32-33.

[4] Fatih Birol, chief economist for the International Energy Agency, cited in James Kanter, "IEA says oil prices will stay 'very high,' threatening global growth," *International Herald Tribune*, October 31, 2007.

of state vehicle registration fees go to mass transit. Also, a portion of tolls from the Triborough Bridge and Tunnel Authority crossings go to mass transit. In a letter to the State Transportation Commissioner in December 2004, MTA Chairman Peter Kalikow suggested a 50 percent increase in the dedicated transit taxes except for the sales tax.

2—Transit funding is also a state and local government responsibility and has to be addressed in the context of state and local fiscal challenges.

With the national economy in recession and the financial markets in turmoil, the State and the City, as well as many of the local governments in New York State, are experiencing heightened budget pressures of their own. In addition, New York State has launched various major spending initiatives in recent years—e.g., increasing school aid under the new foundation funding formula, introducing the "middle class" STAR rebates, capping the growth in the local share of Medicaid expenses—without identifying the revenues necessary to pay for those commitments. More over, at least three times in the last 30 years, New York State has cut back on its financial commitments to local governments in order to cut the personal income tax.[5] These developments put local governments in the position of having to raise property taxes more than otherwise would have been necessary, a trend that has culminated in widespread calls for property tax reform.

To deal with the various fiscal pressures that have been building over several years and that have come to a head in Albany this year, the State may very well have little recourse but to raise personal income taxes, much as it did in 2003-to-2005 in the wake of 9/11 and the recession early in this decade. We would argue that a comprehensive fiscal reform approach is needed that increases local government aid, funds high priority initiatives (including some restitution of State transit operating and capital subsidies), and provides significant property tax relief to households based on their income levels and not on the value of properties in their community.[6]

3—Transit funding should be fiscally and economically sound.

One recent transit-related example that violates this principle is the method New York City chose to finance construction of the #7 subway line extension to Manhattan's Far West Side. Through the Hudson Yards Infrastructure Corporation, bonds were sold backed mainly by PILOT (payments in lieu of taxes) payments based on substantial

[5] As FPI's Executive Director Frank Mauro has noted, these cuts have largely had the effect of reducing tax liabilities for those at the top of the income scale. Mauro notes that if New York State had the same income tax structure it had in 1972 and had adjusted personal exemptions and the tax brackets for inflation, 95 percent of New Yorkers would be paying less but the State would be taking in roughly $8 billion more than it does under current tax law. Frank Mauro, "A Little Bit of Tax History. The Path Not Taken: How New York State Increased the Tax Burden on the Middle Class and Cut Taxes for its Highest Income Taxpayers by Over $8 billion a Year." Fiscal Policy Institute, June 4, 2005. http://www.fiscalpolicy.org/taxhistory2.htm

[6] The Fiscal Policy Institute outlined the need for a fundamental restructuring of the state-local fiscal relationship in "Reduce the Pressure on the Property Tax," in *One New York: An Agenda for Shared Prosperity.* A Discussion Paper, November 2006, pp. 26-32. In a presentation on August 15, 2008, before a number of organizations from around New York supporting immediate property tax relief, FPI Executive Director Frank Mauro outlined a comprehensive approach that combines immediate property tax relief with a multi-year phase-in of increased aid to New York's local government financed by a graduate personal income tax increase. Frank Mauro, "Short Term Tax Relief and Long Term Tax Reform: An Omnibus Approach," Fiscal Policy Institute, August 15, 2008.

property tax reductions. Given that major transit improvements add considerably to property values, it seems ill-advised to unnecessarily restrain tax base growth by granting generous tax reductions for the sole purpose of facilitating an off-budget financing approach.[7]

Some attention has been given in recent years to "public private partnerships" under which transportation systems are sold to private entities. However, it is hard to imagine, given the importance and complexity of the MTA system, that New York's transit users and beneficiaries would tolerate having the MTA under private control accountable only to the shareholders of the private owner.

4—The burden of paying for the operating and capital needs of mass transit must be broadly and equitably shared.
This is particularly true when it comes to the reliance on farebox revenues. At present, New York City transit relies more heavily on farebox revenues than other U.S. systems.[8] Because fares are regressive, they are particularly burdensome for low- and moderate-income workers.

