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Testimony of
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My name is James Parrott, Deputy Director and Chief Economist of the Fiscal Policy Institute. Thank you for the opportunity to testify today.

1. New York State economy has many strengths and challenges

New York's trillion dollar economy has substantial potential as a dynamic, innovative, internationally oriented economy that richly rewards all New Yorkers. Our state is among the most highly educated in the country, with 31 percent of the adult population aged 25 and over having a 4-year college or advanced degree. New York's workforce is also highly diverse in terms of its racial and ethnic composition and it has one of the largest and most varied immigrant populations among the states. New York has a significant productivity edge over the national average and is the most productive among large state with diverse economies. This productivity edge is broadly based across two thirds of industries.[1] The state's many colleges, universities, and research facilities give it a solid technological infrastructure. New York also has the advantage of ranking very high among states for its efficient natural resource use.

As a state, we have our share of challenges as well. The manufacturing-dependent upstate economy has been lagging, the overall quality of jobs offered in the state has deteriorated, and the growth in wages has not kept pace with the growth in productivity. This fact has contributed to the widest gap between the rich and the poor and between the rich and the middle class among the 50 states.[2] One of the most disturbing trends has been the increase in the number and percent of workers misclassified as independent contractors, a status that thrusts workers back to the 19th century without the protection of social insurance programs or employment rights established over the past several decades. While the overall poverty rate today is about the same as it was in the early 1990s, the number of families with a worker but who remain mired in poverty has risen by 75 percent since the early 1990s.[3]

State's current economic development response to these challenges

In 2007, the state spent roughly $3.7 billion in tax expenditures in the name of economic development.[4] When you add in local property and other tax breaks granted by Industrial Development Agencies, the total easily exceeds $4 billion annually. Adding at least $1.7 billion in local New York City tax breaks for economic development under the Industrial and Commercial Incentive program and other programs, the statewide total probably approaches $6 billion.[5]

Through its statutory and administrative responsibilities, State government is in a position to shape this entire expenditure. Despite the enormous amounts currently spent, we have relatively little to show for it, certainly far less than what we should be getting. There is no overall strategy or coordination, too little accountability and transparency, and no wage standards. A program like the Empire Zones Program that has strayed so far from its original, well-intentioned purpose, has become a source of ridicule.

In New York City, the focus is almost exclusively on real estate development, with the result that government actions tremendously boost the value of real estate but we do not necessarily get good jobs in return. The city practices schizophrenic development: government intervenes in the real estate market in various ways that enrich property owners and developers, but refuses to set labor standards on the grounds that it would be interfering in the market.

While there has been important progress over the past year, we would urge that we still need to seriously re-think economic development in New York. The overriding priority is to focus clearly and more effectively on the objective of providing good jobs and more opportunities for New Yorkers and building strong, vibrant communities. Economic development assistance should be targeted to investments in the human capital of our workers whose productivity determines the competitiveness of our economy. The state must work to make jobs better and vigorously enforce and improve labor and employment standards to deter companies pursuing a "race to the bottom" economically. We also need to re-direct the hundreds of millions of dollars the state foregoes in tax expenditures, and more effectively coordinate state and local efforts in pursuit of a sensible statewide economic strategy. Finally, New York should work with its neighboring states to de-fuse the negative sum, "economic war among the states" and New York should seek opportunities to work with other states on regional infrastructure development.[6]

2. Wall Street problems underscore importance of having a pro-active economic strategy

The real estate bubble, the explosion in household debt, and the related surge in financing activity on Wall Street, accounted for much of New York's and the nation's economic expansion since 2003. With the bursting of the broader real estate bubble it is now clear that the dot-com bubble of the late 1990s was not a fluke. It is fair to ask the question: Can Wall Street do well only by doing things imprudently? The contraction in the real estate sector, the subprime mortgage mess and the resulting credit crisis on Wall Street are leading to a serious slowdown, possibly a recession. According to the latest poll of economic forecasters by the Wall Street Journal, there is a 38 percent chance of recession.[7]

As Wall Street regroups from its current woes, policy makers should thoroughly overhaul state economic development activities to improve their effectiveness, and concentrate on other critical sectors, particularly manufacturing.

