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Thank you, Mr. Chairman. I would like to emphasize three points today:

First, this economic and fiscal crisis is not just another cyclical downturn. What we have witnessed over the past year is the end of an era. The old Wall Street – the industry that directly and indirectly generated much of the growth in state tax revenues over the past 15 years – is dead and gone. It won't be coming back in its old form anytime soon, if ever.

This leads to the second point: in the long run, the goal of state tax policy should be to build a more sustainable and diverse economic base in New York. In the short run, as you grapple with massive budget gap, your goal should be Hippocratic: do no harm. At the very least, do as little harm as possible.

And, third, I will conclude by calling your attention to two things the Legislature can do right away, at no budgetary cost, to protect middle-class taxpayers from the worst of the economic and fiscal trends that may lie ahead.

Beginning with the economy: Wall Street's collapse exposed the fatal flaw in New York State's public finance model. Over the past quarter-century —and especially in the last five years—the state budget has been geared to run on an ever-expanding stream of high-octane revenues generated by the profits and payrolls of heavily leveraged securities firms.

Just how dependent on Wall Street had we become? Consider this: in 2006, auto manufacturing accounted for 6 percent of Michigan's economic output. The securities industry was over 8 percent of New York's. Wall Street loomed larger in our budget and economy than oil and gas in Texas, or coal mining in West Virginia.

What emerges from the ashes of the 2008 financial meltdown will be a far leaner, more risk-averse, heavily regulated and less profitable financial sector. In the meantime, a prime goal of state tax policy should be to avoid creating disincentives for reconstituted financial firms to grow here in New York.

Compounding our problems is the severity of the current global recession. As the CEO of Microsoft put it, what we are now experiencing is not an economic downturn but a "reset," in which "the economy shrinks and then it doesn't rebound, it rebuilds from a lower base."

New York needs to adjust the size and cost of government to reflect this new economic reality. Unfortunately, Governor Paterson's budget relies far too heavily on stopgap tax increases rather than structural reform.

Viewed in isolation, as a matter of tax policy, some of the changes proposed by the governor are far more defensible than others. For example, lifting the sales tax cap on gasoline purchases would have little impact on consumer and certainly would not be a shock to the system. In general, the extension of sales taxes to high-volume, low-cost services already taxed by other states and by New York City would not be inherently objectionable – if we weren't sinking into the worst recession in decades, where the main problem is that people are not spending enough (because they previously were spending more than they could afford). Ideally, we'd be talking about broadening New York sales tax base in the context of a revenue-neutral proposal to reduce our tax rates, which are among the highest in the nation. This is the conversation we should have been having years ago—and hopefully, it's one we will plan on having again soon.

Taxes on digital downloads, such as the so-called iTunes tax, are a more difficult call. On the one hand, we tax music sold by stores in the form if CDs, records and tapes. On the other hand, New York will hurt its own attractiveness as a place to do business by imposing a tax that is, after all, based on the "nexus" of a seller who could be anywhere. Indeed, I believe we have already over-reached in self-destructive fashion with the so-called "Amazon tax," now in litigation – and we continue to reach too far in our definition of the "convenience of the employer" rule in the sphere of the personal income tax.

A few of the governor's proposals stand out above the others for their potential to wreak economic havoc at an extremely vulnerable time. The largest of these is his proposed "reform" of Empire Zones. To be sure, strong arguments can be made for overhauling the Empire Zones program—in fact, for shutting it down altogether, going forward. But the retroactive revenue grab proposed by the governor betrays employers who made good-faith agreements to build or expand in New York, and exposes us to litigation and a loss of credibility. On a smaller scale, the proposed 5 percent surtax on luxury goods is a great way to hurt the livelihoods of New Yorkers who sell the goods subject to the tax—which is just what happened when the federal government tried a similar approach almost 20 years ago.

As an alternative to many of these taxes—or even in addition to them--you are now being urged to consider a significant increase in personal income taxes, targeted to the highest income brackets. This idea is being promoted on the grounds that it's necessary not just to close the state's massive budget gap, but to restore "fairness" to the tax code.

