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Testimony of  
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Before the  
**New York City Council**  
**Committee on Finance**

## **FY 2012 Executive Budget Hearing**

New York City  
June 6, 2011

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, tax and economic policy issues. Thank you for the opportunity to testify today.

I would like to make three broad points regarding the proposed Executive Budget:

1—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 and economic adversity remain elevated;

2—The Mayor's Executive Budget proposal contains several harmful budget cuts that will curtail vital services in many critical areas, including 5,600 teaching and support positions in public schools, subsidized child care, senior and youth services, homeless prevention, transitional employment opportunities and family and adult literacy, CUNY community college access, fire houses, and public libraries; and

3—The City needs a more balanced approach to closing large budget gaps that involves reducing outlays on contracting out and looking at the revenue side of the budget.

## I. Lingering effects of the Great Recession

Even though the city's payroll employment decline was much less than anticipated in the dark days right after the September 2008 financial market meltdown, the city suffered a much steeper wage loss and much more prevalent long-term unemployment than during the two previous recessions in New York City. Consider these 10 indicators of the city's economic health:

1. The **number** of New Yorkers officially **unemployed** is still roughly twice the pre-recession level.
2. The **brunt of job loss** has occurred in sectors largely populated by city residents, including construction, manufacturing, trade and transportation, administrative and building services and in the government sector. In fact, even before the headcount reduction proposed in the Executive Budget is taken into account, there has been a steeper decline in local government employment in the city (-3.1 percent) than the net private sector job loss since the local recession began (-1.5 percent.)
3. Most of the reduction in the city's unemployment rate over the past year results, not from a surge in hiring, but from **people giving up looking for work** and dropping out of the workforce.
4. Nearly two years after the ostensible end of the national recession, **initial unemployment claims** filed in New York City are still averaging 10,000 a week, 25 percent greater than before the recession.
5. Well over half (55 percent) of the city's unemployed have been **without work for more than six months**, and over a quarter (27 percent) have been out of a job for more than a year.
6. The **unemployment rate for blacks and Hispanics** in New York City, who comprise half of the workforce, remains about twice the level for non-Hispanic whites.
7. And when you factor in discouraged workers and those working part-time involuntarily, the **under-employment rate** for blacks and Hispanics is about 20 percent.
8. The recession pushed an additional 100,000 New Yorkers into **deep poverty** in 2009 as the city's poverty rate, as measured by the official Current Population Survey, rose from 20.1 percent to 21.3 percent. The Mayor's Center for Economic Opportunity reports that, by its alternative poverty measure, poverty increased fastest in 2009 among single parent families.
9. New York City's **food stamp rolls** have grown by nearly 700,000 (61 percent) since the national recession began in December 2007.
10. **Homelessness is at record levels** with 38,000 people, including 15,000 children, in the city's shelter system.

This year's enacted state budget not only made steep cuts that had a substantial direct and adverse impact on the city budget, it will also result in reduced spending in the city economy in several other ways. In his Budget Summary, the Mayor noted that the total impact of the enacted state budget on New York City was to reduce spending by \$6.8 billion. This includes, in addition to reduced local school aid and the \$300 million revenue sharing cut, cuts to the CUNY budget for senior colleges, reduced state aid to the Metropolitan Transportation Authority, and the postponement of the 10 percent increase in the cash public assistance grant. It also includes the \$2.2 billion state reduction in Medicaid spending and a matching reduction in federal Medicaid funds coming to hospitals and health care providers in New York City. This \$6.8 billion drain on the city's economy is tantamount to taking away a year's worth of federal stimulus aid. The enacted state budget will reduce employment and incomes and impede the city's economy recovery.

## **II. Several harmful city budget cuts**

By now, the Council has heard plenty about the many steep spending reductions in the Mayor's Executive Budget. In addition to hearing from a wide range of constituencies who will be adversely affected, the Council staff briefing reports provide extensive detail on the multitude of budget cuts, large and small, both those proposed as new PEGs as well as the failure to fund programs the Council has restored or initiated in past budgets.

To mention just a few of the largest and most onerous cuts:

- The proposal for the largest cutback in public school teachers since the 1970s fiscal crisis;
- \$50 million less in subsidized child care (along with shifting \$13 million in increased child care co-payments by low-income working parents);
- \$40 million less for senior services;
- A 29 percent (\$90 million) cut in public library funding; and
- \$62 million less for CUNY community college than the amount needed to meet enrollment growth.

Not only do these and most of the other cuts from the FY 2012 Executive Budget greatly diminish several vital public services essential to the well-being of vulnerable low-income communities and to maintain the city's quality of life, but these cuts come at a time when federal stimulus funding that has been critical in many areas has ended or is winding down, and when the enacted state budget is slashing local aid to New York City and funding for a plethora of human services. Many budget cuts are examples of "penny-wise and pound-foolish," such as in homeless prevention, that involve saving a current outlay but that pushup fiscal and social costs down the road.

The city needs a better plan than one that relies so heavily on spending cuts to balance the city budget.

