Economic and Fiscal Outlook 2021
Building a More Equitable New York

Financial Plan and Revenue Options

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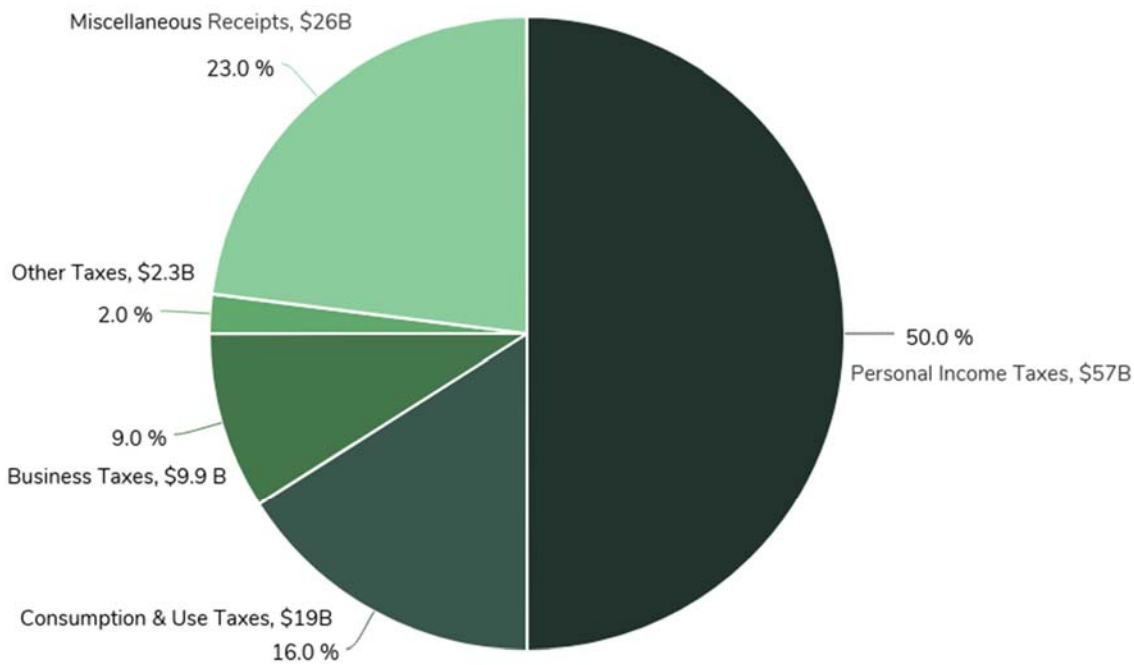
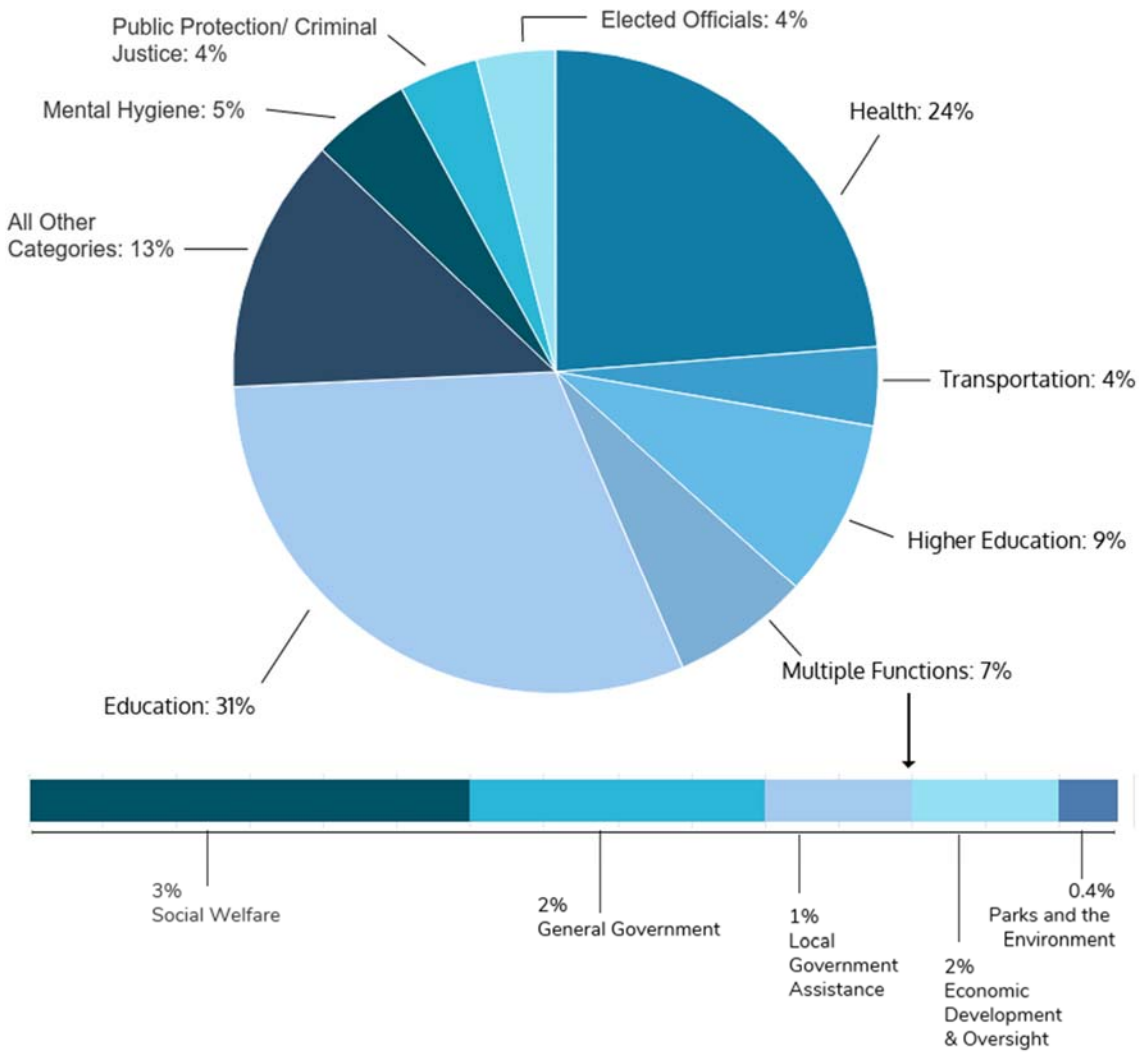
Revenues



