Balancing the State Budget in Tough Economic Times

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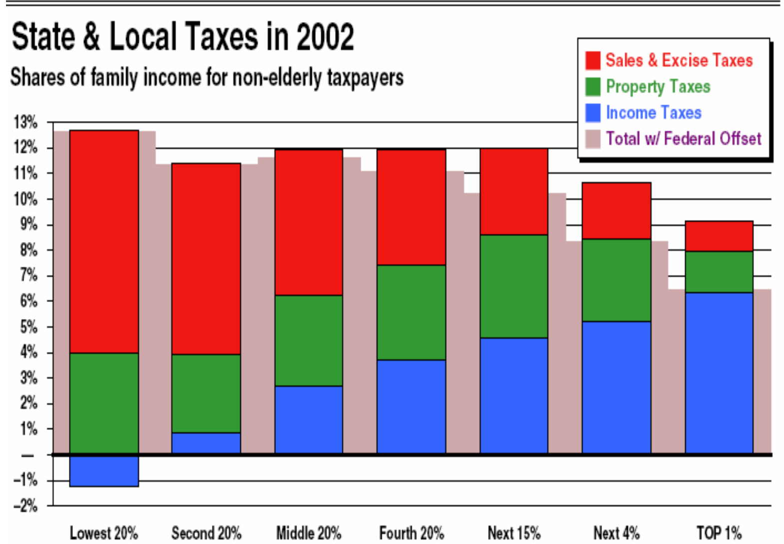
Currently, low and middle-income families in New York pay a much greater share of their income in state and local taxes than the richest New Yorkers. This is because of the pressure that the state has placed on local property and sales taxes over the last 30 years as it has moved New York State's income tax system from one with 14 brackets ranging from 2% to 15% to one with five brackets in a very narrow range from 4% to 6.85%.

The most recent detailed study of the impact of New York's overall state-local tax system on families at different income levels found that the richest one percent of families - those with an average income of $1.6 million – paid only 6.5% of their income in state and local income, property, and sales taxes; while the overall state-local tax burden for families in the middle-of-the-income distribution (those with incomes between $27,000 and $44,000) was 11.6%. The poorest New Yorkers – those with incomes below $15,000 – carried the highest tax burden, 12.6% of their overall income.

This year, the Assembly Majority has advanced a budget plan that includes a temporary increase of less than one percent (from 6.85% to 7.7%) on taxpayers with taxable incomes of more than $1 million a year. This temporary high-end tax increase would restore an important bit of tax fairness to New York's overall state-local tax system. Much of the income growth of the past decade has been at the very top and even with this fraction of a percent increase, those with high incomes will still be much better off than in 2003. But, just as importantly in the current economic situation, a high-end income tax increase would allow the state to balance its budget without jeopardizing critical health, education and infrastructure investments.

Neither tax increases nor service cuts are desirable during a recession. Both take demand out of the economy—making recessions longer and deeper, and making recovery more difficult. But New York, like most other states, is required to balance its budget in

New York



Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20% Next 15%	Next 4%	TOP 1%
Income Range	Less than $15,000	$15,000 – $27,000	$27,000 – $44,000	$44,000 – $74,000	$74,000 – $160,000	$160,000 – $634,000	$634,000 or more
Average Income in Group	$8,700	$20,700	$34,900	$56,800	$102,000	$250,000	$1,663,000
Sales & Excise Taxes	**9.5%**	**7.5%**	**5.7%**	**4.5%**	**3.4%**	**2.2%**	**1.2%**
General Sales—Individuals	3.9%	3.6%	2.9%	2.5%	1.9%	1.3%	0.7%
Other Sales & Excise—Ind.	2.7%	1.6%	1.1%	0.7%	0.5%	0.3%	0.1%
Sales & Excise on Business	2.9%	2.3%	1.7%	1.3%	0.9%	0.6%	0.4%
Property Taxes	**4.4%**	**3.0%**	**3.5%**	**3.7%**	**4.1%**	**3.2%**	**1.6%**
Property Taxes on Families	3.9%	2.7%	3.1%	3.2%	3.5%	2.7%	0.7%
Other Property Taxes	0.5%	0.4%	0.4%	0.5%	0.5%	0.6%	0.9%
Income Taxes	**–1.2%**	**0.8%**	**2.7%**	**3.7%**	**4.6%**	**5.2%**	**6.3%**
Personal Income Tax	–1.3%	0.8%	2.6%	3.7%	4.5%	5.1%	6.0%
Corporate Income Tax	0.0%	0.0%	0.1%	0.0%	0.0%	0.1%	0.3%
TOTAL TAXES	**12.7%**	**11.4%**	**11.9%**	**11.9%**	**12.0%**	**10.6%**	**9.1%**
Federal Deduction Offset	–0.0%	–0.1%	–0.3%	–0.8%	–1.8%	–2.3%	–2.7%
TOTAL AFTER OFFSET	**12.6%**	**11.3%**	**11.6%**	**11.1%**	**10.2%**	**8.4%**	**6.5%**

Note: Table shows 2002 tax law at 2000 income levels.

INSTITUTE ON TAXATION & ECONOMIC POLICY, JANUARY 2003 both good times and bad. So New York has to figure out what mix of spending cuts and tax increases will do the least harm, at this point in time.

Joseph Stiglitz, winner of the 2001 Nobel Prize in Economics, and Peter Orszag, then of the Brookings Institution and now the director of the U.S. Congressional Budget Office, looked at this question in a paper that they co-authored on this subject, *Budget Cuts vs. Tax Increases at the State Level: Is One More Counter-Productive than the Other During a Recession?* They concluded that a temporary increase in the tax on the portions of families' incomes over some relatively high level (i.e., a tax on the portions of incomes that are least likely to be spent) is the least damaging mechanism for balancing state budgets during recessions. In contrast, cuts in government spending on goods and services that are produced locally (like education and healthcare) and cuts in transfer payments to lower-income families are most damaging to the economy since they come closest to taking dollar for dollar out of the local economy.

During the last recession, Governor Pataki was successful in papering over the magnitude of the state's budget problems until after his reelection in November 2002. In fact during the months before that election, he and his budget director besmirched the deficit projections of Senate Majority Leader Joseph Bruno, a Republican, and Comptroller H. Carl McCall, the Comptroller and Pataki's Democratic opponent in that year's election. In January of 2003, Pataki acknowledged that the state had built up a combined deficit of \$11.5 billion for the upcoming 2003-04 fiscal year and the close-out of 2002-03; and he proposed closing that gap primarily through service cuts. But Bruno and Assembly Speaker Sheldon Silver led the Legislature in adopting, over the Governor's vetoes, a much more balanced approach to balancing the state budget including a temporary three-year increase of less than one percent on taxpayers with taxable incomes above \$500,000, and a smaller increase on families with taxable incomes above \$150,000. This approach to budget balancing helped New York rebound faster than it did from the 1990s recession – when it had relied on a strategy similar to what Pataki had originally recommended in 2003. And, it did not have the negative impact on the state's economy, or on the number of high-income taxpayers in the state, that Governor Pataki had predicted in vetoing the Legislature's budget bills. In fact, the number of high-income returns grew steadily from about 245,000 in 2002 to an estimated 420,000 in 2007 and employment in the state increased each year that the temporary surcharge was in place.

The lessons to be learned from New York's fiscal policy choices during the last two recessions are clear. The balanced approach to balancing the state's budget that was adopted in 2003 worked much better than the deep service cuts of the early 1990s which prolonged and deepened the effects of that recession on New York State.