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State and Local Government Finance

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CASE: A COMMUTER TAX FOR NEW YORK CITY?^[1]

Introduction

It is the spring of 2003. New York City's economy has been pummeled by a national recession and by the economic after-effects of the terrorist attack on the World Trade Towers. The city's economy ended 2002 with an unemployment rate far above the national average and an accelerating loss of private sector jobs. In fact, the city's jobless rate jumped by 1.1 percentage points in 2002 and ended the year at 8.4 percent. The national rate, now 6.0 percent, rose just 0.2 percentage points over the same period.

Because of this economic decline, New York City's government faces falling revenue and increasing costs and is having a very difficult time making ends meet. As *New York Times* columnist Bob Herbert put it on November 14, 2002:

We are witnessing the first stage of what may become a precipitous decline in the city's quality of life. All the tax arrows are pointing up and all the service arrows are pointing down. Hunger, homelessness and unemployment are big problems. Library hours are shrinking and resources are being carted away from a school system that was already in deep trouble. It won't be long before sharp cuts are felt in such vital areas as police, fire and sanitation.

In December, 2002, at a speech before the Citizens Budget Commission, a watchdog group funded by some of the city's major business leaders, New York City Mayor Michael Bloomberg put the size of the city's budget gap for the next fiscal year at \$6.4

billion. Depending on how you calculate, this shortfall represents a sixth of the city's budget or a quarter of it. The lower figure is the gap expressed as a proportion of all city revenues, the higher as a proportion of only those revenues raised from city taxpayers. Measured another way, the gap corresponds roughly to the total annual expenditures of New York's Police, Fire, Sanitation, and Corrections Departments combined, or, alternatively, more than the entire 2002 budget for the city of Houston and its surrounding county

The last time New York experienced a shortfall of this magnitude was during the fiscal crisis of the seventies—a parallel that is not, of course, terribly reassuring. That shortfall, which was the result of genuine idealism, calculated generosity, and extremely bad bookkeeping, several times brought the city to the edge of bankruptcy. This crisis cost thirty-five thousand municipal workers their jobs, brought an end to free tuition at City University, forced the suspension of countless public construction projects, and generally ushered in one of the bleaker periods in the city's history. A quarter of a century and two stock-market booms later, New York is, in a very real sense, still paying for it. Every year, the first five hundred million dollars the city collects from its sales tax goes toward retiring bonds issued to resolve the crisis, and this will continue until 2008, when those bonds finally mature.

Mayor Bloomberg does not want to leave this type of legacy. "The law requires us to close the gap," he declared. "Our expenses and revenues have to be the same, and, regardless of the pain, we will make them the same." He praised the City Council for having recently approved the largest property-tax rate hike in New York history—eighteen and a half percent—saying that members of the Council had acted "dramatically and courageously," and he alluded to a series of spending cuts that his administration has in the works. Nevertheless, he insisted that the city should not be called upon to reduce expenditures any further. "The fact of the matter is we have cut as much as I believe we

can,” Bloomberg said. “More cuts risk adversely affecting New York City’s quality of life and reducing the ability to grow our way out of this problem.”

In this setting, Mayor Bloomberg made a bold proposal: a commuter tax.

Mayor Bloomberg’s Commuter-Tax Proposal

Mayor Bloomberg’s proposal has two parts. First, he proposes reducing the rate schedule for the city’s current income tax, which applies only to city residents, by 25 percent beginning July 1, 2003. For city residents earning more than \$90,000 per year, the income tax rate would drop from 3.65 percent to 2.7 percent. The rate cuts would be gradually raised to 38 percent over the next four years, with a final value of 2.25 percent for the top rate. Second, he proposes to apply the new income tax to income earned by commuters in the city.^[21]

According to Mayor Bloomberg, the key principle involved in his proposal is that everyone should help pay for the public services where they work. As he said in a radio address,

If New Jersey taxed New York City residents that come there and get services in New Jersey, that would be appropriate. Everybody should pay for their fair share of the services they use. Those people that come into New York City should pay for part of New York City services. Those people that go to Connecticut and go to New Jersey should pay there. I happen to pay taxes in all these states because my company has offices in most of these states, and I think that's perfectly appropriate as well.

Mayor Bloomberg also emphasized that his proposal brings the city’s treatment of non-resident earnings into conformity with the approach in the New York State income tax, and indeed with the approach used elsewhere.

As a matter of fact, it is the general policy throughout this country for municipalities that have income taxes to charge nonresidents, not just at the state level but at the city level. Cities like Los Angeles, Cincinnati, Cleveland, Pittsburgh, Daytona, St. Louis, Newark, Kansas City, San Francisco, and Yonkers, all tax nonresidents the same ways they do residents. Yonkers is a bit less. All of the others I listed tax exactly the same rate for nonresidents as residents.

The New York City Independent Budget Office (IBO) estimates that 815,000 commuters would pay this tax, and that their contributions would bring the city \$2.2 billion in FY 2004.^[3] The net revenue from the overall proposal would be only \$830 million, however, because of the rate cuts for residents. Because of the additional rate cuts in later years, the projected revenue from this proposal actually becomes slightly negative by FY 2006, but with a positive contribution of \$2.1 billion from commuters. This revenue from commuters would make a substantial contribution to solving New York City's fiscal crisis for many years to come.

This plan drew predictable reactions. The leaders of neighboring communities were unanimous in their opposition. "Mike Bloomberg is telling the suburbs to drop dead," said the Nassau County executive, Thomas R. Suozzi, a Democrat. Leaders in New Jersey and Westchester also panned it. In contrast, members of the City Council praised the mayor's plan, calling it a move in the right direction. The Council speaker, Gifford Miller, said in a statement, "The mayor's plan for a place-of-work tax is a creative approach to solving our revenue problems."

Mayor Bloomberg said that his job would be to convince Albany that his proposal is fair and equitable. "What we're trying to do is say that everybody that works in the city benefits from all of the services — the Fire Department, for example," Mayor Bloomberg said. "And it is only equitable that everybody pays some share of that. And we are trying to do that in a way that spreads the burden."