ALL GOVERNMENAL FUNDS, STATE FISCAL YEAR 2020-21.
NOTE: COMPONENTS MAY NOT SUM TO TOTAL DUE TO ROUNDING.
Source: FY 2021 NYS Executive Budget, January 2020.

Expenditures



ALL GOVERNMENTAL FUNDS, STATE FISCAL YEAR 2020-20.
NOTE: COMPONENTS MAY NOT SUM TO TOTAL DUE TO ROUNDING.
Source: FY 2021 NYS Executive Budget, January 2020.

Financial Plan: The Budget New York Has

The budget gap this year is $6.1 billion.[1] About $2 billion of it is attributable to the structural gap in Medicaid financing. The rest, $4.1 billion, is similar in nature to the array of budget gaps the state faced in previous years. The governor's Executive Budget introduces a series of proposals that would close this gap but increase spending by less than two percent, under the governor's self-imposed cap. The Executive Budget for FY 2021 suggests the total state operating funds spending is projected to increase by $1.93 billion or 1.9 percent; that is in line with the $1.88 billion increase in the budget a year ago. The total of all government spending—which also includes capital funds and federal aid—is expected to grow by $2.12 billion or 1.2 percent, which is less than last year's $3.52 billion, or two percent, increase. Responsible fiscal management calls for increasing revenues considerably further than the governor suggests, to meet past and current needs and to build a reserve fund for the future.

Key Challenges

While the state operating funds expenditures are proposed to increase by only 1.9 percent, Medicaid spending is projected to increase the most among all spending categories, rising by $1.25 billion or 5.7 percent (down from 6.3 percent last year and 6.5 percent the year before). School aid is up by $826 billion, or three percent (that is smaller than the $956 million, or 3.6 percent, increase from last year and still far from being sufficient to meet the state commitment under the Foundation Aid formula). These increases are necessary, yet if some categories grow by more than two percent, the two-percent cap forces changes in other categories to be considerably less or even negative.

The state's financial plan is built around adherence to the two-percent spending benchmark. In fact, the Executive Budget projects the cumulative budget gap to widen considerably in the absence of actions to adhere to the two-percent growth target. The proposed financial plan features no significant revenue actions or resource changes. Two mentioned initiatives—continuously improving collections and recreational marijuana legalization—are likely to deliver sustained, though minor, revenue increases in the future. These are nowhere near enough to meet the state's needs and prepare for the future in a fiscally sound manner.

