Back on Track: Why Progressive Tax Reform Is an Essential Part of New York's Budget Solution

Executive Summary

New York faces one of the largest budget deficits in the country for the coming year at $14.2 billion. The State's 2009-10 fiscal year begins April 1, 2009. Two responses to addressing the crisis have dominated the policy debate. While both acknowledge the detrimental impact Wall Street revenue declines have had on the State's fiscal condition, they diverge in significant ways.

One response frames the deficit as a matter of excessive public spending and calls for massive cuts to public programs and services. The other finds that, following thirty years of personal income tax (PIT) cuts for the wealthiest New Yorkers, the State's overall tax system is highly regressive and incapable of supporting essential service needs. This view warns of the economic damage that would result from large state budget cuts and calls for restructuring the PIT as a necessary step towards fiscal stability in this troubled economic climate.

In the context of a deepening recession, which is the most sensible path to take? This policy brief reviews arguments, analysis and data pertinent to deciding whether progressive tax reform should be part of the solution. We find that:

- **A deficit-reduction plan that relies too heavily on cuts will intensify the economic slump** by reducing consumer spending, counteracting the federal economic stimulus effort, and devastating working and middle class families reliant on public services.

- Economic theory—articulated by such eminent economists as President Obama's budget director, Peter Orszag, and Nobel laureate Joseph Stiglitz—suggests that during a recession, steep state budget cuts hurt the economy much more than a high end income tax increase.

- **High-end income tax increases have not had the negative economic consequences that opponents predicted.** Progressive tax reform in a number of states has not led to the movement of wealthy families out of their states or correlated job loss.

- Other states have successfully restructured high-end PIT rates without resulting economic harm:

    - From 2004 to 2006, following California's implementation of a new national top rate of 10.3 percent on income over $1,000,000, there was a 38 percent increase in the number of millionaires in the State.

    - The number of half-millionaires in New Jersey has grown by 70 percent since increasing their highest rate from 6.37 percent to 8.97 percent in

2002, from 26,000 in 2002 to 44,000 in 2006. (Gov. Corzine recently proposed a one-year increase to 9.75 percent.)

  - New York experienced a comparable increase in high-income returns after temporarily raising PIT rates, from 250,000 in 2003 to over 325,000 in 2005, representing a 30 percent growth.

- States with higher top PIT rates than New York have experienced positive private sector job growth over the past decade. Additionally, during the last temporary PIT increase, New York gained 127,000 jobs.

- Marginal income tax increases will not have a significant impact on small business owners. For example, 98.6 percent of all small business owners make less than $250,000 a year.

- **Current fiscal pressures largely stem from excessive tax cuts made over the last three decades.** New York has cut the top PIT rate on wealthiest residents in half even as growing polarization has left New York with the widest income gap between the top and bottom in the nation. Today a single person with an income of $30,000 pays the same marginal tax rate as a person with an income of $30 million.

- The reality of the claim that state spending is "out of control" is that aside from important commitments involving education aid, healthcare, property tax relief and transportation, state spending from 2004 to 2008 grew at less than 2.9 percent a year, barely the pace of consumer inflation. The state, however, made these commitments without identifying how to sustainably pay for them.

- High-end PIT cuts have led to a massive tax shift. To compensate for lost state revenue, New York has increased the burden on local governments to pay for essential services through increased property and sales taxes. The tax burden now falls heaviest on those with the least ability to pay.

- **New York should consider reforming its top PIT rates** to help close the remaining 2009-10 budget gap, ensure fiscal stability, protect services, and restore sustainability and fairness to the overall tax structure.

- Even after all available federal stimulus funds that can go towards the deficit are utilized, New York would still be left with a $7.5 to $8 billion gap for the coming fiscal year.

- A high-end income tax increase will help blunt the impact of state-wide program cuts while affecting relatively few New Yorkers. For example, raising PIT rates above $250,000 would affect only 2.5 percent of all taxpayers statewide and only one percent of upstate taxpayers.

- Permanent PIT reform would provide the financing necessary to phase in substantial property tax reform once the economy recovers.