NEWS from the Fiscal Policy Institute

For immediate release: December 13, 2008

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Economists to Governor: Raise High-End Income Taxes To Help Close Budget Gaps

More than 100 economists from throughout New York State joined together this week to send a message to Albany: steep cuts in state spending will weaken the already struggling New York economy, and will hurt poor and middle income New Yorkers. In a letter to the governor, the economists urge him to take "a balanced approach" to closing the gap in the state budget between revenues and spending—that is, an approach that includes raising taxes on high-income households.

Governor Paterson received praise from the economists for "tackling the state's budget crisis head on" but, they say, his refusal to consider revenue options will cause undue harm to the economy. The letter is signed by distinguished professors William J. Baumol, Ronald G. Ehrenberg, Robert H. Frank, Teresa Ghilarducci, Alfred E. Kahn, Jeff Madrick, Dimitri B. Papadimitriou, Edward Wolff and more than 100 of their colleagues from across the state.

The letter comes as state policymakers debate the best ways to close the budget gap and stimulate the state economy. Governor Paterson will release his budget proposal on Tuesday, a full month before the constitutional deadline. Paterson has focused on closing budget gaps—and has said he wants to rely exclusively on spending cuts to do so.

The economists find fault with the governor's strategy.

"The federal government's first priority must be to stimulate spending as quickly as possible, deficits be damned," said Robert H. Frank of Cornell University. "The state must balance its budget, but how it chooses to do so will either support or undercut federal attempts to stimulate the economy. To that end, we should raise tax rates for high-income families right away. Most of these families would continue to spend as much as before, while the additional revenue could pay for state spending that would help restore full employment."

Frank, an economist with Cornell University's Johnson Graduate School of Management, is a visiting faculty member at the Stern School of Business at New York University. He writes the "Economic View" column for the *New York Times*.

"Historical experience has borne out basic economic principles many times over," said Edward Wolff, professor of economics at New York University. "Whenever you close budget gaps, you necessarily contract the economy. But raising taxes on high income households is the lesser of two evils. Budget cuts have a greater contractionary impact, since those with plenty of income typically spend only part of it."

"Governor Paterson has been doing good work in Washington," said Jeff Madrick, director of policy research of the Schwartz Center for Economic Policy Analysis at the New School for Social Research and the editor of Challenge Magazine. "Our governor has emerged as a leading voice urging that the federal government deliver timely fiscal relief to help states close budget gaps this year. This is essential for the economic recovery package to be effective. But we also need to be sure that the states won't then turn around and undermine the federal stimulus by slashing their spending."

Frank Mauro, executive director of the Fiscal Policy Institute, pointed to evidence that high-income families are able to absorb some increases. "The governor's concern that the wealthy will choose to leave New York is overblown, to say the least," he said. He said that the last time New York dealt with budget gaps of this magnitude was after 9/11. At that time, in addition to spending cuts, the legislature placed a temporary income tax surcharge on high-income filers.

"Employment in the state grew each year that the surcharge was in place," said Mauro. "And the number of high-income returns grew steadily from about 245,000 in 2002 to an estimated 420,000 in 2007." He also pointed to a recent Princeton study concluded that no net out-migration of the rich resulted from New Jersey raising income taxes on households with incomes over $500,000.

James Parrott, the Fiscal Policy Institute's deputy director and chief economist, coordinated the signing of the letter along with Wolff and Madrick. "This group of 117 spans the spectrum in terms of political ideology. But as economists they all agree: Governor Paterson needs to broaden his gap-closing mission to consider the health of the state economy as well. What's at stake is the private sector's ability to recover from the recession."

Full text of the letter with list of signers below.

The Fiscal Policy Institute (FPI) is a nonpartisan research and education organization that focuses on the tax, budget, and economic public policy issues that affect the quality of life and the economic well being of New York State residents. FPI reports are available at www.fiscalpolicy.org.

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Dear Governor Paterson:

New York State faces enormous challenges in closing a projected $12.5 billion gap in the 2009-2010 state budget. Wall Street is the epicenter of the global financial crisis and there likely will be no quick rebound from what could prove to be a severe recession.

We applaud the leadership you have shown in tackling the state's budget crisis head on. We agree with you that the federal government has an obligation to New York and all the states in providing substantial fiscal relief to help state governments maintain essential public services during this crisis.

We are concerned, however, that steep state budget cuts will exacerbate the economic downturn and harm vulnerable low- and moderate-income New Yorkers. Constrained by a balanced budget imperative, states face only difficult choices in balancing their budgets during recessions. Economic theory and historical experience gives a clear and unambiguous answer: it is economically preferable to raise taxes on those with high incomes than to cut state expenditures.

The reasoning is straightforward: in a recession, you want to raise (or not decrease) the level of total spending—by households, businesses and government—in the economy. That keeps people employed and buying things, and makes it more likely that businesses will want to invest to serve that consumer demand. Budget cuts reduce the level of total spending. Raising taxes on high income households also will reduce spending, but by much less than the amount of the tax increase since those with plenty of income typically spend only a fraction of their income.

By contrast, almost every dollar of state and local government spending on transfer payments to the needy and for the salaries of public servants providing vital services to our communities enters the local economy right away, generating a greater economic impact. The New York local spending impact difference is even greater when you consider that much of the higher state income tax will be deductible against federal income taxes, and that non-residents who commute to high-paying jobs in New York will pay much of the increase.

Raising taxes and maintaining public expenditures and investments also helps New York and America in meeting its long run needs. America today faces two major problems—inadequate investments, especially in infrastructure, and growing inequality. The poor are particularly dependent on government expenditures, and cutbacks would hurt them the most.

Our nation is at an historic juncture. In both Washington and Albany, we need to move away from polarization and toward economic and fiscal policies that restore a better balance between the private and public sectors.

Signed,

(Affiliations are given for identification purposes only.)

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