The issues with Medicaid are not new, nor are they unforeseen. In late March of 2019, the New York Department of Health delayed the disbursement of $1.7 billion for three business days, pushing the difference into the next fiscal year. As a welcome development, the Executive Budget financial plan suggests no new deferrals of this sort are needed going forward.

A projected structural mismatch between the state's estimated Medicaid spending growth and Global Cap indexed at three percent per annum stands at $3.1 billion for Fiscal 2021 unless it is closed. Some of the key fundamental factors that drive the costs up for the state are increases in labor input costs due to the recent increases of New York's minimum wage, sustained federal funding decreases under the Affordable Care Act, and steadily increasing enrollment. In response to the minimum wage increases, the Executive Budget allocates $1.8 billion to support the direct costs of health care workers who provide services reimbursed by Medicaid on behalf of the Department of Health. Clearly, these cost-push factors will continue, and some state-level fiscal action is required to close the growing difference.

The governor's proposal outlines the following course of action in dealing with both the baseline budget gap and the Medicaid structural gap: 1) Combine the $890 million Fiscal Year 2020 savings plan based on the midyear budget update and the new, Fiscal Year 2021 savings plan made of $2.1 billion of better-than-expected tax collections (mostly from better-than-expected revenues from the personal income tax); 2) $2.5 billion in projected cost savings the governor hopes to realize in efficiencies through suggestions from a Medicaid Redesign Team; 3) $1.8 billion in cuts to local assistance; 4) $359 million in agency operations savings; and 5) $252 million designated as other savings. The plan features no significant new revenue.

The Medicaid Redesign Team initiative (MRT II), reprises an effort established in 2011, and is tasked with creating a savings plan of $2.5 billion by April 1, 2020. If there is a failure to achieve the $2.5 billion in aggregate savings from the recommendations made by MRT II, then the governor proposes that uniform across the board cuts be applied to achieve $2.5 billion in aggregate savings. The MRT II has been tasked to have no impact on local governments, or on program beneficiaries, and to focus on identifying industry inefficiencies and areas for potential improved program integrity. The underlying assumption is that there are sufficient savings to be had in the Medicaid system due to efficiency gains, and that they are identifiable and ready to be operationalized before the budget deadline. That conclusion is highly speculative at this point, suggesting that a plan like this opens the door to potential cuts in areas that have nothing to do with the problem to be solved where operational and funding profile is different and under alternate conditions would not involve funding cuts.

Additionally, the Executive Budget proposes a new way to split the state and local share of Medicaid funding. The governor proposes a new way to limit state expenses, which he calls a new incentive structure for localities: counties must cap the growth of the local share of their Medicaid programs at three percent to secure state funding. Failure to do so would mean that local funds must be used to finance above-target program growth. The idea that this is an incentive structure implies that local governments have a considerable degree of control over many fundamental cost-driving parameters, such as Medicaid eligibility requirements. It is not so. Thus, while the practice may indeed result in reduced state spending on Medicaid, it is likely to be largely ineffective as a proper incentive arrangement and will lead to further escalation of local governments' fiscal squeeze. In fact, a troublingly distortive incentives may potentially be introduced instead: localities could end up being incentivized to keep people from getting services they need and are eligible for, by over-bureaucratizing the application and review process. The Executive expects $150 million in state share savings under this structure.

Funding Concerns

Inadequate funding is a feature of Governor Cuomo's fiscal approach across most multiple domains. Education funding has long been an area of concern in New York. The state is currently $3.8 billion behind what it committed to paying to help all schools achieve a sound basic education. The governor proposes an increase of just $504 million to foundation aid, the funds targeted to ensure that all schools can meet this minimum standard, an amount that includes $50 million for community schools—a very worthy initiative, but not something that should count as a substitute for foundation aid. In fact, it is not clear that even all of the $504 million is a genuine increase, since the executive budget also proposes adding new categories to foundation aid. The executive budget includes $200 million in a fiscal stabilization fund, but even if all of that goes into foundation aid it still puts the total at just $704 million, some $3 billion short of what was promised. Advocates are proposing that this year's budget include a $2 billion step toward the $3.8 billion, and the rest next year. That is the least the state can do to avoid starving schools of the funding they need to give students even the bare minimum that is required by our state constitution.

