Developing the 21\textsuperscript{st} Century: Land Use, Construction Law, and Project Finance in the Built Environment

I. Economic outlook improving but too slowly

- The Great Recession: 8 million lost jobs; 6\% annual rate of GDP decline in six months after financial market crash;
- 30 million un- or under-employed in H2 2009.
- 20\% decline in national construction output from 2007 to early 2010.
- Point of reviewing the outlook is not to depress you … but it is sobering … the point is to gird you for action … Now, more than ever, proper policy response is needed … economy won’t recover on its own.
- Coming out of the Great Recession
- Unemployment will stay high for extended period; under-employment also very high for now. Bernanke recently said Fed expects 3-4\% GDP growth in 2011, better than in 2010, but not sufficient to reduce unemployment to acceptable levels. Jan. BC forecast predicted unemployment rate in the fourth quarter of 9.1\%.
- The 2008-09 recession more severe for NYC workers than 2001-03, although payroll job decline less this time. Unemployment rose more …
- Extraordinary economic and social costs of high unemployment (lower future earnings, foreclosure risk, forgo college, adverse health effects)
- It will take another 4 years or so to regain the lost jobs, then more time to accommodate the growth in the LF that took place in the intervening years

- Against this sobering backdrop, NYC economy doing relatively better because:
  - Finance sector stabilized, for now
  - Tourism strong leading to job growth in hotels and restaurants
  - However, much of job growth is contingent (temp jobs) or low-wage (tourism, retail, home health care). Wage growth weak (declines for non-managerial workers, more than half the workforce)
- NYC construction payroll employment dropped by about 23,000 jobs from the peak to the low point early last year, a 17\% decline , but hasn’t fallen as much as nationally.
  - Sidebar on real size of NYC construction: 250K workers, including self-employed, misclassified independent contractors and off-the-books.
Local construction spending off (Dick Anderson) because of excess capacity, suspended projects
Public infrastructure a bright spot in terms of need and demand, but severe financing problems. (More later …

2. State and Federal budget challenges: real and manufactured

- Real
  - 46 states with severe budget problems, revenues yet to recover (12% revenue decline).
  - Stimulus pulled economy back from the brink, but not enough to put economy on sustained recovery path. (White House and many economists mis-judged severity of downturn and the lingering structural problems)
  - Note magnitude and breadth of stimulus spending in NYC; note all stimulus spending went through NYC budget. Total about $16B including making work pay tax cuts, increased food stamp and unemployment spending, and such programs as increased medical and scientific research contracts going to public and private universities.
  - State budgets in NY and elsewhere this year facing huge hole left by winding down of stimulus fiscal relief (FMAP and education aid). Already, huge decline in state and local government employment that is impeding recovery.

- Manufactured--imagined
  - Recession due to government, and the biggest threat now is government spending that started to fill the gap left by the crash.
  - At state level, “government spending out of control”
  - Public workers and their benefits are the culprit …

- Reality about deficits and state budgets
  - Long-term federal deficit mainly due to rising health care costs (source)
  - Even some ardent deficit hawks (e.g., David Walker) argue that our immediate need is for more government spending to stimulate a moribund economy. For some officials, a weak economy is a formula for political gain.
  - States: some observers “lump together current deficits stemming from recession, with longer-term issues relating to debt, pension obligations and retiree health costs, to create mistaken impression that drastic and immediate measures are needed to avoid imminent fiscal meltdown.”
Don’t forget that S/L government comprises the lion’s share of government activity in the U.S. Paraphrase Tip O’Neill: “All government is local (and state.)”
- 90% of gov’t employment at S/L
- 90% of public infrastructure is S/L

We strait-jacket state and local governments at our collective economic and social peril.

3. The economy needs more stimulus and infrastructure should be a key part

The discussion in Washington should be about how to stimulate the economy through increased spending, including infrastructure spending that can serve a dual purpose—immediate job creation as well as building the infrastructure that will enhance our long-term productivity.

Urgency of national infrastructure needs in many areas: roads, bridges, drinking water and wastewater treatment facilities, ports and airports, mass transit systems, inter-city passenger and freight rail systems, schools and other public buildings. As a share of GDP, public infrastructure investment in the past decade was a fraction of what it was in the 1950s, 60s and 70s. The U.S. is clearly falling further behind as China and other countries expand and modernize their productive capacity. (check EPI-CAP anti-deficit plan)

Apparently, the President will stress in the State of the Union tonight the need for increased infrastructure spending as part of our short- and long-range economic recovery.