3. A note about measuring competitiveness – most well-publicized measures are deeply flawed

Economic development discussions, either explicitly or implicitly, employ differing conceptions of the factors affecting the "competitiveness", or economic vitality of a state or region. Our view is that "business cost" approaches that focus only on "costs" as opposed to the "value" of what is produced provide limited insight. In this regard, it is important to point out that New York has the highest value added per worker among the large states with diversified economies and, depending on how measured, the average New York worker is 15 to 30 percent more productive than the national average.

Business cost or business climate measures that ignore the value side of the equation are of limited use. For example, one measure often cited by the Business Council of New York is the Milken Institute Cost-of-Doing Business Index. In the 2007 Milken index, New York ranks 2nd highest overall in the cost of doing business. However, this ranking is largely based on New York's high average wages (2nd highest in the country after Connecticut) and high office rents (highest among all states). But what does this tell us? New York's wages and salaries are high because the skills of the workforce and the productivity of our workers are both very high. Office rents are high because there are considerable economies from the dense concentration of activity in New York City. To be meaningful, costs should be related to the value of the production that the high costs make possible.

The Tax Foundation also publishes a State Business Tax Climate Index. In the latest version of this index, New York ranks 48th out of 50 states (with a high ranking indicating "high taxes".) But what does this index really indicate about the economic competitiveness of states when it looks only at the tax side and not at the value side and where the four top finishers are Wyoming, South Dakota, Nevada, and Alaska? It does not seem that this index measures anything that provides much insight into the competitive position of states with economies similar to ours.[8]

This is not to say that costs are not important, but to stress that New York needs to provide very good value for businesses, in terms of a quality workforce and in terms of the public infrastructure and services needed to sustain high value production. Too often, commentators invoke a mantra that "taxes are too high" and a hindrance to "competitiveness" without regard to the essential investments in infrastructure or public services.[9]

Some times analysts too readily rely on crude indicators of the total New York state and local tax burden or of various "business climate" rankings rather than looking at how typical businesses are affected by state and local taxes. For example, in its report prepared for the Spitzer Administration's economic development team, management consulting firm A.T. Kearney cites New York's state and local tax burden as the first item under "exorbitant cost of doing business".[10] Yet, in a study for the Citizen's Budget Commission, economist Don Boyd found that while businesses operating in New York City had higher federal-state-local tax rates than like businesses in six other neighboring and "competing" states, businesses operating elsewhere in New York State had the lowest federal-state-local tax burdens compared to the six other states (California, Connecticut, Florida, Massachusetts, New Jersey, and Texas).[11]

Too often, statewide comparisons fail to account for the cost and tax structure of New York City, and the fact the average productivity in the city is far above the national average.

CFED, a national economic development organization, argues that "measuring the standard of living and working in a state and how well the state is building foundations for future growth is just as important as how hospitable that state is to businesses." In the preface to its Development Report Card for the States, CFED writes:

> Economic development is a complicated thing, but fundamentally, it should strive to serve the needs of everyone in a community. It certainly includes providing an environment in which companies can thrive, but that should not be the exclusive goal. ... [B]ecause at the end of the day, businesses share the same needs as their employees, suppliers, and customers. Both businesses and individuals benefit from dependable infrastructure, good schools, a healthy environment, a good quality of life, accountable and transparent government, financial security for households, and a lack of strong divisions across, for instance, class and race." [12]

4. We can't have a middle class without middle class jobs

There is no question that individual workers are much more likely to succeed in the labor market if they get a college education. However, it is by no means certain that, given current trends in the economy and reasonable projections made based on those trends, there will be a sufficient supply of high quality jobs in the future. Following the national occupational projection methodology employed by the U.S. Bureau of Labor Statistics, the New York State Department of Labor has projected the occupational composition of the jobs likely to exist in 2014 (a 10-year projection using 2004 as the base year).