On immigration, Governor Cuomo suggests some small steps in the right direction by proposing to make occupational licensing possible for some immigrants, and by proposing to codify rules requiring state agencies to provide translation and interpretation. But the Executive Budget has precious little in the way of funding to support immigrant integration. Expanding support to help newcomers learn English—increasing Adult Literacy Education from $7.79[2] million to $25 million—would seem like an obvious win for everyone. Yet this year, rather than an expansion, the governor proposes reducing the already insufficient funding to $6.29 million.[3]

The Executive Budget leaves behind the New York State Enhanced Services to Refugees Program, a nation-leading initiative that helps refugees living in New York to thrive, supports upstate economic revitalization by attracting newcomers, and keeps on track resettlement agencies that are anchor institutions in their communities. Funding for this program should be expanded from $2 million to $5 million, but the governor allocates exactly zero. Nor does the Executive Budget allocate any funding for the Liberty Defense Project, the state-led public-private project providing legal services to immigrants in New York who face deportation. The governor cannot sincerely claim to support these programs if he leaves it to the Assembly and Senate bring funding for them to the table.

Steps in the Right Direction

On a positive note, proposals relating to the Working Family Tax Credits were included in the governor's Executive Budget for Fiscal 2021, with $157 million proposed to close a loophole in the Empire State Child Credit (ESCC). The ESCC currently excludes families with children under the age of four from receiving the credit. However, the governor's proposed eligibility requirements differ for families with young children, as their adjusted gross income (AGI) cannot exceed $50,000/annually. The current structure of the credit has a phase out of $75,000 of income for single filers and $110,000 for joint filers. This means that if the governor's proposal is enacted a single parent with a 3-and 6-year old who earns $58,000/annually will receive the ESCC for the 6-year old, but will still receive nothing for the 3-year old.

Creating an uneven income eligibility structure within the ESCC undermines the legislative intent of the Child Tax Credit, and continues to impede outcomes for very young children. Relatedly, the governor also kept intact the $3,000 earnings requirement for the ESCC. Doing so means children living in families experiencing deep poverty will not benefit from the credit. The ESCC would work better for our state's children with the following changes: 1) Create a $1,000 Young Child Tax Credit for children under the age of 4 that preserves existing income eligibility requirements; 2) Adjust the maximum credit to $500 for children aged 4-17; 3) Adjust the phase in to one dollar of income, which will benefit over 31,000 families.

With respect to the EITC, the governor proposed allowing the state Tax Department to review filings and grant the credit to eligible filers even if they did not claim it on their returns. While this is a welcome and progressive proposal, there is much more that can be done to make our tax policy more equitable for working people. At present, the credit excludes two classes of filers: young childless workers aged 18-24, and workers filing with Individual Taxpayer Identification Numbers (ITIN) (it should be noted that filers with ITINs are eligible to claim the ESCC). Young childless filers and ITIN filers are excluded from claiming the credit because our state EITC is coupled with the federal, and the federal EITC excludes these filers. The federal EITC is also modeled on the federal minimum wage of $7.25/hour, which is far out of step with our state minimum wage.

We recommend that New York State decouple from the federal EITC, which would allow us to model our state EITC on our higher state minimum wage, so that more working people and families can benefit, include young childless filers, and include ITIN filers. The income boost provided by the EITC helps struggling New Yorkers close holes in their household budgets while also boosting local economies and creating community economic stability. New York State has enacted a middle-class tax cut that, when fully phased in, will cost the state over $4 billion in revenue. A strong middle-class is important to New York State, so our tax policy should seek to create parity for working people and families. Doing so will ensure that more people can move into the middle-class and achieve economic security.

Progressive Alternative: The Budget New York Needs

New York is a wealthy state with a growing economy and solid economic indicators. Yet, New York also has a backlog of unmet needs in education, health care, housing, human services, infrastructure, and more. Despite some of New York's advantages and leadership on several economic and policy issues, the state falls far short of meeting the needs of New Yorkers. We can, and should, do better.

Below are several proposals for how to set the state onto a better course. We examine where the governor's Executive Budget makes good progress, and where it falls short.

Abandon the Arbitrary Two-Percent State Spending Cap

Over the years, the two-percent cap has become Governor Cuomo's trademark budget policy principle, meant to be a sign of his strict adherence to fiscal discipline. However, unforced austerity does not represent good governance at a time when so many needs are going unmet. An arbitrary two-percent cap at a time when health and education spending is rightly growing means not just a cap but often a reduction in spending in many other areas where it is needed, and where the state could well afford it. The governor's evident lack of interest in growing the rainy-day fund during an economic expansion also hardly reflects sound fiscal management.

It is difficult to assess true spending growth precisely, as the Executive Budget continues to use reclassifications, prepayments, and other budgetary maneuvers that mask actual expenditure.

Spending is clearly being unnecessarily constrained. This lack of transparency may suggest that behind the budget curtain the governor is finding that an undue fiscal restraint is not advantageous.