But, we shouldn’t lose sight of the connection between state and local budgets and our capacity to carry out infrastructure investments. If states are forced to drastically cut essential services in order to cope with their budget gaps, you can rest assured there will be far less money for public infrastructure. No public official wants to defend denying health care to the uninsured in order to invest more in brick and mortar projects no matter how economically vital.

We need a more encompassing and forward-looking view of government spending overall. If we slash health care and education spending, unemployment will rise, the economy will worsen and we likely will get less infrastructure spending, not more.
We need to make the case that government spending, whether for essential public services or public infrastructure, is a positive force in economic development, and particularly in terms of the current demand-starved condition of the macroeconomy.

4. **Important to understand relation of state/local taxes to economic activity and productivity**

For better or worse, a widely-held view in Albany is that the overwhelming bulk of actions to cope with next year’s budget gap should be on the cutting side. There is talk of a spending cap, a tax freeze and a local property tax cap set at the lower of 2% or the rate of consumer inflation. The common narrative is that “spending is out of control,” and “our tax burden is holding back our economic recovery.”

I think that is an ill-informed perspective that fails to properly account for the severe recession we’ve been through, and the structural implications of our changing economy, not to mention a basic understanding of the major budget actions taken over the past two decades.

I could certainly talk at greater length about the origins of New York’s fiscal challenges and discuss what is behind rising expenditures on school aid, Medicaid or employee benefits, and about misguided budget actions such as a state tax cutting binge in the late 1990s that helped push up local property taxes and a proliferation of unaccountable business tax expenditures that grew willy-nilly out of control. Let’s do that another time.

Let me focus on one aspect of this: the notion that New York’s taxes are impeding our economic recovery. After all, the Tax Foundation says our tax structure gives us the absolute worst business climate in the nation—a charge uncritically echoed by certain leaders in Albany. NY does have a high state/local tax burden, but that is not because its magnitude is excessive given our economic base, but because our tax structure is regressive overall. Are taxes harmful to economic growth, or a prerequisite?

State taxes are about average, but New York’s overall state/local tax burden is high because of our great reliance on regressive local property and sales taxes. Upstate businesses do not pay inordinately high taxes—e.g., a 2007 study by the Citizens Budget Commission found that among representative companies in a number of major industries in upstate New York, in New York City, and in six “competing” states, state and local taxes were lowest in upstate New York. Taxes were highest in New York City but what does that tell you about the relative importance of state and local taxes that are a relatively small portion of business operating costs.
I think it is remarkable that the various business climate rankings like that of the Tax Foundation only focus on the cost side of the equation. They fail to consider the value or productivity generated by businesses operating in different states. Whatever the measures on the cost side—taxes, wages or rents—they are all treated as negatives and in isolation from what those costs buy a business in terms of value added or productivity. Thus, it might come as a surprise to the folks at the Tax Foundation that value added per worker by businesses operating in New York is the highest in the country. And this is not just because of our high-flying finance sector. Among the 10 largest states with diversified economies, New York ranks first or second in value added per worker in 14 of 20 major sectors of the economy. “Profit” per worker is correspondingly high in New York relative to other states. This is true in construction, real estate, information, professional services (which includes engineering and architecture), wholesale trade, administrative services, hospitality, and non-profit services.

In other words, high taxes, high salaries and high rents are associated with high productivity. In case you’re wondering, the states that rank “best” in the eyes of the Tax Foundation when it comes to business tax climate are, in order, South Dakota, Alaska, Wyoming, Nevada, and Florida.

Not surprisingly, value added per worker in New York City is typically much higher than the statewide figures. New York City has such high value added per worker because we have a highly urbanized economy with high “agglomeration economies.” This is an economics term for the economies external to an individual firm that result from co-locating in a tight geographic area with a range of suppliers, customers and competitors. We might call these economies the “synergies” that derive from being in close proximity to those you do business with. Density accelerates information flows, learning and feedback, and technology transfer.