### III. A more balanced approach to balancing the city budget

The city contracts out over \$3 billion annually in professional, clerical, maintenance and other non-social services, some of which could be performed at reduced cost by City employees.<sup>1</sup> The City-Time and other recent scandals involving out-of-control contracting out clearly argue for a wholesale review of this practice and for more initiatives to bring work in-house where it can be monitored more closely and carried out more cost-effectively using city employees. This will obviously also have a local economic development benefit.

The city needs to look at the revenue side of the equation as well. The city should begin by thoroughly examining its business tax expenditures, the tax breaks provided and the business tax loopholes that exist, ostensibly to aid the city's economic development. Over the past 10 years, business tax expenditures have mushroomed from \$920 million to over \$2.6 billion annually. Chart 1 attached details these various tax breaks. This near-tripling in business tax breaks means that the city has given out tax breaks at a rate two-and-a-half times as fast as the growth in city tax collections. If business tax breaks had grown no faster than overall city tax collections, there were be an additional billion dollars in tax revenues in the city budget in the coming year.

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, at the same time there was a temporary increase in the state personal income tax. However, the city's income tax did not increase when the state raised its personal income tax rates in a progressive manner in 2009. Overall, the thrust of local tax and other revenue changes has contributed to the 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.<sup>2</sup> 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. The top 1 percent pays a much smaller share 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.

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<sup>1</sup> This total excludes the \$2.2 billion for special education schools, and excludes contracts for waste export, legal aid, and financial-related contracts.

<sup>2</sup> Chart 2 and the discussion of income concentration in New York City are drawn from Fiscal Policy Institute, *Grow Together or Pull Further Apart? Income Concentration Trends in New York*, December 13, 2010. The estimates in Chart 2 do not include the impact of water and sewer fees that are also regressive in their incidence and have doubled since 2002. See Chart 3 for the trend in overall income distribution in New York City since 1990.

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.)

The city could realize additional property tax collections by improving the quality and timeliness of assessments. In particular, the city should review all properties claiming tax exemptions and should revert to the previous method of assessing hotel properties.

Another revenue option that should be carefully examined is eliminating two tax loopholes that primarily benefit hedge fund managers. The city's Independent Budget Office estimates that eliminating the "carried interest" exemption on the City's Unincorporated Business Tax (UBT) would generate \$200 million yearly.<sup>3</sup> This loophole leads to 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 are organized as partnerships and limited liability companies.

There is a second loophole that generously benefits highly profitable hedge fund managers. The city's Finance Department reports that in 2008, 5,000 New York City millionaires benefited to the tune of \$121 million from a loophole that provides a credit against the New York City personal income tax for UBT taxes paid.<sup>4</sup> It is likely that most of those with incomes that high who are paying city UBT taxes are hedge fund and other fund managers who are also benefitting from the carried interest exemption loophole.

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.<sup>5</sup> 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.

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<sup>3</sup> New York City Independent Budget Office, *Budget Options for New York City*, April 2011. For more on 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](http://www.fiscalpolicy.org/FPI_RethinkingTaxTreatmentOfCarriedInterest.pdf)

<sup>4</sup> New York City Department of Finance, Office of Tax Policy, *Annual Report on Tax Expenditures, Fiscal Year 2011*, February 2011, p. 119.

<sup>5</sup> 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](http://www.fiscalpolicy.org/FPI_NewYorkCitysTwoRecessions_20091119.pdf).

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.

*The Fiscal Policy Institute (FPI) is an independent, nonpartisan, nonprofit research and education organization committed to improving public policies and private practices to better the economic and social conditions of all New Yorkers. Founded in 1991, FPI works to create a strong economy in which prosperity is broadly shared.*