Tax the True Economic Income of the Wealthiest New Yorkers

New York is home to some 112 billionaires that 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 but usually pay less taxes as a portion of their income than do average hard-working 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 sale with a purpose to minimize their tax liabilities. Working people do not have such a chance. In order to ensure fairness of our income tax, it is beneficial to mark assets to market on a regular basis 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.[4]

It is reasonable to start implementation of the new tax approach with publicly traded assets that should be valued annually based either on end-of-year public-trading prices or on a 52-week moving average. For assets that do not trade in liquid markets special considerations are needed and asset valuation approaches and methodologies need to be established. For some types of non-traded assets as for example artwork, insurance policies could serve as sources of relevant market-like information; and for others—as privately held businesses—fundamental firm valuation can be done every 3-5 years to establish the long-term value gain of an asset. In addition, forensic economic methods for deriving prices on non-uniform assets in the absence of a well-established market or good information can be used. This is a wholly untapped new source of income tax and, with taxpayers with less than $50 million in assets excluded, can yield substantial new revenue.

Enhance the Millionaires Tax and Make it Permanent

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.

Because of the substantial budget needs New York faces, this year it is reasonable to consider a stronger version of the proposal we outlined last year. The chronic program underfunding requires a reversal of course towards raising additional revenue. As the needs increase, so should the fair contribution at the top echelon of incomes. In this proposal we suggest the same additional new 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.

Figure 1. The Enhanced Millionaires' Tax Can Generate $4.5 Billion in Additional Revenue

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**

Source: 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 2021 Economic and Revenue, February 2020. Note: 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.

Enact a Pied-à-Terre Tax

The state of New York can generate additional revenue and address its housing crisis by taxing luxury homeowners' residential property which they do not use as a primary residence. In addition to raising revenues, this tax will improve 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 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 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.[5]

Other Ideas Worth Discussing

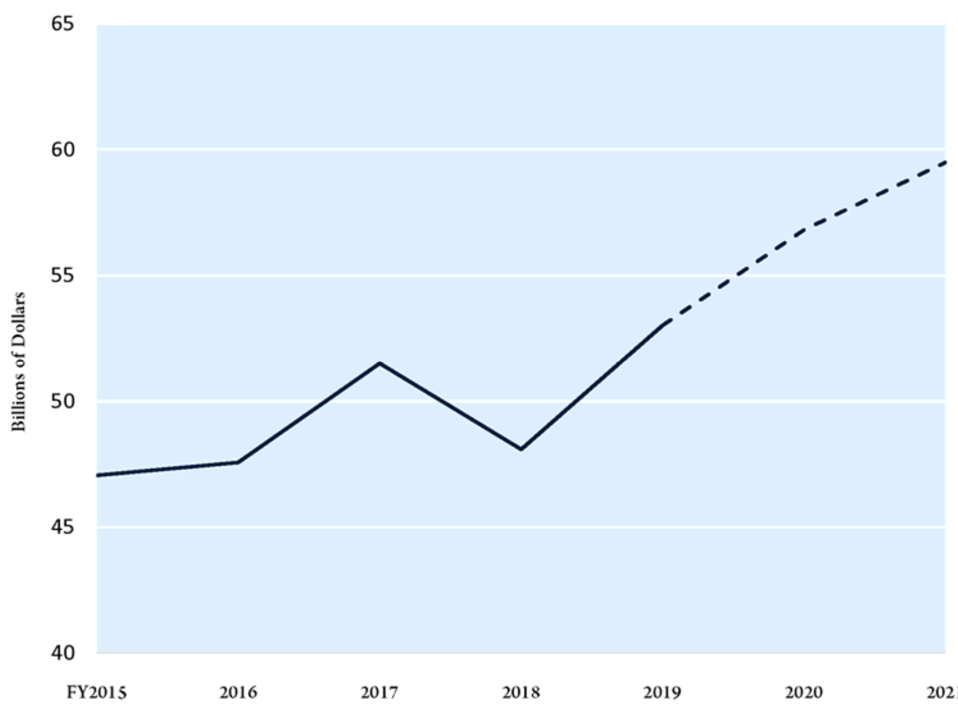
Stock buyback tax	A tax on stock buybacks at the rate of 0.5 percent of the value of open market share repurchases.
Carried interest fee	State-level surcharge on carried interest that addresses the carried interest loophole and makes private equity and hedge fund managers pay the same tax rate on their incomes as everyone else.
Tax on multinational corporations	Increase in state corporate tax for biggest companies.
Luxury land tax	Special assessment on highest-value land tracts. These are mostly in Manhattan: (sections of 57th Street, Park Avenue, Hudson Yards, TriBeCa, High Line and West Village, etc.)