To paraphrase the late Sen. Daniel P. Moynihan, advocates of the so-called "millionaire tax" are entitled to their own opinion, but they're not entitled to their own facts. The facts don't support the claim that New York's tax structure is tilted in favor of the rich. Nor does economic experience support the claim that we can raise income taxes on anyone without negative economic consequences in an already severe recession.

In 2007, at the peak of the last boom, the highest-earning one percent of New Yorkers generated 41 percent of the state's tax revenues, up from 26 percent in 1995.

While the increase in the taxes for the wealthiest New Yorkers tracks their income gains over the past decade, their larger share also reflects the impact of the state's 1995 Taxpayers Relief Act. Under that law, the biggest tax cuts were targeted to low- and middle-income New Yorkers – thus shifting more of the remaining burden to the upper end of the income scale.

More than a half-million New Yorkers were removed from the tax rolls, and the Earned Income Credit was expanded as a wage subsidy for the working poor. Savings for low- and middle-income households have been further buttressed by the creation of the Empire Child Credit.

Between the EIC and refundable child credit, a single mom supporting two kids while working full-time in an $8-an-hour job qualifies for a $1,559 tax refund from the state – a *negative* income tax rate of nearly 10 percent that offsets most of the other state and local taxes she would typically pay.

Despite what you're being told by some groups, the working poor in New York do <u>not</u> bear a heavier state and local tax burden than the wealthy. In fact, when the EIC and the Empire Child Credit are considered, the typical low-income working New Yorker with children has a very small state and local burden – which is exactly as it should be.

Some point to recent history as evidence an income tax hike targeted to higher brackets would be harmless. After all, they say, the state temporarily raised income taxes in 2003 (on incomes as low as $150,000), yet the state's economy rebounded and high-income payers allegedly didn't "desert" New York over the next three years. But proponents of this argument fail to note those tax hikes took effect the same day as much larger federal tax cuts. At that point, the economy and the stock market were already poised for recovery. While the higher tax rates were in effect, Internal Revenue Service data show, the growth in high-income taxpayers was lower in New York than in 48 other states, and our private sector job growth was far below the national average. If our rates had not been raised, we could have done better by both measures.

Obviously, economic conditions in New York now are far worse than they were at this time in 2003, and federal tax policy is headed in the opposite direction. While the federal stimulus package includes targeted individual and business tax cuts, massive federal tax increases are just over the horizon, aiming at the same wealthy households. In a state as diverse as New York, how do we define "wealthy" anyway? The rent re-regulation bill just passed by the Assembly defines those in need of protection as earning up to $240,000—just $10,000 below the threshold of "wealth" targeted for large tax increases by the so-called "fair tax" campaign.

As the late Walter Wriston observed, "Capital goes where it's wanted and stays where it's well treated." When the global economy finds its footing, investment capital will be more mobile than ever. Meanwhile, high-income households have always been the most mobile of all taxpayers. States opting to impose steeply rising income tax rates can expect to lose some of their most industrious and talented citizens to jurisdictions with low (or no) income taxes. Highly skilled individuals remaining in the state make up for the larger tax bite by charging more for their labor and services, which further drives up the cost of living and doing business. Individuals affected by tax hikes earn less, save less and invest less in the state. Employers create fewer high-paid jobs and more low-paid jobs. In effect, the "soak-the-rich" approach ends up soaking everyone.

The real problem with New York's state and local tax structure is not that the wealthy are under-taxed, but that middle class residents are badly over-taxed by national standards. But the right policy goal is to reduce tax rates on the middle, not to increase them at the top.

While the state obviously can't afford a middle-class tax cut now, it can take a long-overdue step in that direction by immediately "indexing" its income tax brackets and exemptions to inflation, as the federal government does. This would have no fiscal impact in 2009-10, since the Consumer Price Index is now near zero, but will protect middle-class New Yorkers against "bracket creep" tax hikes when inflation inevitably rises again.

Indeed, given the mounting federal deficit and repeated "liquidity injections" by the Federal Reserve, many economists expect a resurgence of inflation as the economy recovers. Thus, it is essential to get indexing in place before this happens.

At the same time, the Legislature should enact the school property tax cap proposed by Governor Paterson and passed by the Senate last year. Given the repeal of the STAR rebate, it is more urgent than ever to protect property owners from the tax shift that might otherwise result from necessary reductions in state school aid.

Thank you.