Staff:

Tanisha Edwards
Counsel

Raymond Majewski
Chief Economist/Deputy
Director

Paul Sturm,
Supervising Legislative
Financial Analyst

Aleksandr V. Gevorkyan,
Senior Economist

Jonathan Auerbach,
Legislative Financial Analyst

T H E C O U N C I L
REPORT OF THE FINANCE DIVISION
PRESTON NIBLACK, DIRECTOR

COMMITTEE ON FINANCE
HON. DOMENIC M. RECCHIA, JR., CHAIR

December 10, 2012

PRECON. RES.: By: Council Members: Lander

TITLE: Resolution calling upon the United States Congress and the President of the United States to reach an agreement on debt reduction before the end of the year that would avert short-term economic damage.

1. Introduction

The U.S. economy is moving forward slowly, but it faces a significant challenge. If no action is taken by Congress and the President, a set of expiring tax provisions and automatic spending reductions could put the economy back into a recession.These expirations, known as the "fiscal cliff", would begin January 1, 2013.(Since the spending reductions and tax increases would take place over several years, it is actually more of a "fiscal hill" than a cliff, but the impact will nonetheless be dramatic for the economy and citizens.)

In addition, the Federal debt ceiling will need to be raised soon.Failure to do so may leavethe governmentunable to finance its operations and service its debt.

2. National impact background

Fiscal deficit reduction as priority

Fiscal deficit reduction has been on the legislative agenda for quite some time.After lengthy negotiations, a preliminary compromise was reached in August of 2011 via the Budget Control Act (BCA).[1]A provision of the BCA will go into effect in 2013 if no alternate deficit reduction actions take place. At roughly the same time, a number of tax provisions will expire, and across the board automatic spending cuts will take effect. The resulting "fiscal cliff" will consist of:

- The end of 2011's temporary payroll tax cuts, leading to a 2 percent tax increase for most workers in the United States.
- Changes in the Alternative Minimum Tax which would raise taxes for a significant share of taxpayers.
- Reversal of tax rate reductions and of expanded credits and deductions enacted in 2001, 2003 and 2009.

[1]Budget Control Act of 2011 (Pub.L. 112-25, S. 365, 125 Stat. 240). Available online: http://www.gpo.gov/fdsys/pkg/BILLS-112s365eah/pdf/BILLS-112s365eah.pdf

- Expiration of the more recent emergency unemployment benefits beyond the standard 26 weeks.
- Across the board cuts to approximately 1,000 government-sponsored programs, including domestic programs, defense and Medicare .[2]

If Congress takes no action, the CBO estimates that in 2013 the fiscal cliff will cause $375 billion in tax increases and $88 billion of spending reductions.These actions would reduce the federal government's deficit; CBO (2012a) estimates the deficit will shrink approximately $641 billion or 4 percent of country's GDP during the 2013 federal fiscal year.[3]

The Financial Times also forecasts a sharp improvement to the deficit starting immediately in the first quarter of 2013.[4]According to this estimate, the budget deficit improves from approximately $1.1 trillion to an almost balanced $0 by 2017.This balanced budget achievement would be significant,and possibly considered prudent by some. Nevertheless,there are many considerations that should go into any austerity action.

Macroeconomic policy challenge

According to IHS Global Insight, the above five factors of fiscal tighteningthat form the 'fiscal cliff' would cost the U.S. economy 3.1 percent of its GDP in 2013. With real GDP growth in the 3rd quarter of 2012 only 2.7 percent, annualized,[5]not addressing the fiscal cliff could push the U.S. economy back into a recession.