Mezzanine debt tax	Apply a mortgage recording fee to mezzanine debt used financing of residential real estate purchases.
Bank tax	Reinstate bank tax
Yachts and jets tax	Reinstate the state tax on private yachts and jets.
Stock transfer tax	Stop rebating 100 percent of the stock transfer tax.

Economic Outlook and Fiscal Environment

The economy continued performing strongly both at the state and national levels throughout 2019, despite evident markers of potentially approaching a slowdown, such as yield curve inversion in the summer when the interest rates on 10-year U.S. Treasury bonds were briefly lower than the interest rates on 2-year bonds. The Federal Reserve reacted promptly and accommodatingly by lowering the federal funds target rate in an effort to provide the economy with the stimulus and the financial markets with the confidence they needed. Both investor and—most importantly—consumer confidence, at its highest level since 2000, powered the country's continued economic expansion strengthening hiring, wage growth, and consumer spending during the holiday season of last year.

Figure 2. Personal Income Tax

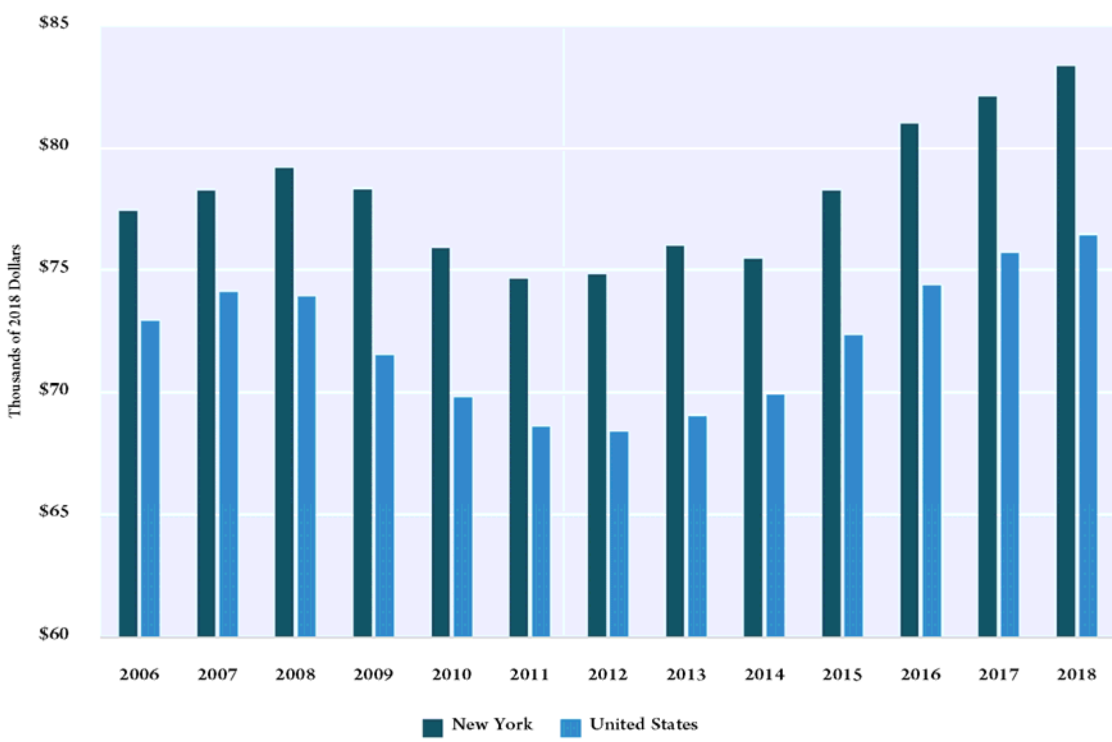


Source: NYS FY2020 Executive Budget Financial Plan, January 2019.

For the state of New York the favorable economic conjuncture contributed, most evidently, to the unexpectedly large personal income tax (PIT) collections as the state has reached the record highest number of private sector jobs in its history. Nonetheless, with the overall state unemployment at four percent, which is above the national 3.5 percent, New York's economy might have some untapped labor potential. In fact, an increasing or stable unemployment rate at the time when the economy is growing, can be a positive indicator that previously discouraged workers return to the job market. The majority of the 97,700 new private sector jobs last year were created in New York City and Long Island that together accounted for 78,700 new jobs. They were followed by Rochester, Syracuse and Ithaca with 6,500, 3,100, and 2,300 new jobs respectively. The rest of the state showed relatively slower rates of new job creation with some parts of the state such as Glens Falls even shrinking by 1,000 jobs or 2.3 percent.

