Real Estate Forefront

Emerging Developments in the NYC Marketplace, #13

Wall Street Volatility and Its Impact On New York City's Economy

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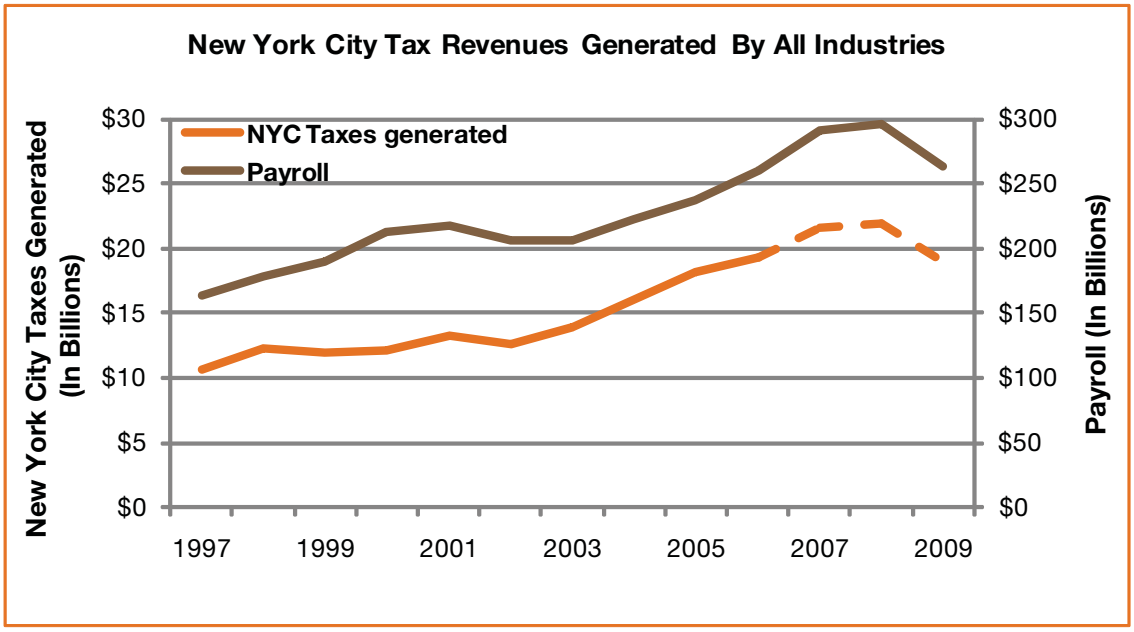
The new financial regulatory reforms that will likely pass in the next few weeks pose significant trade-offs to New York City's economy. New York City's dependence on Wall Street for its tax base has grown substantially over the last two decades as profits have soared, but Wall Street is also largely responsible for the heavy volatility in New York's economy as the charts herein show.

To quantify Wall Street's impact on New York City's economy we obtained data from the New York City Department of Finance that shows city tax revenues generated by each of the city's industries[1]. The NYC DOF data extends through 2006, but we were able to estimate the tax revenues generated for 2007 through 2009 to show not only how volatile tax revenues from finance firms have been but how deeply the recent financial crisis hurt city tax collections in 2008 and 2009.

Our estimates indicate that Tax Revenues attributed to the city's employment base declined by $2.9 billion[2] in 2009.

As the charts show, the taxes generated by the city's employment are strongly correlated to payroll for the same period. Therefore, in a simple regression analysis we were able to estimate the taxes generated for 2007 through 2009 by using current payroll data through year-end 2009.

Payroll and taxes increased in 2008, but taxes generated by finance firms decreased in 2008 along with payroll (see appendix).