While acknowledging the upside to reducing thebudget deficit, CBO (2012a) draws attention to several concerns over economic policy of fiscal tightening. Most importantly, fiscal tightening would

[2]Medicare cuts are limited to provider payments. Social Security, veterans' benefits, federal pensions, Temporary Assistance for Needy Families (TANF), food stamps (SNAP), Medicaid, the Childrens Health Insurance Program (CHIP), unemployment insurance, and several other programs are exempt from the automatic cuts.
[3]CBO. 2012a. An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022. August 2012. Available online: http://www.cbo.gov/publication/43539
[4]Politi, J., C.Nevitt, K. Carnie, and N.Sivathasan. 2012. What is the fiscal cliff?.*Financial Times.*http://www.ft.com/intl/cms/s/0/57fec19e-3021-11e2-a040-00144feabdc0.html#axzz2ECml3nC0
[5]U.S. Bureau of Economic Analysis, gross domestic product, third quarter 2012 (second estimate).

likely lead the economy into a recession, resulting in at least 0.5 percent decline in real GDP between the last quarter of 2012 and the fourth quarter of 2013. The unemployment rate would be expected to rise to 9 percent early in the second half of 2013, posing additional stress to the economy and raising demand for unemployment benefits and other services (CBO, 2012a).

As an alternative, CBO (2012b) looks at the possibility of extending some or all expiring tax breaks and avoiding the most severe spending cuts. The CBO report finds evidence for strong output and employment improvement in the medium term.[6]This allows adequate time to develop a more sustainable long term policy. For example, in some CBO scenarios, output and employment would be greater than the full “fiscal cliff” scenario (e.g. extending the 2 percent cut in payroll tax and emergency unemployment benefits would result in a real GDP boost of 0.75 percentby the end of 2013; or extending all expiring tax provisions and maintaining spending policies that are currently subject to expiration would contribute 2.25 percent to real GDP growth). In the best case scenario, real GDP would receive a 3 percent boost by the end of 2013.

According to economists J. Bradford Delong and Lawrence Summers, normally the Federal Reserve is in a position to offset the economic effects of lower government spending and higher taxes. With interest rates currently near zero, however, the Federal Reserve’s main tool to accelerate a slowing economy is no longer available. According to these economistsgreat caution is needed with the pace of deficit reduction. Trying to cut the deficit too quickly could tip the economy back into recession.[7]

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[6]CBO.2012b. Economic effects of policies contributing to fiscal tightening in 2013. November 2012.
[7] DeLong, J.B. and L. H. Summers, “Fiscal Policy in a Depressed Economy”, Brookings Papers on Economic Activity, forthcoming.

3. **Impact on the New York State and New York City economies**

New York State

According to The National Economic Council, 7.3 million middle-class New York families will see their taxes go up as tax cuts such as the Child Tax Credit, marriage penalty relief, and the American Opportunity Tax Credit expire.[8] On average, a median income of a NYS family of four could see its income taxes rise by $2,200 (for income of $81,500). Among other things, this would have a negative impact on NYS consumer spending and as a result affect the 915,000 New Yorkers employed in the retail industry – the biggest beneficiary of consumer spending.

For a typical NYS family of four earning $81,500 a year, there couldbe an increase of $1,000 in taxes because of the drop in the Child Tax Credit (from $1,000 to $500). An additional $890 tax increase would be due to the merging of the 10 percent tax bracket into the 15 percent bracket. There would be another tax increase of $310 due to the expiration of marriage penalty relief.

Over 718,000 middle-class NYS families will lose the help they receive paying for college from the American Opportunity Tax Credit.

These examples are simple consequences of the fiscal cliff. The ultimate results could be even more severe. The State Comptroller notes several elements of the "fiscal cliff" that would hit New Yorkers the most.

Among the worst, changes in the Alternative Minimum Tax would increase the number of New Yorkers paying the tax to 3.9 million (from currently under 500,000 in 2010—the latest annual data

[8]The National Economic Council. (2012). The President's plan to extend middle-class tax cuts: impact for New York. December 2012. Available online: http://www.whitehouse.gov/sites/default/files/uploads/middleclassreport_7_24_2012.pdf

available). It would also result in an additional $20.8 billion impact in 2013, an average of $5,180 per tax filer.[9]

The other significantevent, Social Security payroll tax returning to the 6.2 percent rate, would cost New York workers $7.7 billion in 2013. The State Comptroller's report finds that practically all 8.9 million workers in the State will see higher payroll withholdings.