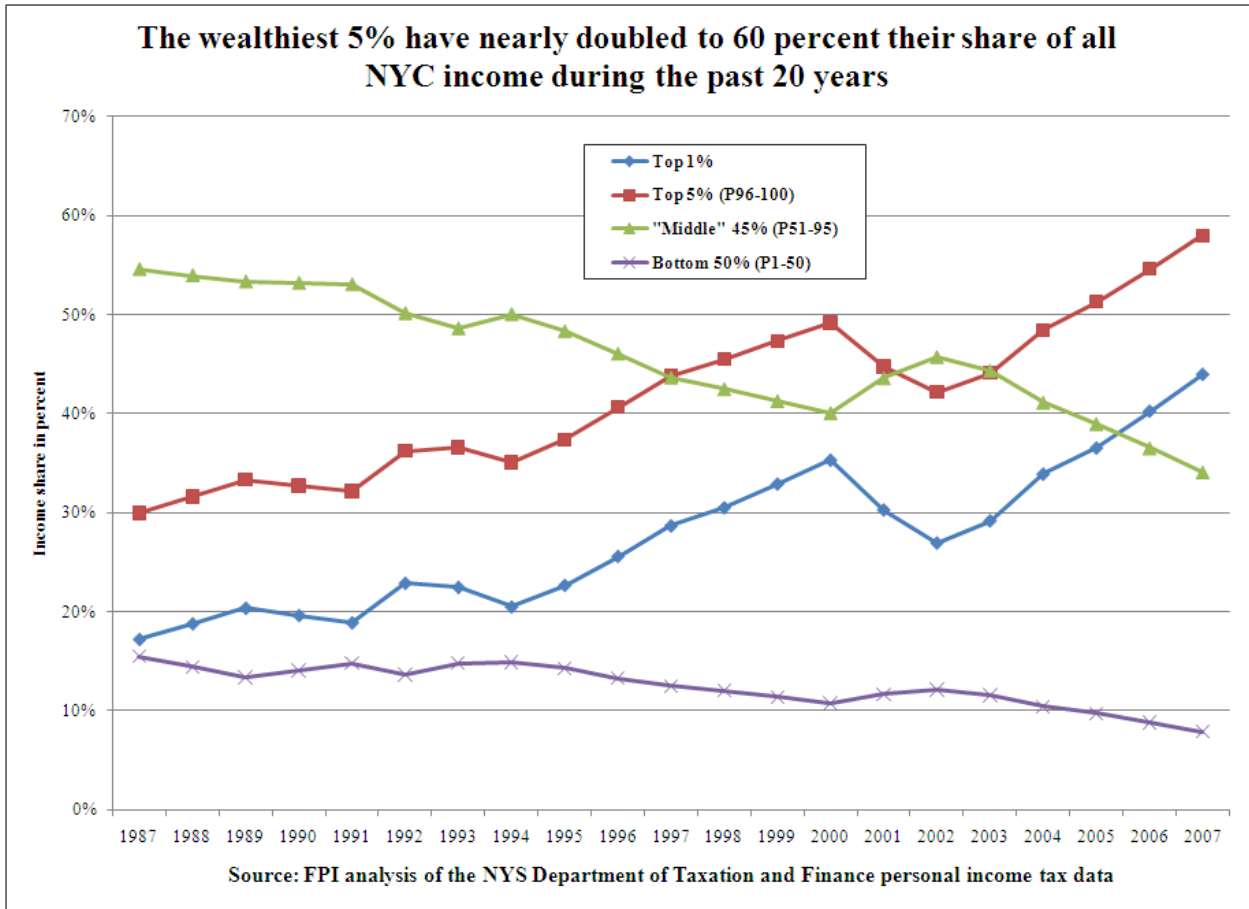
## NYC's Business Tax Expenditures have nearly tripled since 2001, and now total nearly \$3 billion

(in millions of dollars)			
	FY 2001	FY 2011	% change FY 2001-2011
<b>Real Property Tax</b>			
Industrial & Commercial Incentive Program	\$177.7	\$623.4	250.8%
Other Commercial & Industrial Exemptions	\$31.9	\$30.2	-5.3%
Industrial Development Agency	\$66.0	\$249.1	277.4%
Economic Development Corporation	\$3.9	\$10.2	161.5%
Urban Development Corporation -- Commercial	\$103.6	\$197.7	90.8%
Battery Park City Authority -- Commercial	\$43.8	\$74.7	70.5%
Teleport, Port Authority	\$6.7	\$10.0	49.3%
<b>NYC Personal and Business Income, Sales and Mortgage Recording Taxes</b>			
Business Income and Excise Tax Expenditure	FY 1998	FY 2007	
Business and Investment Capital Tax Limitation	\$32.0	\$497.0	1453.1%
Insurance Corporation Non-Taxation	\$193.0	\$303.0	57.0%
Other (Energy Cost Savings Program, Film Production, etc.)	\$205.0	\$305.0	48.8%
<b>Sales Tax Expenditures</b>			
Fuel Sold to airlines	\$30.0	\$134.0	346.7%
Unincorporated Business Tax Credit on NYC Personal Income Tax	FY 1999	FY 2008	
	\$25.0	\$158.3	533.2%
<b>TOTAL, above tax expenditures</b>	<b>\$918.6</b>	<b>\$2,592.6</b>	<b>182.2%</b>
		FY2010	
<b>Industrial Development Agency Tax Expenditures (other than Real Property Tax)*</b>			
Mortgage Recording Tax Exemption and PILOT Savings		\$32.2	
Sales Tax Exemption		\$2.8	
Energy Tax Savings		\$0.6	
Tax Exempt Bond Savings on NYC Personal Income Tax		\$6.0	
Unincorporated Business Tax -- Exemption for Carried Interest**		\$200.0	
<b>Grand Total, all NYC business tax expenditures</b>		<b>\$2,834.2</b>	
Source: Unless noted with an asterisk, data are from New York City Finance Department, <i>Annual Report on Tax Expenditures, FY 2001, and FY 2011</i> .			
* New York City Economic Development Corporation, Local Law 48 report for FY 2010 Table 2-1			
** New York City Independent Budget Office, <i>Budget Options for New York City</i> , April, 2011.			

## CHART 1



## CHART 2



## CHART 3