The History of New York City's Previous Commuter Tax

Until a few years ago, New York City had a commuter tax, which brought in \$350 million dollars a year. This tax was enacted by New York State in 1966 under the guidance of two Republican leaders, Gov. Nelson A. Rockefeller and New York City Mayor John V. Lindsay. This law allowed the city to impose a tax of 0.25 percent on the incomes of people who work in the city but live elsewhere. Five years later, the state increased the tax to 0.45 percent,^[4] in the form of a law that expired periodically. This law was renewed several times.

This commuter tax was by no means out of line with standard practice. The 0.45 percent rate in New York City was below the 0.8 percent rate in Los Angeles, the 1 percent rate in Newark, the 1.5 percent rate in San Francisco, the 2 percent rate in Cleveland, and the 4.3 percent rate in Philadelphia. Moreover, as noted earlier, commuters pay the same tax rate as city residents in all those other cities, whereas New York City imposed a rate on residents that was eight times greater than the rate on commuters. Even Yonkers, the only other city in New York with a commuter tax, has a tax rate of 0.5 percent.^[5] In addition, commuter taxes have often been used as a way for a state to help a big city facing a difficult fiscal situation.^[6]

In 1999, however, the legislature and the governor decided not to renew the second part of the commuter tax and even to repeal the original 0.25 percent tax for residents of New York State. The 0.25 tax was retained for residents of other states, but this provision was quickly thrown out by the courts as a violation of the U.S. Constitution, which prohibits a state from applying a tax to people from other states that is not also applied to its own residents.^[7]

The decision to repeal the commuter tax was made with surprising speed. Once the issue was raised, the state's three top leaders, the Republican Governor George E. Pataki, the Republican Majority Leader of the State Senate, Joseph L. Bruno, and the

Democratic Speaker of the State Assembly, Sheldon Silver, quickly agreed on the repeal. H. Carl McCall, the State Comptroller, called it “surprising” how fast they managed to move. He noted that the so-called Albany Three had dithered for months, the same as they do every year, without coming close to accomplishing the main thing they are paid to do: pass a budget. Yet in no time, with about as much debate as you find in a football huddle, they agreed to do away with the miniscule tax that New York City imposes on suburbanites. Assemblyman Anthony S. Seminerio, a Queens Democrat who voted against repeal, echoed this view. “They can’t get a budget together, they won’t talk to one another, all the prima donnas, but when it came to this piece of garbage, they are all talking and scheming all over the place.”

The repeal of the commuter tax began as just one more overture to voters in a 1999 special election for a State Senate seat in Rockland County, northwest of New York City. First one candidate, then the other declared that the state should end the tax on commuters who work in the city, never expecting repeal to amount to anything more than talk.

About 800,000 commuters paid the tax, and it was obviously not popular in the suburbs.^[8] Suburban lawmakers of both major parties had agitated for years to end the tax, but it took a confluence of events for them to win. The State Senate race was the most prominent of these events, but equally important was New York City’s strong fiscal health at the time, with a \$2 billion surplus, and then-Mayor Rudolph Giuliani’s plans to cut taxes for city residents.

State Senator Dean G. Skelos, a Republican from Nassau County, first raised the issue in late April, 1999 after Giuliani announced his proposed budget. Skelos wondered whether it was fair for the Mayor to ask Albany to approve his tax-cut package while ignoring the commuter tax. “This is not a matter of sticking it to the city or doing anything negative for New York City,” Skelos said. “The issue is one of fairness.”

But the repeal did not galvanize the Capitol until early May, when three Assembly Democrats from the suburbs held a news conference in Rockland County with the Democratic candidate for the State Senate seat, Kenneth Zebrowski, who was the majority leader of the County Legislature. The four men called for the elimination of the tax, saying that the state should help offset the resulting revenue loss for the city with revenue from the recent settlement with the tobacco companies.

The idea was that it would be a good political ploy. To rally support for their State Senate candidate, these Democrats were endorsing what had long been little more than a suburban whim. State Republicans, not to be outdone on what is normally a Republican issue, quickly supported the concept, adding that the Republican-controlled State Senate would approve the legislation. Because the Governor could be expected to endorse the measure, the Democratic Assembly with its Democratic Speaker, Sheldon Silver of New York City, was considered the fail-safe that was sure to stop the plan. After all, Silver represented New York City's lower east side.

For political reasons, however, Mr. Silver decided that his Democratic Assembly would vote with the Republicans. Because of his political power, he was then able to convince many Democrats in the Assembly, including 21 of the 59 from the city, to go along, and the repeal passed easily, 92 to 49. Mr. Silver argued that the city had a fat surplus and could afford the loss. But most observers believe that Silver saw a chance to shrink the Republican's margin in the State Senate, where they held a 35 to 25 advantage before the special election, and to undermine support among suburban voters for Republican Mayor Giuliani, who was widely expected to run for the U.S. Senate the following year. The political nature of this decision was widely recognized at the time.^[9] Even some supporters of the repeal acknowledged that lawmakers were not setting the best example by altering the city's longstanding tax structure with no hearings or study, little debate, and political considerations at the forefront. Opponents of the repeal had stronger language. "God forgive you all," Assemblyman Seminerio told his colleagues.

“You don’t deserve to be elected officials.” State Senator Roy M. Goodman, a Republican supporter of the commuter tax, said the repeal would “go down in the annals of the Senate as one of the most foolish pieces of fiscal folly ever perpetrated on the public.”

Moreover, Silver’s strategy ultimately backfired.^[10] The Republican, Thomas Morahan, defeated the Democrat, Kenneth Zebrowski, in the special election in Rockland County and the Republican advantage in the State Senate increased from 35-25 to 36-25. In addition, Mayor Giuliani eventually dropped out of the Senate race for health reasons and Democrat Hillary Clinton won easily. Using the political calculus of the time, therefore, one could say that New York City lost at least \$350 million of revenue each year for nothing.

Some people also blame Mayor Giuliani for what happened. He was slow to take seriously the possibility that the commuter tax would be repealed, and he did not show his characteristic energy and doggedness in trying to work out a compromise with Mr. Silver. As Mitchell Moss, a political scientist at New York University, put it at the time, “His style of leadership is now costing New Yorkers.” After the fact, Mayor Giuliani went to court to challenge the repeal of the commuter tax, arguing that the state could not repeal this tax without the city’s permission. State law provides that before the state passes a law directly affecting a local government, it usually needs a request from that government – a so called “home rule message” – to make the change. “There is no question that you need a home-rule message in order to do this,” Mayor Giuliani said. “We are very much entitled to this small tax. Sometimes the game of politics gets out of control, and this is a situation in which the game is overwhelming the public good.”