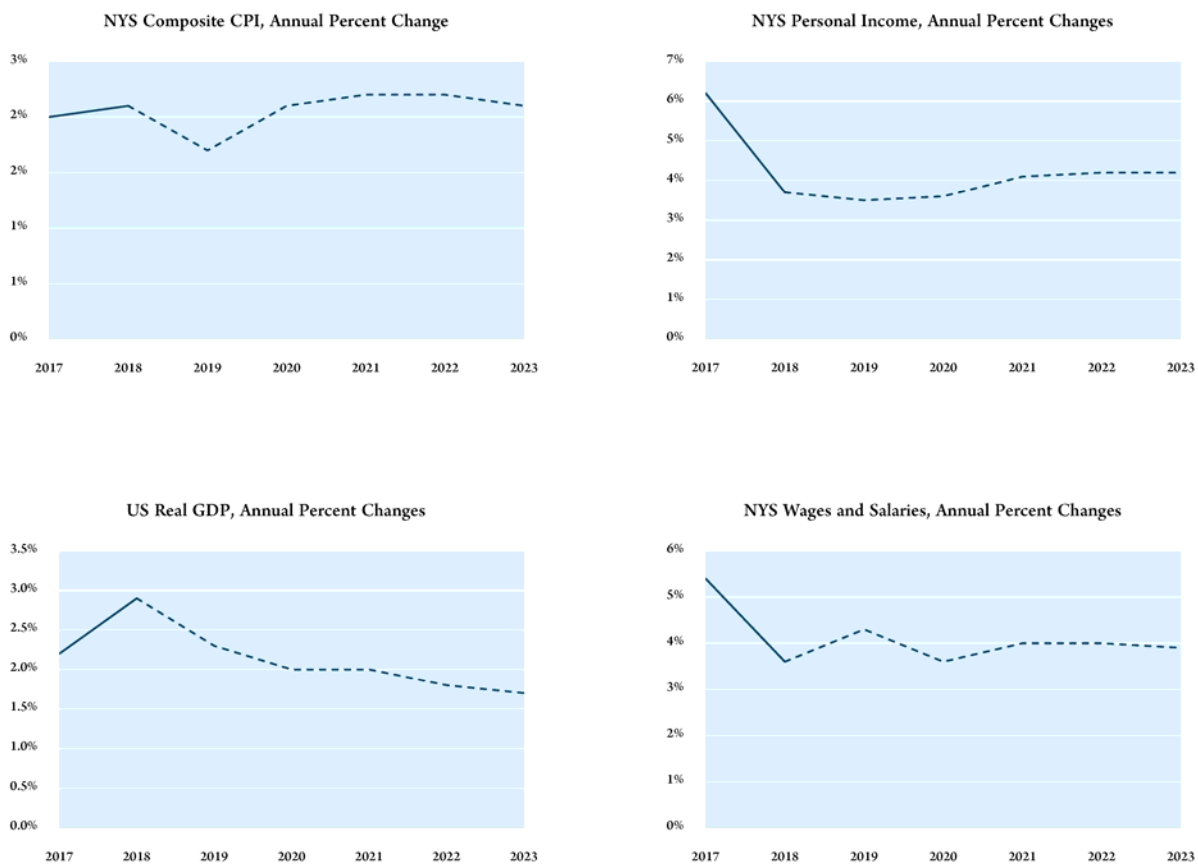
The personal income tax revenue is projected to continue to rise against the favorable economic backdrop. It is likely that New York State will continue to gain valuable advantages due to a combination of factors as New York City continues to assert itself as a premier global destination for finance and technology industries. With that said, the Department of Budget's PIT forecast contrasts their projections of declining growth rate. In fact, accelerating personal income is assumed to outperform that of the past two years by calendar 2021. It is not entirely clear whether these projections are accurate, or too optimistic: the ongoing economic expansion is already the longest on record and while there's no necessity for a recession to occur any time soon, it would nonetheless be prudent to consider past business cycle history for duration samples.

Figure 3. Median Real Family Incomes in NYS, 2006-2018



Source: Fiscal Policy Institute presentation of American Community Survey data.