These agglomeration economies are enabled by the high density of business in New York City, and that, in turn, is enabled by a dense and extensive physical infrastructure. This density could not exist without an extensive regional mass transit system (or set of systems) that creates a vast regional labor market with an unparalleled diversity of skills.

There is a close linkage here: a rich public infrastructure, high density development, highly productivity workers, high compensation and high profitability per worker, and high taxes needed to support the foundation for this high value-added economic chain.

That’s not to say that costs or taxes are not important, or that they don’t have limits. It’s just to acknowledge that you shouldn’t look at taxes in isolation from the economic
system within which they exist and without understanding the relative productivity that
that system generates and sustains.

All indications are that growth industries and leading edge enterprises thrive in highly
urbanized settings. Reinvesting in, modernizing, and expanding our infrastructure is
essential to our future growth. We need to pay close attention to that at all levels of
government.

5. Financing NY’s infrastructure needs

My guess is this audience has a very good understanding of New York’s critical
infrastructure needs, whether it’s the need for new school facilities, for a new Tappan
Zee Bridge, or for the components of the MTA’s current five-year capital plan.

The biggest challenge is how we’re going to pay for those needed investments and how can we do better at organizing and managing the procurement, coordination and construction of those investments. There is a
lot of expertise in this room on these questions, and that we’ll hear about as the day
progresses.

In his recent report on New York’s Transportation Infrastructure, former Lt. Governor
Richard Ravitch persuasively argued that “New York must get serious about pricing its
transportation network effectively.” Ravitch argued for a downstate regional tolling
strategy that encompasses all key bridges, statewide roads and the parkway system.

Ravitch also called for “the creation of special taxing districts for certain megaprojects
that have the potential to dramatically increase economic activity and property values in
an area.” In this regard, one example where we didn’t do the right thing, I think, is the
Hudson Yards development. As the Bar Association’s New York City Affairs
Committee noted in its 2007 report on the financing of the Hudson Yards
Development, the city failed to justify the need for tax breaks it granted to development
that occurs in the Hudson Yards district. I long felt, and the Bar’s committee agreed,
that the tax breaks were configured to create PILOT payments so that the City could
finance through revenue bonds the extension of the #7 train outside of the normal
financing of MTA capital projects and outside of the normal review that would have
taken place were the city to use general obligation bonds. In this case, the tax breaks
lessened the tax revenues that would otherwise have been generated by a public
transportation investment that facilitated much higher density commercial and
residential development.

At the time the City acted to put this financing approach in place, Senator Schumer
stated that he did “not believe that we need to give developers tax breaks—the reduced
PILOTS—to get them to the West Side. That money should be used for the building of the #7 if needed. “

On another front, public-private partnerships have received a great deal of attention, in part because some people think that such an arrangement opens up new financial avenues. In a report released earlier this month, State Comptroller DiNapoli identified four primary financial risks associated with the public-private partnership model.

- Failure to identify the full value of public property.
- Unfavorable pricing mechanisms.
- Unrealistic expectations and poorly drafted agreements, and
- Budget gimmickery such as P3 agreements used for short-term fiscal relief that push costs to the future and potentially increase public debt.

6. Conclusion

In this very problematic and political budget and economic policy environment, in Albany and Washington, we can't take for granted that people understand and appreciate the vital role of government spending and taxation in creating the conditions for a thriving market economy. The risk is that a straitjacket is put on government to further the short-term political agenda of those seeking to capitalize on the widespread adversity created by the 2008 economic crisis. It is the height of lunacy to think that shrinking public spending and investments will unleash private investment, job creation and economic recovery.

The state should be working on getting out of the recession through job creating energy sustainable infrastructure investments, and by maintaining essential operating investments in our health care system, better K-12 education opportunities, and affordable public higher education.

In addition to getting serious about financing essential transportation infrastructure investments, there’s also an argument to be made for a transit-manufacturing, transit-innovation NYS economic development strategy that builds on the downstate transit system and a fully-funded transit capital plan.

The Construction-Engineering-Design-Development sector is critically important for NY for many reasons, not only because it builds the infrastructure that supports our high productivity economy and designs a vibrant city that attracts top talent and tourists from the world over, but also because more than almost any other industry, and particularly the construction part of the sector, it provides many middle-income paying jobs and offers many career ladder opportunities for people to advance economically.