The home-rule principle in New York State does not apply when the issue is not purely local, however, or when there is an overriding state interest involved. Thus, the Court of Appeals, New York State’s highest court, rejected Mayor Giuliani’s argument. “This is obviously not a purely local matter,” explained Vincent Bonventre, a professor at

Albany Law School, “because the tax applies to people outside the city, so it is a state concern.” Moreover, as Richard Briffault, a professor at Columbia Law School explained, the state prevailed because the “State Constitution presumes that taxes are a state matter.” Ultimately, therefore, Mayor Giuliani’s efforts to save the commuter tax were too little, too late.

New York City’s Current Fiscal Situation

Mayor Bloomberg managed to deal with a projected \$4.7 billion deficit in the FY 2002 budget by convincing the City Council to pass an 18-1/2 percent increase in the city’s property tax. This tax increase will also help in future years, of course, but even with this increase, the city’s fiscal woes are far from over.

In fact, because of its deteriorating economic circumstances, New York City faces a potential budget gap of \$1.1 billion in FY 2003 and \$6.4 billion in FY 2004. Mayor Bloomberg’s proposals for closing the gap are outlined in Table 1. As this table makes clear, his proposed changes in the income tax, including the new commuter tax, play a key role in bringing the city’s budget into balance. The commuter tax is by no means the whole story, however, and the plan also includes a battery of budget cuts, including reducing the police force by an additional 1,900 officers, cutting education spending by \$215 million, and shutting several centers for the elderly.^[11]

The key problem with this plan is that it relies on actions by the state government. Councilman Bill de Blasio of Brooklyn said that many council members liked Mayor Bloomberg’s commuter tax proposal but doubted that Albany would approve it. Without state approval of all Mayor Blumberg’s proposed changes to the income tax, which would provide the city with \$1 billion more next year, the city may have to raise its personal income tax rates, Councilman de Blasio said. “The numbers are so staggering, unless you believe that you are going to get the expansive version of the commuter tax, you almost have to” raise the personal income tax “to make things work.” The dependence of this plan on decisions by Albany also factored into Standard & Poor’s

recent decision to change its assessment of the city's fiscal outlook to negative from stable.

Table 1.
Closing New York City's Fiscal Shortfall

| | FY 2003 | FY 2004 |
|--|----------|----------|
| Budget Gap To Be Closed | \$-1,073 | \$-6,360 |
| Proposed Gap-Closing Program | | |
| Cuts in services | + 844 | +1,108 |
| Property tax increase | +1,133 | +2,335 |
| State-approved measures, including expanded income tax | | +1,413 |
| Federal initiatives | | + 200 |
| Improvements in workforce productivity | | + 600 |
| Payments to General Reserve Fund | - 100 | - 100 |
| Money from FY2003 used for FY2004 | - 804 | + 804 |
| Remaining Gap/Surplus | 0 | 0 |
| Source: Mayor's Office of Management and Budget | | |

New York City's dependence on state action is by no means limited to the commuter tax. In fact, the city faces severe restrictions on the steps it can take without state approval. Without the state's permission, the city cannot raise its fines for illegal parking, offer its own employees early retirement, or restructure its own debt. It cannot lower speed limits on some roads. It cannot even do something New York counties can: decide what time the bars close. For all of those things, the mighty city must go, hat in hand, to Albany. Thus, alongside the larger, attention-grabbing items like mayoral control of the schools, there are much smaller favors that must be wheedled out of Albany's byzantine legislative maze.

“The list is shocking because so much of it seems like stuff that's appropriate for local control,” said Richard D. Emery, a civil rights lawyer who is familiar with the inner workings of New York's government bodies. “The mayor ends up being responsible in the perception of the public, but not in control.” Or, as Dr. Richard Briffant, a Columbia Law School professor who specializes in local government, put it, “A lot of the major activities of daily life in New York City are not controlled by the city; they're controlled by the state.”

The city is, of course, a creature of the state. But where some states give cities a wide range of powers, New York City, whose budget is bigger than all but those of eight states, has little autonomy, a fact that has long frustrated city leaders and puzzled government scholars. In the 1970's and 80's, the state blocked Mayor Edward I. Koch's plan to require that police officers and firefighters live in the city. In 1991, at the peak of the city's crime wave, when Mayor David N. Dinkins wanted a tax surcharge to pay for more police officers, he had to beg the state.

The state's generosity toward the city has gone up and down over the years. In their 1991 book, *America's Ailing Cities*, for example, Professors Helen Ladd of Duke University and John Yinger of Syracuse University find that state assistance to New York city, both through institutional mechanisms, such as the commuter tax, and through intergovernmental grants, ranked 19th among 70 large cities in 1972 but rose to 6th by 1982.^[12] Most of this assistance came in the form of grants. The record in recent years is mixed. Between 1989 and 2000, state aid (including aid for education) increased 5 percent in real terms, but declined from 19.9 percent to 17.7 percent of the city's budget.^[13]

According to some commentators, the prevailing attitude in Albany is that New York City is a money pit, and an expensive one at that. “What they don't realize upstate,” said Professor Briffault, “is that the lion's share of the tax revenue comes from the city. So we're shipping a lot of money to Albany and then struggling to get it back.” Indeed,

the city's struggle with the state has not been going well in recent years. Not only was the commuter tax repealed in 1999, but the next year the state abruptly broke a decades-old promise involving the stock-transfer tax worth \$114 million a year to the city and boosted the city's pension obligations by \$363 million per year. "What these things have done is taken away \$1.1, \$1.5 billion," Mayor Bloomberg said in defense of his commuter tax. "So we're just getting back some of what we've lost." But faced with its own budget problems, the state does not appear to be listening. In fact, Governor Pataki recently proposed cutting the city's education aid by \$400 million and implementing various other cuts and hospital charges that would take an extra bite of about \$140 million out of the city budget

Other commentators are now worried that Albany has not yet grasped the urgency of the city's fiscal problems this year. It would be easy, Mr. Emery said, for the city to revert to the crime-ridden, broken-down metropolis it was just a decade ago. "Unless they act now, it's going to be too late," he said. "The specter of a bleaker, darker New York City is already on us."