More over, there has been a dramatic increase in income polarization over the past twenty years, particularly since 2003. Among the 50 states, New York State has the widest gap between the rich and the poor and the fourth greatest gap between the rich and the middle class.[9] According to the latest Internal Revenue Service tax data, the Adjusted Gross Income (AGI) of the richest 1 percent of New York taxpayers was over two-and-a-half times as great as the AGI of the entire bottom half of New York taxpayers. This was the greatest disparity among all states.[10]

A combination of revenues are needed to fix MTA's financing crisis

A combination of funding measures are needed, including periodic (but modest) fare increases, restoration of the inflation-adjusted value of state and New York City subsidies, more federal

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[7] Testimony of James A. Parrott, Fiscal Policy Institute before the New York City Industrial Development Agency on the Proposal to Amend the Uniform Tax Exemption Policy for Hudson Yards Commercial Construction Projects, New York City, August 3, 2006; and James A. Parrott, Fiscal Policy Institute, "Hudson Yards Tax Breaks, Unwarranted and Fiscally Irresponsible," Paper presented at the New York University-Federal Reserve Bank of New York tax policy working group, October 27, 2005. The Far West Side Tax breaks were cited in 2007 by commercial real estate interests in opposing changes to the city's Industrial and Commercial Incentive Program. Those changes would have reduced property tax breaks related to the renovation of commercial properties.
[8] Robert Paaswell, Director, University Transportation Research Center, "A Brief on Transit Fare Policy," August, 2008.
[9] FPI, "Pulling Apart in New York: An Analysis of Income Trends in New York State," April 2008.
[10] Institute on Taxation and Economic Policy (ITEP), "Latest IRS Data Reveal Fundamental Mismatches in the States," August 5, 2008. Contributing in part to the acceleration in income polarization in this decade has been the emergence of a wide gap between growth in the productivity of New York's workers and the growth in wages they receive. From 2000 to 2006, the real output per worker in New York increased by 11.4 percent while real average wages per worker grew by only 1.1 percent. More over, wage gains have been very highly concentrated with households at the very top of the income distribution receiving far greater wage gains than low- and middle-wage households. FPI, *The State of Working New York 2007: Encouraging Recent Gains but Troubling Long-Term Trends***,** September 2007, pp. 30-34.

assistance, expansion of some of the existing dedicated revenues, and one or more new dedicated taxes.

In a recent editorial on MTA finances, the New York Times noted: "Neither the city nor the state is paying its fair share, despite what they claim."[11] At a minimum, the State should fund its share of 18-b operating assistance from general revenues rather than drawing them from the pool of dedicated transit taxes.[12] New York City should increase its school fare subsidy to the MTA which was cut sharply in 1995 and has not been adjusted since. The City should also restore the real value of its annual subsidy to the MTA capital program which was over $200 million twenty years ago but is now only about one-quarter of that amount when adjusted for inflation.

Traffic is choking the downstate region, worsening our air quality and public health. There needs to be further consideration of how to use congestion charges to both encourage more people to rely on transit and to pay for the system improvements needed to enable people to make switching to mass transit a preferred alterative.

One revenue source that was considered in the 1980s and was suggested by the Regional Plan Association in a 2004 report is the idea of a modest payroll tax applied on all business payrolls within the MTA district. A payroll tax has the advantage of a large base that allows for a very low rate. A payroll tax would also be more stable over the course of the economic cycle than most of the current dedicated taxes.

On the negative side, payroll taxes are usually linked to employee social insurance (social security, unemployment, disability, etc.), and using a payroll tax to finance mass transit would be a departure from that direct connection between employment status and employment-related benefits. However, since the majority of transit trips do involve work commutes, a transit payroll tax would benefit workers.