In 2004, 21.5 percent of New York's jobs required a college degree or higher. This category of occupations is projected to grow slightly faster than the average for all occupations, but at a rate that will only raise the 2014 share of occupations requiring a college degree or higher to 22.4 percent. Similarly, the share of occupations that require some college (but less than a 4-year degree) will rise from 10.1 percent to 10.5 percent. Nearly a third of New York's 25+ workforce already has a 4-year college degree or better, whereas only 22 percent of jobs in 2014 will require that level of education. On the other hand, 46 percent of New York workers have less a high school diploma or less, yet slightly over two-thirds of the jobs that are projected to exist in 2014 will require no more than that level of education.[13]

While there may be several reasons why workers hold jobs for which they have more formal education than required, the conclusion is inescapable that we already have a workforce that, on average, is overqualified for the jobs our economy offers. The policy challenge presented by this mismatch between educational attainment and the educational requirements of jobs suggest that more needs to be done to increase the supply of jobs requiring better educated workers. And the fact that most jobs for the foreseeable future will not require higher education and consequently will likely offer more modest pay and benefits, suggests that strategies are needed to improve the quality of these jobs.

MIT Sloan School economist Paul Osterman has proposed two strategies for improving job quality that have relevance for New York's labor market challenges. Improving job quality requires labor standards such as increasing and enforcing the minimum wage and ensuring that economic development subsidies be tied to quality employment opportunities. Second, he urges that programmatic assistance be given to employers and workers to encourage job and skill upgrading. The resulting increased productivity will enable businesses to more easily pay higher wages and needed fringe benefits.[14]

5. Leveling the playing field among businesses through aggressive labor standards enforcement: helping the tax base, businesses and workers

Lack of labor standards enforcement is not sound economic policy. Twelve years of lax enforcement under the previous administration contributed to serious misclassification problems and lack of compliance with mandatory social insurance programs.[15] This compounded the funding problems for both workers' compensation and unemployment insurance and raised costs for law-abiding businesses.

The Spitzer Administration has recognized this and has moved aggressively to tighten enforcement of compliance with both of these essential worker safety net programs.[16] It is safe to say that the enforcement effort under the Joint Enforcement Task Force on

Employee Misclassification will readily pay for itself in terms of increased revenues to the unemployment trust fund, the workers' compensation system, back wages to workers, and increased tax personal and business income taxes to the state treasury. In fact, given the magnitude of the problem, it would make good budget sense for the State to double or triple the number of enforcement staff.

6. Tighten up tax subsidy programs to protect the tax base as well as maximize their economic development benefits

Considering our $6 billion in economic tax expenditures and the unimpressive results of those expenditures, there is much to be gained from re-examining the whole panoply of programs. Let me cite just three examples: Empire Zones, the Investment Tax Credit, and New York City's Industrial and Commercial Incentive Program.

<u>Empire Zones</u>

In its assessment of New York's economic development programs, the A.T. Kearney management consulting firm concluded:

> [The Empire Zones program was] … the best example of good economic development intentions gone wrong. Its original mission has been morphed by political patronage, legislative revision and commercial manipulation, effectively repositioning it from a program primarily helping distressed communities to one routinely offering tax relief for ongoing businesses.[17]

The Empire Zone (EZ) program as it now exists is seriously flawed, it produces paltry results and is a major drain on the state's tax base. Audits by the State Comptroller's office detail the lax administration and abysmal results that characterized the program for several years. The costs of the program have jumped from $30 million in 2000 to a projected $558 million in 2007. In addition, there is an overhang of over $500 million in EZ-related tax credits that have been carried forward and will drain further revenues from the state treasury in the years ahead.[18]

Responding to the findings in the Kearney report and adverse publicity about the widespread practice of "shirt changing" companies that changed their legal ownership structure mainly for the purpose of cashing in on Empire Zone benefits, the Administration sent 3,000 letters to companies that had received zone benefits (about one-third of the total) asking those firms to show why they deserve to stay in the program.

The Empire Zone program is so severely flawed that it should be scrapped. If it is continued, it should be radically reformed to serve its original purpose of targeting economic assistance to distressed areas and it should be strengthened through the inclusion of job quality standards and further improved transparency and accountability.

Investment Tax Credit

New York's Investment Tax Credit (ITC) is so generous that many large corporations pay only a nominal amount in corporate income taxes. Many companies routinely can use only a portion of the ITC and end up paying the state's alternative minimum tax. But they are allowed to carry forward unused credits for up to ten years. For 2003, the total amount of ITC benefits carried forward was $1.6 billion. This means that large companies could stop reinvesting in New York altogether and would still be able to reduce their tax liability to the legal minimum or close to it for another decade.