Source: Eastern Consolidated, NYS Dept. of Labor, and NYC Dept. of Finance

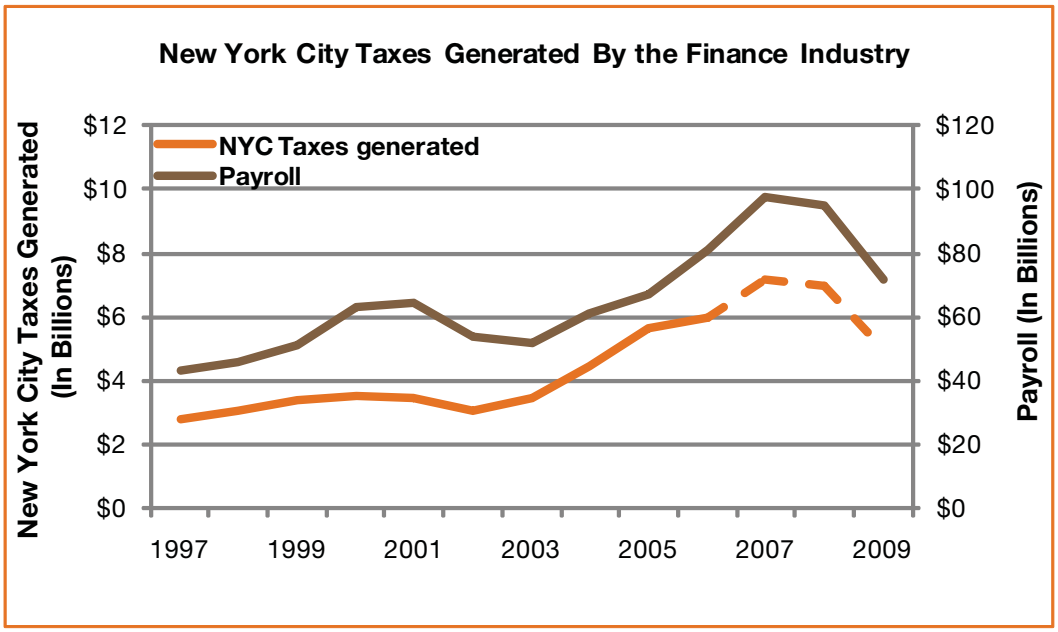
1 The NYC DOF compiles the data from personal income tax records as well as general corporate taxes, unincorporated business taxes, banking corporation taxes, property taxes, commercial rent taxes, utility taxes and the DOF estimates sales taxes based on BLS consumer expenditure surveys. The total tax revenues generated by employment do not include all tax revenues. It leaves out property taxes on residential property as well as sales taxes from tourism to name a few.

2 Using ordinary least squares method, also called a regression analysis, total tax revenues (TR) were estimated as a function of payroll (PR) as per the following: TR = -5.2038 + 0.0917 x PR. $R^2 = 0.809$

Of the $2.9 billion decline in taxes directly related to the city's employment base, $1.9 billion[3] was attributable to the finance industry, or two-thirds of the total loss.

The NYC DOF data shows that the finance industry (including securities, banking and insurance) has historically generated more taxes related to employment than any industry: from 25% in the late 1990s to over 30% in 2006 (see appendix).

Of this $1.9 billion decline, $1.4 billion was attributable to the securities industry alone. Securities has generated between 15% and 22% of total taxes (see appendix).

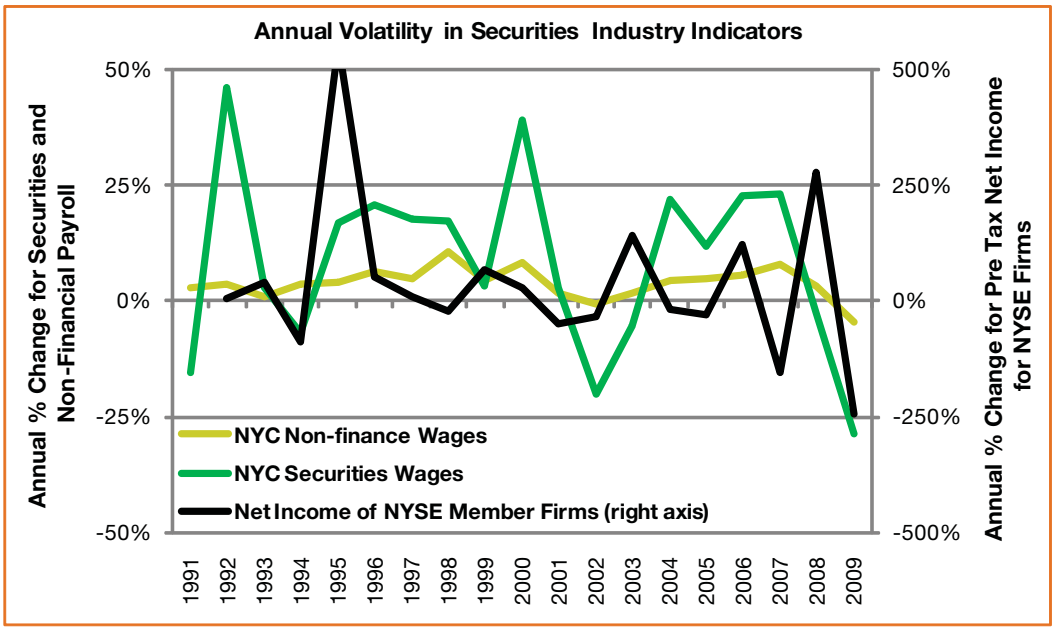


Source: Eastern Consolidated, NYS Dept. of Labor, and NYC Dept. of Finance

3 Using ordinary least squares method, also called a regression analysis, finance tax revenues (FTR) were estimated as a function of payroll (FPR) as per the following: FTR = -1.002 + 0.084 x FPR. R2 = 0.735

To illustrate how the securities industry swoons compared to the rest of New York City, we charted the annual percentage change in securities payroll along with net income from New York Stock Exchange Member Firms[4] (black line). Note that NYSE member profits data was so volatile that it had to be listed on a separate axis.