Taken all together, the State Comptroller estimates the immediate tax impact due to the fiscal cliff to be $43.4 billion in 2013 and $44.9 billion in 2014.

Certain recently suggested compromisescould also have a detrimental impact on the New York State economy. For example, reduction or elimination of the federal tax exemption on municipal bonds would mean higher debt costs on the State and local government levels. The negative implications for the State's and City's capital funding programs are clear and would be immediate.

Finally the New York State Division of the Budget estimates that the State and its localities stand to potentially lose over $5.0 billion in federal aid transfers over the next nine years. During the Federal FY2013 (ending September 30, 2013), NYS would lose $609 million in aid including $210 million in education programs, $137 million in health and human services, etc. Over 100,000 unemployed New Yorkers would stop receiving their unemployment benefits should the "fiscal cliff" go as scheduled. Evidently, a more balanced approach is needed during these difficult times.

New York City

In the event of a "fiscal cliff", the City would experience an impact equivalent to the national and state scale described above. OMB estimates the reduction in Federal aid to the City would be $285 million across City Fiscal 2013 & 2014. The sequestration would affect FFY 2013 spending. This wouldimpact the City budget in CFY 2013-2015. In FFY 2014, mandatory cuts would work differently and,currently it is impossible to predict their impact on NYC.

[9]DiNapoli, T.P. (2012). Impact of the fiscal cliff on New York State.Office of the NYS Comptroller. Available online: https://www.osc.state.ny.us/press/releases/dec12/120612.htm

Under the Budget Control Act of 2011, the total pool of discretionary spending will grow at a rate of a bit over 2% a year – significantly less than the economy. This will reduce non-defense discretionary spending to a post WWII low,by FFY 2014with sequestration, and by FFY 2017 without.

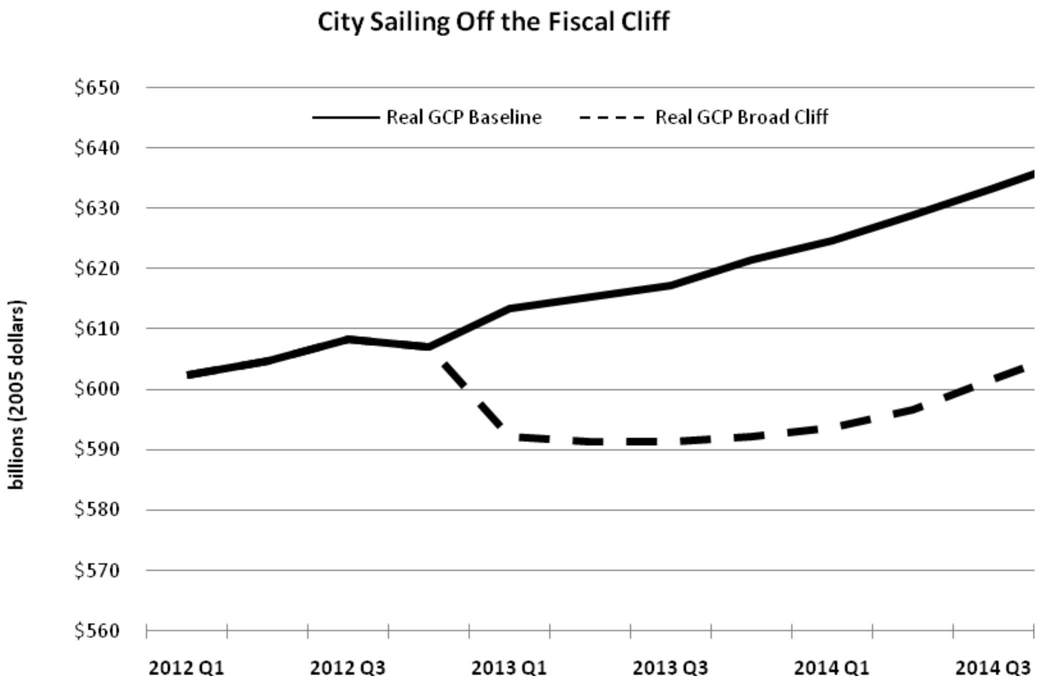
Over the last 20 years, federal aid to the City has grown at an average rate of about 4 percent.After FFY 2013 the composition of BCA and sequestration cuts are impossible to specify as mentioned above.But the BCA limits the growth rate of discretionary spending to around 2 percent.. Given this, it is likely that Federal aid will continue to shrink as a percentage of City revenue