At the same time, we have seen the emergence in New York in this decade of a gap between the growth in productivity and the growth in wages. The ITC could be changed to, in part, address this gap. The ITC should be modified to reduce the amount of credits provided without any requirement for job creation or retention, and increasing the amount of credits that can be earned through job creation and retention. For example, the five percent ITC could be linked to job growth and reduced in value in the first year along with increasing the value of the credit under the Employment Incentive Credit in subsequent years, with the credit directly linked to job retention and creation. The enhanced Employment Incentive Credit would replace the ability to carry forward ITC credits independent of employment levels.[19]

New York City's Industrial and Commercial Incentive Program

Under New York City's Industrial and Commercial Incentive Program (ICIP), property taxes are reduced on an as-of-right basis for several years in exchange for investments in renovations or new construction, with benefits varying in value and duration depending on area, with higher benefits for manufacturing than commercial uses. Earlier this year, the City's Economic Development Corporation undertook an analysis of several thousand recipients over a period of years and concluded that most retail projects around the city and most office projects in the midtown Manhattan renovation zone would have taken place even without ICIP benefits. Retail and midtown office renovations account for a significant share of the $410 million annual cost of these property tax breaks. The City seemed inclined to recommend that the State scale back the ICIP program when it expired at the end of June, but then it changed course and sought a much more minor adjustment in eligibility (ICIP was extended for a year and now expires June 30, 2008). The City should be commended for undertaking a careful analysis of the impact of the ICIP program. State policy-makers should review that analysis when the renewal of the program is taken up in the coming year, and should consider requiring similar analyses of state subsidy programs.

7. New York needs a clear economic objective and strategy and vastly improved implementation and evaluation

To capitalize on our potential and get an economy that produces good jobs, more opportunities and less inequality, we should have a clear objective: good jobs and strong, vibrant communities.

Strategy should have four essential components:

- Strategic
- Diversifying
- Coordinated
- Accountable

The Executive and the Legislature should work together to develop a compelling and long-term economic strategy that incorporates a comprehensive workforce development strategy. As part of this process, which should start with an objective assessment of the state's key economic resources – human, environmental, financial, educational, and technological – the state's economic and workforce development agencies should seek local input in crafting recommendations that fit strengths and needs o each region in the state.

The Fiscal Policy Institute's *One New York: An Agenda for Shared Prosperity* elaborates many details of this programmatic framework.[20] In addition to arguing for a coherent and coordinated economic development strategy, *One New York* outlines proposals to revitalize upstate cities, reverse "sprawl without growth", and advances a comprehensive reform of the state-local fiscal relationship in New York geared to reducing he pressure on the property tax. FPI Executive Director Frank Mauro addressed the fiscal reform agenda in his testimony on December 13, 2007, at the Budget Division's Public Hearing on Property Taxes.[21]

<u>Strategic</u>

- State should focus on modern, well-maintained infrastructure and make it a priority to invest in worker skills and education [California's explicit economic development goal is to raise living standards].

- Priority should be to help groups of firms in **sectors** key to regional growth. The economic development agencies should look at the Labor Department's recent initiative, "Regional Economic Transformation Strategies Through a Sector or Cluster-Based Approach."

- Government's role is to address instances of "market failure" where individual companies under-invest in things vital to competitiveness like worker skills, new technology, or market development because individual firms cannot sufficiently appropriate benefits of those investments.

- When individual companies are aided, establish clear **performance-based criteria for receiving aid**: above average wages/benefits for that industry; low employee turnover; above average productivity for that industry; commitment to invest in worker skills [these are used by Michigan Manufacturing Technology Center].

- All economic development **assistance should be tied to wage standards**. Wage standards should be incorporated into legislation renewing the Industrial Development Agency and Industrial and Commercial Incentive program legislation in the coming year.

Diversifying

- Critically important to diversify the state's economy, particularly in light of the turmoil on Wall Street.

- Can't write off **manufacturing**, it's still central to most upstate regions. No large economy can have a broad middle class without manufacturing (or very high unionization). Too many people are ready to give up on manufacturing, which would be a serious mistake. However, the state has not done much to dissuade people from that.