But while the state has tremendous legal authority, experts point out, the city is not powerless. A large chunk of the Legislature, including a majority of the Assembly's Democratic majority, is from the city — even though those lawmakers have not always hewed to the mayors' agendas. Moreover, the city holds a trump card, namely the fact that the state cannot afford to let a huge part of its economy collapse. "The mayor of New York, unlike other local executives, has a huge microphone," said Alan G. Hevesi, the former city comptroller. "No elected official in the state wants to be blamed for bad conditions in the city." Mayor Bloomberg is trying to use this microphone. In one of his weekly radio addresses he declared that "New York City is the economic engine for the entire region and state, so keeping the city strong benefits everyone."

Some analysts have suggested that Mayor Bloomberg is asking for a sure-to-be rejected commuter tax as a negotiating tactic. After all, rejection of this proposal gives

him an excuse for raising city taxes. “My private view is that Bloomberg wants someone to throw him in the briar patch,” says Gerald Benjamin, a state government scholar and the dean of the College of Liberal Arts and Sciences at SUNY College at New Paltz. “In other words, force him to tax.” Others think Mayor Bloomberg is proposing a large commuter tax but hoping to re-instate the old one. “To me it seems so clearly undoable politically, it almost smacks of being a tactic,” said Edmund J. McMahon, a senior fellow at the Manhattan Institute, a conservative policy group. “It’s, ‘Oh, you don’t like this? How about the old commuter tax?’ But it is such a clear overreach, that it may hurt them in the end.”

Arguments for a Commuter Tax

The principal argument for a commuter tax is a fairness argument: Commuters use city services so they should help to pay for them. As Mayor Bloomberg put it in his 2003 State of the City address:^[14]

To those who say taxing people who work here but live elsewhere is unfair, remember... their livelihoods, property values, and standard of living are to a large extent a function of their proximity to New York City.

And when our police officers and firefighters respond to calls, residency doesn’t matter—and it shouldn’t.

Everyone should pay equally for the police, fire, sanitation and other services they benefit from. It’s really just that simple.

This is, of course, an application of the well-known benefit principle, which says that the people who benefit from certain public services should pay for them. It was the main argument made in support of the original New York City commuter tax and, proponents argue, it has just as much force today. Moreover, Mayor Bloomberg also pointed out, it is an argument already used by the state to justify the provision that levies

the New York State income tax on people who commute into the state from New Jersey or Connecticut.

The positive foundation of this argument is that nonresident commuters boost the amount of money a city must spend on public services such as transportation, police protection, and fire protection. Several studies have looked into this issue. In their 1991 book, *America's Ailing Cities*, for example, Professors Ladd and Yinger, find that, all else equal, cities with many commuters have higher public service costs than cities with few commuters. More specifically:

A 10 percent difference between two cities in private employment per capita leads to a 2.9 percent higher cost for general services and to a 3.9 percent higher cost for both police and fires services in the city with the higher employment. A city with private employment per capita one standard deviation above the mean must pay about 10 percent more for general services and over 14 percent more for police and fire services than a city with an average value for this variable.

More recent evidence along these lines is provided by Professors Howard Chernick and Olesya Tkacheva of Hunter College in an article in *StateTax Notes* in 2002. They find that a city with a number of jobs per capita one standard deviation above the average must spend \$439 dollars, or 23 percent, more per capita than the average city. Professors Chernick and Tkacheva also find that this same difference in jobs per capita would result in a 7.0 percent difference in police expenditures, and a 6.3 percent difference in fire expenditures.

Professors Chernick and Tkacheva then apply these estimates to New York City. Combining their estimated coefficients with the number of commuters per capita in New York City, they find that the additional expenditures “associated with the jobs that are held by non-residents, is equal to somewhere between 2.2 and 3.8 percent of the current budget, or \$1.2 to \$1.9 billion in 1997.” This is obviously a large impact, far greater

than the \$350 million collected from the city's original commuter tax and somewhere in the ballpark of the revenue from Mayor Bloomberg's proposed commuter tax.

In short, nonresident commuters appear to impose substantial costs on a city government. Moreover, it seems unlikely that the incidental taxes they pay, such as sales taxes, will compensate the city for these costs.^[15] Based on likely fiscal flows, therefore, one can make a case that without a commuter tax, commuters do not bear their fair share of the city's tax burden.

This argument for the commuter tax is strengthened, many analysts argue, because commuters have relatively high incomes. As a result, a commuter tax adds progressivity to the system of taxes paid by the beneficiaries of city services. According to a report by the finance division of the New York City Council, the average household with at least one adult commuting to work in New York City earned more than \$144,000 a year in 1997, while the average household living in New York City earned slightly less than \$43,000 a year. The average individual commuter had annual earnings of about \$88,000. In 1998, the last year in which New York City imposed a commuter tax, the average commuter working in the city earned \$99,400, according to IBO. That year, the average city resident earned \$33,700. "On average, certainly commuters were higher-income earners," said Doug Turetsky, an IBO spokesman. In addition, most commuters to New York City are white and work in white-collar jobs, said Andrew Beveridge, a Queens College sociologist who has researched commuter demographics.

As Ronnie Lowenstein, the director of IBO puts it, the commuter tax is "equitable, both because commuters have higher average incomes than city residents do and because it seems fair to have individuals who work here and use local services bear some of the costs."

A few analysts push the progressivity argument even farther. The state is responsible for creating the set of local governments and the tax system that supports

them. It is appropriate to evaluate this tax system as a whole, not just to evaluate it within each jurisdiction separately. In general, this tax system is fairly regressive because tax burdens tend to be higher in poor cities than in rich suburbs.¹¹⁶¹ As a result, a commuter tax makes the overall system less regressive (but hardly progressive), and therefore makes the overall tax system fairer, at least to those who believe that progressivity is a good thing. This argument holds even if commuters do not benefit significantly from city services.