The impact of the expiration of tax breakswill lead to a change in the tax bracket of a typical household. For example, a single mother with an income of $24,000 will see a tax increase of $1,670 - $1,500 because of a reduction in the Child Tax Credit and $170 because of the disappearance of 10 percent tax bracket. With the loss of the $1,500 child credit, most single mothers would find it hard to continue to afford child care while they work.

In other examples from the National Economic Council, a middle class family will lose $1,000 because of the Child Tax Credit reduction, $890 from the expiration of the 10 percent tax bracket, and $310 because of the end to the marriage penalty relief (which would reduce their standard deduction). An upper middle class family will lose $890 because of the expiration of the 10 percent bracket, $3,150 from a combined lossof marriage penalty relief and increase of the 25 percent bracket to 28 percent.

Finally, the failure to reach a deficit reduction agreement will push the City economy back into a recession worse than that of 2009. The Finance Division expects the City's economy to grow by slightly less than 2 percent in 2013 (Figure 1). Real (inflation-adjusted) Gross City Product (GCP) is forecasted in a "Baseline" scenario (Council Finance's current forecast) and a "Broad Cliff" scenario, which assumes no agreement is reached for a prolonged period of time.If the "fiscal cliff" hits,we expect GCP to shrink by slightly more than 2 percent when compared to 2012 - for a net loss of around 4 percent of GCP when compared to the baseline. The net loss would be about $25 billion of GCP in 2005 prices. That would reduce employment in NYC by 170,000 in 2013 compared to 2012. The resultwould be a worse recession than that of 2009.

Figure 1. New York City Gross City Product Simulation



Source: NYCC-Finance calculations based on IHS Global Insight data, 2012.

4. Some Special Issues for Deficit Reduction

Equity Across the Country. One revenue-raising option under consideration is reducing or eliminating some or all tax deductions. Depending on the framing, scaling back itemized deductions can have a disparate effect on different regions in the county.New York City is an expensive place.Residents spend a lot on housing and taxes, and the City has a large capital program which is dependent on its ability to sell tax exempt bonds.For example consider homeowners.The home mortgage interest deduction is used extensively by middle income as well as upper income families. Depending on which part of the country the taxpayer resides, the price of two similar homes can vary considerably, impacting mortgage interest costs. According to the Council for Community and Economic Research, mortgage payments required in order to buy a home in Brooklyn or Queens are more than twice the national average for a similar home.[10] The average mortgage deduction in New York State was $10,639 in 2010 compared to $7,177 in Iowa or $7,764 in Arkansas.[11]

Equity for Middle Class and Working Families. The vast disparity in income among Americans, and as a result, the ability to afford spending cuts or tax increases is also an issue. Data from the U.S. Bureau of the Census shows that in 2011 the lowest 20th percentile of household income was $20,262, compared to the 95th percentile at $186,000.Income inequality has dramatically increased through time. A study from the University of California at Berkley found that real income among the top 1 percent grew by 52 percent between 1993 and 2010 while that of the bottom 99 percent grew by only 6.4 percent. The top 10 percent of households in 2010 received 48 percent of all market income, up from 35 percent in 1980.[12] Families with income above $250,000 are better able to afford the higher tax rates than middle and low income families whodependongovernment funded social services and other programs slated to be cut.