- With 550,000 jobs statewide, manufacturing is tied with the finance and insurance sector as the fifth largest source of private jobs in New York. Much of New York's manufacturing involves advanced production skills. Among the 12 largst manufacturing states, New York has the second highest share of workers in highly skilled occupations.[22]

- A.T. Kearney NYS strategy: biotech, cleantech, nanotech, and financial back offices for upstate cities. Kearney analysis had little to say about potential for or advisability of maintaining a large upstate manufacturing base.

- Establish criteria discussed above, then undertake systematic assessment of all manufacturing in the state, identify sectors and clusters where they exist, figure out skill, technology and marketing needs, send results to all IDAs and make sure they prioritize these companies.

- Exploit potential for growth in **green technologies**, energy efficiency, and mass transit equipment upstate. Under the Governor's "15-by-15" energy plan, there is the potential for a real commitment to job training to both promote retro-fitting and energy conservation like "green building" materials, and to exploit opportunities related to developing renewal energy sources.

- With one-third of U.S. transit ridership, New York should tap this huge market potential to develop more **transit-related manufacturing upstate** and export innovative products to the rest of the U.S., and eventually, to foreign markets.

<u>**Coordinate**</u>

- To maximize return for government investments in infrastructure, education, and workforce development, make sure all our oars are pulling together and that we are moving forward. Wage standards should accompany any major spending, e.g., expanded state investment in affordable housing. In construction, in particular, there are clear dangers and fiscal costs of the underground economy. These were recently documented by FPI for New York City's construction sector.[23]

- A top priority is to get IDAs to make sensible investments, stop pirating from each other, stop subsidizing retail and projects that would because of market considerations, happen anyway, regardless of government subsidy.

- **Scrap the troubled EZ program**, or if it is retained, re-focus it on its original purpose to provide good paying jobs and opportunities for high poverty areas.

- Coordinated approach needed to revitalize upstate cities and provide better opportunities for their populations. Curb suburban sprawl/concentrate development in cities, combine with broad tax reform (lower property taxes paid for with graduated state income tax) and restructuring of state-local fiscal relations so local governments can aid in their revitalization.[24]

<u>**Accountable**</u>

- Eliminate political favoritism and ensure that companies deliver on commitments or pay back subsidies if they do not.

- Subsidy decisions should be smart, strategic and advance the objective of good jobs and vibrant communities. If we have a smart strategy, people will support it, and they will be better able to make sure IDA boards are investing wisely.

- In New York City, link government subsidies and land use actions to wage standards and commitments to invest in workers and provide career ladders.