Another argument in favor of a commuter tax is that, in Ms. Lowenstein's words, it "reduces the incentive for individuals who work in the city to reside in the suburbs." A possible alternative to the commuter tax is an increase in the income tax on city residents. According to Ms. Lowenstein,

Either increasing the base rate for high-income filers from 3.2 percent to 4.2 percent or adding a 10 percent surcharge for all filers would each raise about \$550 million annually. The advantage to raising income taxes is that the increases fall most heavily on high-income residents, who are best able to pay. At the same time, however, many of New York's highest income residents are particularly mobile, and could continue to work in the city but avoid city personal income taxes by residing elsewhere.

A loss of high-income residents obviously poses a serious threat to the long-run stability of the city's tax base and of its neighborhoods.

Further increases in the property tax, another alternative to the commuter tax, also might undermine the attractiveness of the city to high-income households and to businesses. The same can be said for the third main alternative, namely, cutting local services. How many households or businesses would want to move to, or even stay in, New York City after a drastic cut in its public services? As Ms. Lowenstein puts it,

“Dirtier streets, rising crime and dilapidated parks can be as much a disincentive to living or working here as rising taxes.”

Arguments Against a Commuter Tax

One argument against a commuter tax that is outside the boundaries of the standard public finance focus on tax burdens is provided by Governor Pataki. In an op-ed piece in *The New York Times* right before he signed the repeal legislation in 1999, Governor Pataki argued that commuters make sufficient contributions to the city without a commuter tax.^[17] As he put it,

Repealing the commuter tax will help the New Yorkers who commute to the city and contribute to its economy in so many ways – shopping, dining, visiting museums and theatres, investing on Wall Street and so on. Commuters spend plenty of money in the city. Cutting their taxes by \$210 million will give them more to spend as they wish. That’s good for the city economy and the budget.

Mr. Daniel Greenberg, a commuter from New Jersey, supported this argument in a letter to *The Times* a few days later:

My commute to New York City from New Jersey costs \$2450 a month. When I arrive at Penn Station I choose to walk to my office, because after spending hundreds of dollars in commuter taxes, I would rather save the additional cost of a taxicab or a bus.

Wouldn’t the city prefer, Mr. Greenberg continued, “that I spend my money on cabs, buses and subways, restaurants and shops than pay it directly as a tax?”

Another argument against the commuter tax is political. Because New York City must negotiate with the state for many things, including state aid to education and virtually any change in taxing authority, some people argue that it is a poor strategy to insist upon a revenue source, such as the commuter tax, that antagonizes so many suburban

legislators. The help of these legislators is needed, after all, for the passage of many other things.

One example of this argument comes from the 1999 debate about the original commuter tax. Assemblyman Richard L. Brodsky, a Westchester County Democrat and a proponent of repeal, said that Democrats from the city should back the tax cut because suburban legislators had long supported measures that solely benefited the city. Each area needs to look out for the interests of the other, Brodsky said. “The repeal of this tax is fair, just and reasonable, and represents an expression of that interdependence.”

The importance of this claim is difficult to determine, however. The repeal of the commuter tax in 1999 did not result in a vast new flow of benefits from the state to the city. Indeed, New York City still receives less aid per pupil than the average district in the state.^[18]

In any case, Mayor Bloomberg appears to be counting on cooperation from the state. Specifically, his budget plan includes a wish list of things Albany could do to help the city out of its fiscal mess, ranging from state absorption of the city's share of Medicaid costs, which would save City Hall \$4 billion next year, to a state contribution of \$275 million a year to help pay for the city's new contract with the United Federation of Teachers, which raised teachers' salaries in exchange for longer work days.^[19] Mr. Bloomberg is also counting on \$200 million in transportation initiatives that would require either the state's approval or the approval of the Metropolitan Transportation Authority, which is controlled by the state. Those include imposing tolls on East River bridges, a move Governor Pataki has opposed, and having the M.T.A. take over city-subsidized private bus routes in Queens.^[20] The Mayor may not be able to get all this and a commuter tax, too, particularly given the shaky fiscal condition of the state government, which also must figure out how to eliminate a large deficit.

Perhaps the most important argument against a commuter tax is that it might scare jobs away from New York City and thereby undermine its long-run growth. A person with a job in New York City could not avoid a commuter tax by moving out of the city; indeed, the main point of a commuter tax is to make sure that city workers help pay for services no matter where they live. In contrast, a firm can enable its employees to escape the commuter tax, and thereby boost their real incomes, if it moves from the city to the suburbs.

Although evidence on the magnitude of this effect is difficult to come by, many policy makers and analysts believe that it is important. During the debate over the original commuter tax in 1999, for example, Lena Cymbrowitz, a Democratic member of the Assembly from Brooklyn said that by ending the commuter tax, the state would lure more people to work in the city, which would generate more revenue for city businesses. “Let’s show good will and encourage people to come,” she said.

The argument has also appeared in the current debate. Mr. McMahon of the Manhattan Institute warned that it could drive businesses away from the city.

It's a huge tax shift to two classes: commuters and their employers. The people who will pay the property tax increase on commercial properties are the firms that employ commuters. And they will have to increase salaries to offset the higher tax on commuters.

Similarly, E.J. McMahon, a columnist for the NY Post, wrote in December 2002: “In this shaky economy, the city desperately needs to attract and retain more commuters – a goal that will not be served by slapping them with what amounts to a wage toll.”

Governor Pataki also argued that reinstating the commuter tax would hamper the city's economic recovery. In a recent speech he said:

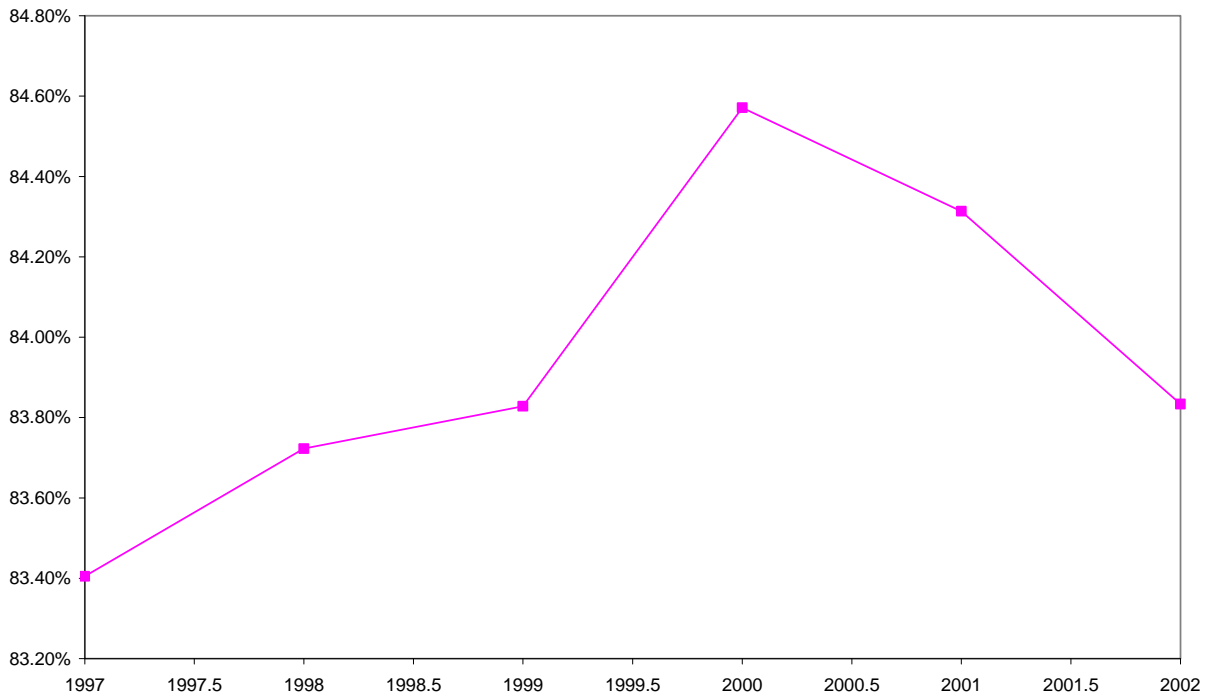
We have thousands of jobs, tens of thousands of jobs, that have been temporarily dislocated. And it's very important that we fight very hard to bring all those jobs back. And we can't do that if we're telling employers, we're telling employees, 'Come back to Lower Manhattan, come back to New York City, and by the way, we're going to hit you with a new tax.'

Governor Pataki concludes that "Reimposing the commuter tax now would be extraordinarily counterproductive."

One formal estimate of the link between a commuter tax and employment Philadelphia comes from Professor Robert Inman, a well-known public finance economist at the University of Pennsylvania's Wharton School. Using data from Philadelphia in the 1980s, he found that a 1 percentage point increase in the city's wage tax, which applies to both residents and commuters, would result in a 13 percent drop in the number of jobs in the city. Because Philadelphia's commuter tax rate is 4.3 percent, a tax increase of this magnitude corresponds to roughly a 25 percent increase.

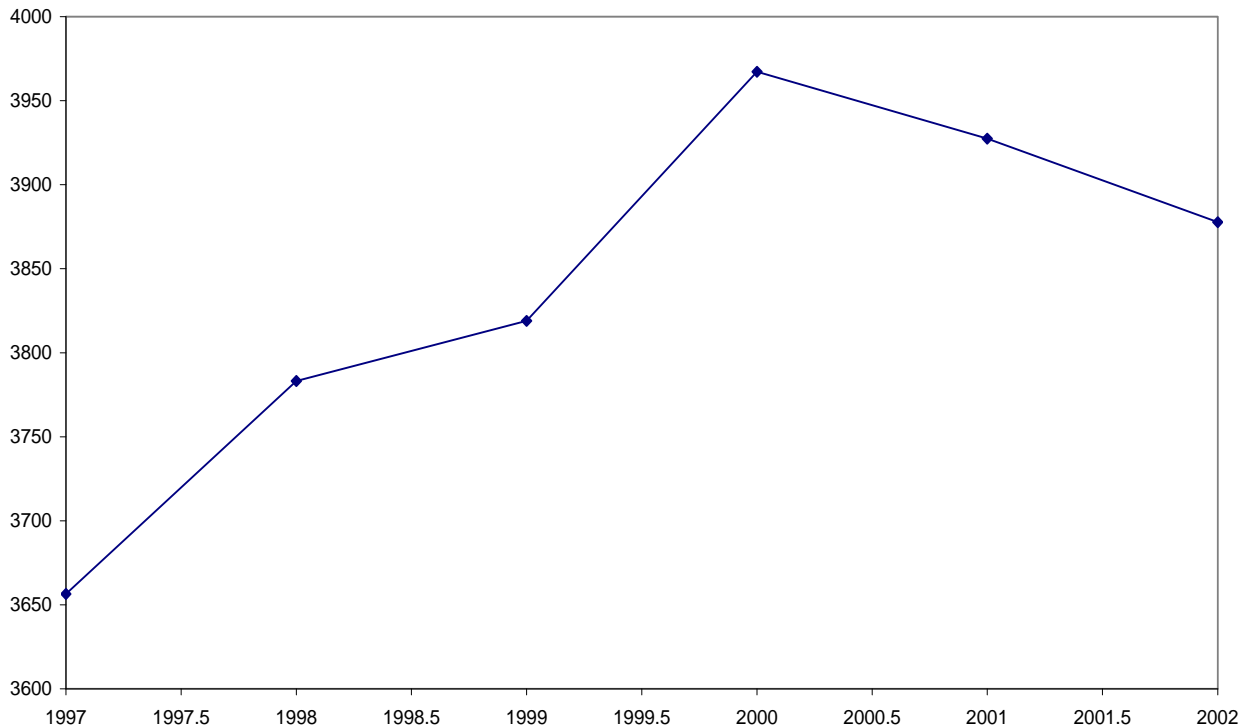
No one knows, however, whether this result applies to a change in the commuter tax alone or whether the response would be as large for New York City. A cursory look at the employment numbers for New York City suggests that it might. As shown in Figure 1, New York City's share of employment in the New York Metropolitan area jumped from 83.8 percent in April 1997, when the commuter tax was in place, to 84.6 percent in April 2000, shortly after this tax had been repealed.^[21]

Figure 1
New York City's Share of Metropolitan Employment



A closer look indicates, however, that something else might be behind this jump. Specifically, the city's share of total employment seems to rise during upturns in the economy and to fall during downturns, regardless of whether there is a commuter tax. See Figure 2. The city's share increased during the growth years from 1997 to 1999, for example, even though the commuter tax was in place, and the city's share declined during the recession years of 2001 and 2002 even though the commuter tax had been repealed. Thus, the big jump in the city's share between April 1999 and April 2000 may simply reflect the booming economy during that year, during which employment in the New York metropolitan area increased by almost 4 percent.