While payroll taxes are typically paid by employers, the consensus of the economics literature concludes that since the burden of a payroll tax is likely borne by employees, such a tax is generally regressive.[13] The regressivity of the payroll tax could be addressed by establishing a minimum threshold for wage and salary payments that are subject to the payroll tax. In its 2004 report on revenue options for the MTA, the Regional Plan Association suggested a $50,000 wage threshold.[14] Regressivity could also be addressed by ensuring that there should be no cap on the wages to which the tax is applied. This would also help to keep the rate as low as possible.[15]

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[11] "The Riders Pay," editorial, *New York Times*, September 8, 2008.

[12] City Comptroller William C. Thompson, Jr., "Putting the Brakes on the Bus and Subway Fare: Options for Eliminating Fare Increases in 2008 and 2009," August 2007. Comptroller Thompson also proposed that the level of state and city 18-b operating assistance be increased.

[13] Lower-income households rely more heavily on wages. U.S. Government Accountability Office, "Mass Transit. Issues Related to Providing Dedicated Funding for the Washington Area Transit Authority," GAO-06-516, May 2006, p. 65.

[14] Regional Plan Association, "Financing Options for the MTA Capital Program," October 2004.

[15] The 2008 taxable wage base for the federal Old Age Survivors and Disability Insurance tax is now capped at $102,000, while there is no wage limit for the much smaller 1.45 percent Medicare payroll tax. The extremely low taxable wage base of $8,500 for the New York State unemployment payroll tax is the main reason the state's trust fund ran out of reserves at the beginning of the year just as the current recession was beginning. See Fiscal Policy Institute, "New York's Rising Unemployment: The Other Crisis in Albany," August 28, 2008. Another argument for

Consideration should also be given to having a slightly higher payroll tax rate in Manhattan, the densest part of the urban core and the location that is, by far, best-served by the existing MTA system. A tax rate differential depending on density of transit service would strengthen the connection between the tax and transit benefits.

It is also critical that there be strict enforcement against misclassification of workers as independent contractors which is a way that some employers have sought to avoid responsibility for the payment of payroll taxes, particularly social insurance premiums for workers' compensation and unemployment insurance.[16]

Winning over the public

Winning over the public to the idea of raising taxes and fees, even if the proceeds are dedicated to mass transit, is a daunting task. New Yorkers have a justifiable concern about raising taxes and fees, particularly given the current economic slowdown. The success of any one proposal is contingent on a viable overall financing package. This is equally true for both the MTA's operating and capital budgets, as well as for how the state budget is balanced in lean times without sacrificing essential service delivery or reneging on fundamental commitments such as state aid to ensure a "sound basic education" in all school districts across the state. Transit riders, businesses and all taxpayers need to be assured on several fronts, including that:

- the MTA will be well-managed and accountable, and the system well-maintained;
- a balance of financing sources will be used that broadly and equitably share the funding burden;
- sufficient revenues will be identified to fund the capital program in order to minimize reliance on further borrowing and keep the debt service burden manageable;
- MTA resources will not be diverted to other purposes as has been done in the past;
- service adjustments and capital planning reflect the input, concerns and priorities of riders and other major stakeholders.

New Yorkers are rightfully concerned about the overall tax burden and Albany will have to make some tough choices to align its recurring spending needs with recurring revenues. It will not be easy to do this during a downturn, but it is imperative that the State and the City put in place a phased-in approach that stabilizes MTA finances for the long-term. New York has a highly productive, mass-transit enabled economy that has generated immense benefits and high incomes. Albany has to get away from tax and spending habits such as cutting state taxes that result in less aid to local governments and higher local property taxes, or curtailing subsidies to mass transit that have saddled the MTA with an unsustainable debt service burden.

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not having a cap on the wage base for a transit payroll tax is that many of the largest Manhattan companies—such as the large Wall Street firms—that pay the highest wages have contracted out many services.

[16] Drawing data from state unemployment insurance audits, a 2007 study by Cornell University researchers estimated that nearly 10 percent of workers in New York State were misclassified as independent contractors by their employers. Linda H. Donahue, James Ryan Lamare, and Fred B. Kotler, "The Cost of Worker Misclassification in New York State, Cornell University ILR School, February 2007. For a discussion of several indicators of an increase in employee misclassification in New York, see, FPI, *The State of Working New York, 2007: Encouraging Recent Gains but Troubling Long-Term Trends*, September, 2007, pp. 20-22.