Endnotes

[1] Fiscal Policy Institute, *The State of Working New York 2007: Encouraging Recent Gains but Troubling Long-Term Trends*, September, 2007, pp. 32-33. Among the ten largest states, New York has the highest value added per worker in eight sectors and the second highest in five other sectors out of the 19 sectors comprising the private economy.
[2] See *The State of Working New York 2007.*
[3] See *The State of Working New York 2007*, p. 27/
[4] New York State Division of the Budget and Department of Taxation and Finance, *Annual Report on New York State Tax Expenditures, 2007-2008.*
[5] The New York City total includes local property and sales tax breaks provided granted by the New York City Industrial Development Agency, the Urban Development Corporation and the Battery Park City Authority. City of New York, Department of Finance, Office of Tax Policy, *Annual Report on Tax Expenditures, FY 2007*, August 2007. http://www.nyc.gov/html/dof/html/pdf/07pdf/ter-2007_final_rev_9-5-07.pdf
[6] See the classic essay, "Congress Should End the Economic War among the States" by Melvin L. Burstein and Arthur J. Rolnick in the 1994 Annual Report of the Federal Reserve Bank of Minneapolis, http://minneapolisfed.org/pubs/ar/ar1994.cfm. At the time, Burstein was executive vice president and general counsel and Rolnick was senior vice president and director of research at the Minneapolis Federal Reserve.
[7] Phil Izzo, "Economists Say Recession Risk Is Climbing," *Wall Street Journal*, December 11, 2007, A3.
[8] The Public Policy Institute of New York State calculates something it calls the "New York State Cost Gap" that is supposed to represent the extent to which the "government-related costs of living and doing business in New York" exceed the national average. However, forty percent of the "cost gap" stems from personal income taxes, yet PPI fails to adjust New York's income tax burden for the portion paid by commuters. According to Division of the Budget estimates, non-residents paid 16.3 percent of New York State personal income taxes in 2004. New York State Division of the Budget, *Executive Budget 2007-2008, Economic and Revenue Outlook*, February 2007, p. 254.
http://publications.budget.state.ny.us/fy0708app3/fy0708appd3.pdf
[9] Robert G. Lynch, "Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development," Economic Policy Institute, 2004.
[10] The A.T. Kearney report also cites the "Economic Freedom Index," prepared by the Pacific Research Institute. In his study, *Grading Places: What Do the Business Climate Rankings Really Tell Us?*, economist Peter Fisher concludes: "The Economic Freedom Index is a sometimes bizarre collection of policies and laws libertarians love, or love to hate, but few have any plausible connection to a state's economic potential." Peter Fisher, *Grading Places*, Economic Policy Institute, 2005.
[11] Donald J. Boyd, "A Simulation of Business Taxes in New York City and Other Locations," Final Technical Report, Prepared for the Citizens Budget Commission, June 2, 2007.
[12] CFED, "Economic Development: Of the People, By the People, For the People," http://www.cfed.org/focus.m?parentid=2346&siteid=2346&id=2406.
[13] Using occupational projections from the New York State Department of Labor, FPI aggregated educational requirements for occupations for which current and projected employment levels were shown on the Department of Labor website. See, FPI, *The State of Working New York, 2007*, Figure 2.11, p. 23. Educational attainment for the population 25 years and older from the 2004 American Community Survey.
[14] Paul Osterman, "Improving Job Quality: Policies Aimed at the Demand Side of the Low Wage Labor Market," Prepared for the W.E. Upjohn Institute on Employment Policy Conference: "A Future of Good Jobs? America's Challenge in the Global Economy." June 22, 2007.
[15] Fiscal Policy Institute, *New York State Workers' Compensation: How Big Is the Coverage Shortfall?* January 25, 2007; 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.
[16] The Workers' Compensation legislation signed into law in March included tough new anti-fraud enforcement measures and in September the Governor signed an Executive Order establishing the Joint Enforcement Task Force on Employee Misclassification. When Governor Spitzer signed his Executive Order to prevent employee misclassification, State Labor Commissioner Patricia Smith noted that the Joint

Enforcement Task Force would "reverse several years of lax enforcement." Governor Spitzer Press Release, September 7, 2007.

[17] A.T. Kearney, *Delivering on the Promise of New York State: A Strategy for Economic Growth & Revitalization*, 2007, p. 26.

[18] For more on the Empire Zone program, see Trudi Renwick, Fiscal Policy Institute, "New York's Empire Zone Program," presentation at the conference, "The High Road Runs through the City," September 27, 2007, Buffalo.
http://www.fiscalpolicy.org/publications2007/Renwick_NewYorksEmpireZoneProgramSept07.pdf

[19] One example of this suggested approach is Assembly bill A05323, sponsored by Assemblyperson Ortiz.

[20] See FPI, *One New York, An Agenda for Shared Prosperity*, pp. 16-32.

[21] Testimony of Frank J. Mauro, Fiscal Policy Institute before the New York State Division of the Budget, Public Hearing on Property Taxes, December 13, 2007.
http://www.fiscalpolicy.org/DOBHearingDecember132007.pdf

[22] Richard Dietz and James Orr, "A Leaner, More Skilled U.S. Manufacturing Workforce," *Current Issues in Economics and Finance*, Federal Reserve Bank of New York, February/March 2006.

[23] Fiscal Policy Institute, *Building Up New York, Tearing Down Job Quality: Taxpayer Impact of Worsening Employment Practices in the New York City Construction Industry*, December 5, 2007.
http://www.fiscalpolicy.org/publications2007/FPI_BuildingUpNY_TearingDownJobQuality.pdf

[24] See FPI, *One New York, An Agenda for Shared Prosperity*, pp. 26-32, and Testimony of Frank J. Mauro, Fiscal Policy Institute before the New York State Division of the Budget, Public Hearing on Property Taxes, December 13, 2007.