Figure 2
Total Employment in the New York Metropolitan Area
(in thousands)



To put it another way, Figure 1 may reflect nothing more than the city’s role as engine of the regional economy. According to Mark Zandi, the chief economist of the Economy.com Web site, says that “New York is different from nearly every American city in that the core is central to its economic success.”^[22] Marc Goloven, a senior regional economist at J. P. Morgan Chase, echoes this view. “The rising income tide of New York City,” says Mr. Goloven, “tends to lift all the boats in the surrounding counties.”

Finally, some people are concerned about the fairness of Mayor Bloomberg’s package of income tax changes, if not about the commuter tax itself. As pointed out earlier, Assemblyman Skelos argued in 1999 that a commuter tax makes no sense unless

taxpayers and bureaucrats in New York City are called upon to make a similar sacrifice. A similar argument has also been made in response to Mayor Bloomberg's recent proposal, which includes, of course, an income tax cut for the richest city residents combined with a property tax increase. For example, Bonnie Brower, the executive director of the City Project, a liberal budget watchdog group, said the shifting burden on city residents could favor the wealthy and hurt the poor.

The shift from a personal income tax to a real estate tax really transfers the burden from people best able to afford to pay more taxes, because they have higher incomes, to people who may not have higher incomes but whose property values may have increased because of the shifting of the real estate market.

George Sweeting, deputy director of IBO, takes a similar position. He says that for city residents as a whole, Mr. Bloomberg's plan is regressive — that is, it would benefit the rich disproportionately. “The property tax is already more regressive than the income tax, and they're talking about raising the property tax and lowering the income tax,” he said.

This view has been disputed by others, however, who do not believe that property taxes are shifted onto renters. An analysis of the Mayor's overall plan by Mr. McMahon, for example, concludes that “For the vast majority of New York City taxpayers, it's designed to deliver some net reduction in taxes, paid for by commuters and commercial property owners.” Indeed, Mr. McMahon adds, “The biggest hit by far is on commuters, so it's a very progressive tax increase.”

In addition, several analysts have argued that New York City has not done all it could to cut its spending. According to Ms. Fortuna of the Citizens Budget Commission,

Mayor Michael R. Bloomberg should abandon notoriously inefficient work practices that have persisted through good times and bad. The city can save \$200 million annually, for example, by modernizing procurement procedures, essentially replacing paper purchase orders with online transactions. Savings are

also possible in more visible public services. In the Police and Fire Departments, overtime is routinely budgeted for predictable tasks that could be staffed more cheaply. Also, uniformed workers fill thousands of jobs that could be performed more efficiently by civilians. The city could make many of these changes without reopening union contracts.

The city should also bring municipal workers' fringe benefits into line with standard public and private practice. The city pays 100 percent of the cost of comprehensive health insurance for its workers, retirees and their families. Most companies and other governments (including the federal and New York State governments) require some contribution toward premiums. If the city required premium contributions, it could save more than \$500 million annually.

It would not be fair, Ms. Fortuna concludes, to impose a commuter tax (or any other tax increase) until the city government gets its own house in order.^[23]

The Assignment

Speaker Silver, who favors a return to some type of commuter tax for New York City, has placed this issue on the calendar of the New York State Assembly. Not surprisingly, virtually all the other Assembly members from New York City also support a commuter tax. Moreover, sympathy for the city in the wake of the terrorist attacks of September 11, 2001, makes it possible that other Assembly members, particularly those from upstate, would support a reasonable commuter-tax proposal. Passage of a well-crafted commuter tax proposal therefore seems possible in the Assembly.

The prospects for a commuter tax proposal are less promising in the New York State Senate. The Republican State Senate leader, Joseph Bruno, has summarily rejected the idea of commuters donating to the city. However, several Republicans from New York City have leadership positions in the State Senate and are in a good position to push for some type of commuter tax. Many other state senators also may have sympathy for

New York City's fiscal challenges because of the terrorist attacks. Governor Pataki has, of course, expressed opposition to a commuter tax, but even he might be brought along if a plan emerged from the State Senate.

You are the chief analyst on the staff of the New York State Assembly's Committee on Cities. The members of the assembly have asked you to take a thorough look at the commuter-tax issue and to present your analysis and recommendations to the Assembly. In particular, you have been asked to evaluate the pros and cons of Mayor Bloomberg's proposal, to examine other possible commuter tax proposals, and to recommend the course of action that you think is best. You may support the Bloomberg proposal, support some other commuter-tax proposal for New York City, or reject the idea of a commuter tax altogether.

Although Speaker Silver has come out in favor of a commuter tax, your instructions make it clear that you should not be bound by his position; instead, you have been asked to make your own recommendation and to clearly state the criteria upon which your recommendation is based. Moreover, your assigned task is analytical, not political. You should come up with criteria that you think will have broad appeal, but you have specifically been asked not to worry about politics, per se. If you do support a commuter tax of some type, you may, if you wish, combine it with other policies or requirements. And if you do not support a commuter tax, you should briefly indicate whether New York State should be looking for other ways to help New York City.

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Table A-1
Distribution of New York City Tax Revenue (in Percent)

| FY | Property Tax | Personal Income Tax | Sales Tax | Business Income Taxes | Other Taxes |
|-------------------------|--------------|---------------------|-----------|-----------------------|-------------|
| 1977 | 51.4 | 9.9 | 13.8 | 11.5 | 13.4 |
| 1982 | 43.9 | 14.1 | 17.2 | 12.5 | 12.2 |
| 1987 | 39.2 | 17.1 | 16.1 | 14.0 | 13.5 |
| 1992 | 45.9 | 19.0 | 13.4 | 11.4 | 10.4 |
| 1997 | 37.8 | 22.7 | 15.2 | 15.2 | 9.0 |
| 2001 | 34.6 | 24.4 | 15.6 | 14.0 | 11.5 |
| 2002* | 38.0 | 20.2 | 15.0 | 12.7 | 14.2 |
| * Estimate | | | | | |
| Source: Sweeting (2002) | | | | | |

ENDNOTES

^[1] This case was written by Professor John Yinger solely for the purposes of class discussion. All of the quotations and many of the sentences in the text are taken from the newspaper articles in the bibliography. Howard Chernick and Mary Lovely provided helpful comments.