5. Conclusion

This resolution calls upon Congress and the President to reach a deficit reduction agreement in a timely manner so as to avert damage to the economy.It asks that any agreement consider the growing income disparity, the preservation of vital programs, and fairness in the treatment of all regions of the

[10] Council for Community and Economic Research, "ACCRA Cost of Living Index", October 2011.
[11] Wall Street Journal, "Uneven bit of limited deductions," November 19, 2012.
[12] Piketty, T. and E. Saez. (2003). Income inequality in the United States 1913-1998 - updated to 2010, *Quarterly Journal of Economics,* 118(1): pp. 1-39.

country, including cities like New York.It endorsesPresident Obama’s approach and recommends allowing the Bush-era tax cuts to sunset for the top two tax brackets.

Preconsidered Res. No.

Resolution calling upon the United States Congress and the President of the United States to reach an agreement on debt reduction before the end of the year that would avert short-term economic damage.

By Council Member Lander

Whereas, On January 2, 2013, barring Congressional and Presidential action, all the tax cuts enacted under President George W. Bush will expire, and there will be $1.2 trillion in automatic sequester spending cuts; and

Whereas, Also due to expire are the payroll tax cut of 2 percentage points, emergency unemployment benefits beyond the standard 26 weeks, and the special depreciation incentive for capital equipment purchases; and

Whereas, According to IHS Global Insight, together these actions would create a ‘fiscal cliff’ that would cost the U.S. economy 3.1 percent of its gross domestic product, pushing it back into recession and likely causing an increase in unemployment, which is already too high at 7.9% nationally; and

Whereas, Income inequality has dramatically increased over the last thirty years, and households with the highest incomes are better able to afford higher tax rates than are middle- and low-income families, as shown by a study from the University of California at Berkley which found that real income among the top 1 percent grew by 52 percent between 1993 and 2010, while that of the bottom 99 percent grew by only 6.4 percent, and found further that the top 10 percent of households in 2010 received 48 percent of all income, up from 35 percent in 1980; and

Whereas, Social Security, Medicare, and Medicaid are central to the vitality of the middle class and keep millions of Americans out of poverty, and federal investments in education and infrastructure are essential to the nation's future prosperity;

Whereas, New York City, and other large urban centers nationwide, have high concentrations of high-need populations who can ill afford cuts in the federal domestic discretionary spending and entitlement programs they depend upon, programs that are especially important in the wake of Hurricane Sandy, and cuts to federal spending often shift costs to cities and states at moments when they are least equipped to handle them; and

Whereas, One revenue-raising option reportedly under consideration is limiting itemized tax deductions, which could result in disparate effects in different regions in the county; and

Whereas, According to economists J. Bradford Delong and Lawrence Summers, while normally the Federal Reserve is in a position to offset the economic effects of lower government spending and higher taxes by lowering interest rates, with interest rates currently near zero, the Federal Reserve's main tool to speed up a slowing economy is no longer available; therefore great caution is needed with the pace of deficit reduction, because trying to go too fast could tip the economy back into recession; and

Whereas, President Obama has proposed a long-term deficit reduction plan that takes into consideration the current condition of the economy, the income disparity in this country, and the differing conditions and needs of various parts of the country; now, therefore, be it

Resolved, That the New York City Council urges both political parties to reach an agreement on debt reduction before the end of the year that would avert short-term damage to an already struggling economy, minimize additional burdens on middle and low income families, and prioritize broadly-shared economic recovery, and be it further

Resolved, That in framing debt reduction, the Council appeals to lawmakers to factor in the vast disparity in income among Americans, and the subsequent ability to shoulder necessary spending cuts or tax increases, and preserve the Bush Era tax cuts for 97% of Americans while allowing tax rates on the wealthiest 3% of households to return to the levels of the Clinton Administration; and be it further

Resolved, That the Council urges Congress and the President to enact a deficit reduction plan that takes into account the need to treat different parts of the country equitably; and be it further

Resolved, That the Council of the City of New York calls upon the United States Congress and the President of the United States to reach an agreement on debt reduction before the end of the year that would avert short-term economic damage.

LS 4974