We also included payroll for *non-financial employees* (yellow line) as a reference to show how stable the rest of the City's payroll compares to these securities-related indicators.



Source: Eastern Consolidated, NYS Department of Labor, and NYC Office of Management and Budget

Of course, one could argue that Wall Street contributed a significant fraction of the tax revenue gains some years, which is accurate. *However, in 2006*[5] *the overall taxes generated by the securities industry declined by 1.6% even though the industry employed 8,800 (5%) more people than in 2005 and paid out 22% higher salaries (see appendix).* According to the DOF, this decline was due to the removal of a personal income tax surcharge on taxable income above $90,000. Moreover, the data shows that the finance industry contributed a significant fraction of the losses in 2001 – 2002.

4 We would like to thank the NYC Office and Management and Budget for help with this data.

5 We would like to thank the Office of Tax Policy at DOF for their guidance on this.

Conclusion

The earliest reports on what will likely be passed in the pending regulations suggest that the industry will face challenges in the next few years as it figures out how to comply with the new rules. But the details of the reforms will still be left to the regulatory agencies to fine tune and implement which means that lobbyists will still have the opportunity to exert their influence in the final language. This means that loopholes are likely to remain in the regulations and Wall Street will evade the worst of the harshest reforms. The bounce in financial stocks since June 25th when the legislation was "finalized" reinforces the sentiment that Wall Street can breathe a sigh of relief.

The charts above demonstrate that Wall Street's impact on the city's economy is significant in both good years and bad. The pending financial regulatory reforms are aimed to curb the industry's volatility which should rein in profits for Wall Street firms in the short term but should stabilize revenues in the long run. That the market has interpreted the new reforms to go easy on the industry suggests that the rollercoaster ride that Wall Street has ridden over the last 20 years will likely continue.

Appendix: New York City Tax Revenues Generated by the Finance and Securities Industry

	NYC Taxes Related To All City Employment (In Billions)	NYC Total Payroll	Total Taxes Generated As a% of Payroll	NYC Taxes Directly Related To The Finance Industry (In Billions)	Finance Payroll (In Billions)	Finance Taxes Generated As a % of Payroll	Finance Taxes As a % of Total Taxes	NYC Taxes Directly Related To The Securities Industry[6] (In Billions)	Securities Industry Payroll (In Billions)	Securities Taxes Generated As a % of Payroll	Securities Taxes As a % of Total Taxes
1997	$10.73	$163.36	6.6%	$2.81	$43.40	6.5%	26.2%	$1.69	$27.30	6.2%	15.7%
1998	$12.21	$178.75	6.8%	$3.07	$45.90	6.7%	25.1%	$1.85	$32.00	5.8%	15.2%
1999	$11.90	$189.87	6.3%	$3.38	$51.20	6.6%	28.4%	$2.13	$33.10	6.4%	17.9%
2000	$12.04	$213.12	5.6%	$3.54	$62.83	5.6%	29.4%	$2.34	$46.11	5.1%	19.4%
2001	$13.28	$217.44	6.1%	$3.47	$64.77	5.4%	26.1%	$2.53	$47.40	5.3%	19.1%
2002	$12.67	$205.86	6.2%	$3.09	$53.91	5.7%	24.4%	$2.09	$37.83	5.5%	16.5%
2003	$13.91	$206.69	6.7%	$3.46	$52.10	6.6%	24.9%	$2.25	$35.79	6.3%	16.2%
2004	$15.97	$223.02	7.2%	$4.45	$61.27	7.3%	27.9%	$3.00	$43.63	6.9%	18.8%
2005	$18.17	$236.93	7.7%	$5.65	$67.22	8.4%	31.1%	$3.93	$48.83	8.0%	21.6%
2006	$19.28	$260.32	7.4%	$5.97	$80.92	7.4%	30.9%	$3.86	$59.89	6.5%	20.0%
2007*	$21.5	$291.47	7.4%	$7.2	$97.54	7.4%	33.3%	$4.8	$73.70	6.6%	22.5%
2008*	$21.9	$295.28	7.4%	$6.9	$94.86	7.3%	31.7%	$4.7	$71.90	6.6%	21.5%
2009*	$18.9	$263.32	7.2%	$5.0	$71.74	7.0%	26.4%	$3.3	$51.37	6.4%	17.3%
Decline in 2009	-$2.9			-$1.9				-$1.4			
% of Total 2009 Decline	100%			66%				49%			

*Estimated using ordinary least squares (see footnotes 2, 3 and 6).

Source: Eastern Consolidated; NYS Department of Labor, NYC Department of Finance

6 Using ordinary least squares method, also called a regression analysis, securities tax revenues (STR) were estimated as a function of payroll (SPR) as per the following: STR = -0.3075+ 0.0698 x SPR. R2 = 0.750

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