^[2] Reverse commuters — people who live in New York City but work outside it — would still have to pay the city income tax under the proposal.

^[3] The cost to commuters would be significantly less than \$2.2 billion, however, because they would be able to deduct the increased taxes on their federal tax return. If commuters face an average federal marginal tax rate of 30 percent, then the net impact on them would be only \$1.54 billion.

^[4] The rate on self-employment income was 0.65 percent.

^[5] Several New York City officials expressed outrage that Albany leaders did not even consider repealing the Yonkers tax when they repealed New York City's tax in 1999.

^[6] As Helen Ladd and John Yinger point out in their book *America's Ailing Cities*, "5 of the 6 cities with the poorest standardized fiscal health [in 1982] and 11 of the 20 least healthy cities are allowed to tax the earnings of nonresident commuters." Standardized fiscal health is a measure of a city's fiscal situation based on factors outside its control

and before state assistance. In a paper published in the *National Tax Journal*, these professors also find that states give unhealthy cities over four times as much assistance through institutional changes, such as giving them access to a commuter tax, as through state aid.

^[7] Article IV of the U.S. Constitution states that “The citizens of each state shall be entitled to all privileges and immunities of citizens in the several states.” This ruling by the courts was anticipated, largely because of a U.S. Supreme Court decision striking down a New Hampshire income tax that applied only to commuters who lived in other states, and the authors of the commuter-tax repeal bill included a provision saying that if the tax imposed only on out-of-state commuters were struck down by the court, the tax would be voided for all commuters, rather than re-instated for in-state commuters.

^[8] Of the 800,000 tax filers who paid commuter taxes to New York City in 1998, 265,938 were from Long Island; 251,660 from New Jersey; 103,292 from Westchester County; 30,765 from Connecticut; and 25,123 from Rockland County.

^[9] The political nature of the decision is highlighted by Speaker Silver’s decision to delay sending the repeal legislation to the State Senate after the Assembly had approved it in an effort to prevent the Governor from staging a bill-signing ceremony in Rockland County to promote the Republican candidate in the special Senate election. Moreover, State Senator David D. Paterson, a Democrat from Manhattan and the deputy leader of the Democrats in the Senate, openly admitted that he favored the bill simply to help the Democratic candidate in the special election and would have opposed the measure under other circumstances.

^[10] Speaker Silver has since changed his position. In January 2002, he proposed re-instating a commuter tax for New York City. Mayor Bloomberg did not pick up on this proposal at the time.

^[11] The education cuts elicited some angry reaction. Bertha Lewis, executive director of New York Acorn, which led demonstrations protesting education spending cuts in the spring of 2002, said “This is outrageous. There has got to be something that is held harmless. If, in fact, he is the education mayor, why, why would he even look at education? We already know that our school kids are not getting their fair share.”

^[12] It should be noted, however, that even after this assistance, New York City’s fiscal health ranked 67th out of the 70 cities (up from 70th in 1972). State assistance to New York City was relatively high in absolute terms, but was not proportionate to need.

^[13] These budget numbers come from reports on municipal affairs prepared by H. Carl McCall, who was the New York State Comptroller through 2002. Real values are

determined using the consumer price index provided by the Council of Economic Advisers.

^[14] In an earlier statement, Bloomberg made the same point a bit more colorfully: “Last time I checked, when the firefighters went into the World Trade Center they didn’t ask anybody where the hell they lived.”

^[15] As Professors Ladd and Yinger point out, commuters also might pay some of the property tax on nonresidential property if it is shifted forward into prices or backward into wages. A similar argument applies to the city’s corporate income tax. Estimates of this shifting are not available, but few experts believe that it is significant. New York City’s tax system is described in appendix table A-1.

^[16] A 2000 report by George Sweeting, Associate Director of IBO, found that homeowners in New York City pay \$9.77 in city taxes (property, income, and sales) per \$100 of household in 1997 compared to \$8.67 in the New York City suburbs.

^[17] According to George Wachtel, president of Audience Research and Analysis, the suburbs have provided a steady 25 to 30 percent of the total Broadway audience over the last 20 years.

^[18] A law suit, *CFE v. New York*, has been brought to force the State to give more education aid to New York City. As measured by student test scores or drop-out rates, the performance of the City’s schools is far below the state average; this suit argues that the State is responsible for this situation. The State lost the first round of this suit, but the trial court’s decision was overturned upon appeal. Now the Campaign for Fiscal Equity, which brought the suit, is appealing to the state’s highest court, the Court of Appeals.

^[19] Unlike New York, most states do not expect local governments to help pay for Medicaid. “We would not be in the situation we are today if we didn’t have to pick up that cost,” says Mayor Bloomberg.

^[20] Other items on Mayor Bloomberg list would not cost the state anything. These include reining in Medicaid costs; charging a 2.4 percent levy on hospital care to pay for health care for children who are not eligible for Medicaid; limiting the city’s liability for lawsuits; allowing the city to refinance its debt; permitting the city to sell 900 new taxi medallions over the next three years; using money from state environmental bonds to pay for the city’s recycling program; letting the city use more cameras to catch drivers going through red lights; and allowing OTB parlors to simulcast thoroughbred races at night.

^[21] The data behind Figures 1 and 2 come from the Bureau of Labor Statistics.

^[22] Mr. Zandi goes on to say that “this is changing. It is becoming more like the rest of the country.” He observes that the income earned by suburban commuters peaked at \$22.1 billion in 2000 but is expected to drop to \$17.1 billion this year.

^[23] Although Ms. Fortuna criticized the idea of new taxes without management improvements, she also praised one feature of the Mayor’s commuter tax proposal, namely that it brings New York in line with other cities that tax commuters, typically at rates close to those paid by residents. “It’s smart from a tax policy perspective,” she said.