Figure 4. While the Economy is Expected to Decelerate through 2020, the Forecast is for Robust Wage, and Income Growth in Out-Years while Consumer Prices Remain Stable



Source: NYS FY2020 Economic and Revenue Outlook, Economic Backdrop section, January 2019.

Responsible budgeting is important. The continuing good economic times offer a vital opportunity for the state to make long-term decisions. In anticipation of an eventual economic downturn, New York State should seek to increase revenues and grow its reserves in order to be able to respond to the growing needs and decreased revenues associated with a recession.

The median family income has recovered and surpassed the pre-recession levels of 2007 and 2008 both nationally and in New York. Thus, the probability of a new downturn increases with each month. While household incomes recovered from the Great Recession, with median household incomes showing aggressive growth since 2008, if broken down by demographic categories the picture is mixed and highly uneven. The income of a typical (median) white family is almost double that of a typical black family. Black families are in fact twice as likely to be low-income. The state of New York has increased its minimum wage to boost the incomes at the low end of the income structure, but it needs to do more.

Regressive recessionary cuts could further undermine essential operations, lower output quality, and hurt vulnerable communities around the state.

Will Millionaires Leave?

The question of migration of the wealthy and high-earning taxpayers is ever-relevant, especially when new taxes come about. While adjustment to new taxes is not uniform, research suggests that even fairly substantial increases in the tax burden on top earners does not result in the exodus of the rich. In fact, taxes appear to be but one factor considered by the wealthy when they decide where they want to live. New York is a particularly attractive destination, and offers globally unparalleled economic opportunities and resources in the fields of finance, professional services and, increasingly, technology as well as cultural and quality of life advantages for the wealthy that are difficult to match elsewhere. This is no doubt one reason the number of millionaires in New York has climbed since the enactment of the millionaire's tax in 2009; despite a higher tax rate, New York is still an appealing place to live. Indeed, the incomes of millionaires have grown much faster than those of non-millionaires, so that even in purely financial terms there seem to be advantages to locating in New York. When the millionaire's tax was first implemented, critics claimed millionaires would flee the state. However, the number of resident millionaire tax returns grew from 28,000 in 2009 to 53,000 in 2017. Their total income grew from $104 billion in 2009 to $221 billion in 2017.

That is not to say no one moves because of taxes. Research confirms that some tax-related migratory adjustment does take place. In a recent study, Moretti and Wilson report, "We find that billionaires' location is highly sensitive to state taxes . . . but despite high tax mobility, we find that the revenue benefit of a tax exceeds the cost for the vast majority of states" (including New York).[6] This means that even accounting for mobility, state revenues rise after raising taxes on high earners. More to the point, the minority of high earners who opt to move in response to higher taxes tend to be more "footloose" with shallower connections, weaker social ties to the place or residence and less involved in active job creation there. Those millionaires who stay or move here are, by contrast,[7] those with stronger ties with the local community through charity and board membership, more involved in job creation, and more likely therefore to share the view on taxes that pay for vital services and make the community stronger and more sustainable as an investment in the public goods the wealthy also get to enjoy. This makes the place where they chose to live attractive.

Thus, there is room to raise state taxes on the wealthy without substantial negative effects.

[1] A budget gap is a dynamic measure of a difference between the projected levels of expenditures and means and, as such, reflects a set of relevant assumptions and conditional reasoning based on a variety of information types. In this sense, a budget planner might render the gap either existing or addressed by adopting requisite assumptions. This makes it important to critically assess their quality with respect to long-term fiscal sustainability.

[2] State of New York, Senate-Assembly, January 15, 2019: https://nyassembly.gov/2019budget/budget/A2003d.pdf

[3] Description of 2020-21 New York State Executive Budget Recommendations for Elementary and Secondary Education: https://www.budget.ny.gov/pubs/archive/fy21/exec/local/school/2021schoolaid.pdf

[4] Jenny Bourne, Eugene Steuerle, Brian Raub, Joseph Newcomb, & Ellen Steele, More Than They REALIZE: The Income of the Wealthy, 71 NAT TAX J. 335 (2018).

[5]Jonas Shaende, 2019. *The Pied-à-Terre Tax: An International Review and Evaluation for New York*, http://fiscalpolicy.org/wp-content/uploads/2019/03/Pied-a-Terre-FPI.pdf

[6] Enrico Moretti and Daniel J. Wilson, 2019. "Taxing Billionaires: Estate Taxes and the Geographical location of the Ultra Wealth", NBER Working Paper #26387.

[7] Cristobal Young, et al, 2016. "Millionaire Migration and Taxation of the Elite: Evidence form Administrative Data", American Sociological Review, 81(3).