Media Release

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Fiscal Policy Institute, New Yorkers for Fiscal Fairness and Economist Robert Frank Applaud Klein's Efforts to Restore Progressivity to the Income Tax But Question Use of Tax Cuts to Provide Economic Stimulus

(Albany, N.Y.) New Yorkers for Fiscal Fairness and the Fiscal Policy Institute praise Senator Jeffery Klein's efforts to reform New York's current inequitable tax system. Senator Klein has wisely chosen to increase rates at the top of the income spectrum and to attempt to provide relief for moderate income tax payers. However, we feel that the Senator's bill simply does not raise enough revenue to offset a meaningful amount of the onerous budget cuts proposed by the Governor. Unfortunately, the middle income tax relief in this bill will not provide stimulus if spending cuts, are in effect, paying for those tax cuts.

When it comes to balancing their budgets during a recession, states face only bad choices – either cutting spending or raising taxes. Neither is good for the economy. Yet Columbia University economist Joseph Stiglitz , winner of the 2001 Nobel Prize for economics, and President Obama's Director of the Office of Management and Budget Dr. Peter Orszag (not to mention over 100 economists from throughout NYS- http://www.fiscalpolicy.org/FPI_Release_EconomistsOnFiscalPolicy_December2008.pdf) have suggested that the best way to deal with the budget gap and minimize harm to the local economy is to tax some high portion of wealth and use it to avert cuts in state funded services or aid to the poor. The reason they say, is that every dollar of state and local spending enters the economy right away, generating a greater economic impact. The impact is especially large when the money goes to aid for the poor or to pay for the salaries of teachers, policemen, firefighters, state workers, doctors, and nurses that provide vital services in our communities and spend their salaries locally.

We further believe that if the Senator's goal is to provide middle class tax relief, that a property tax circuit breaker that includes renters would be a better approach than a proposal to increase the standard deduction. A targeted circuit breaker would provide relief to those that need it the most.

Besides it being better to use the revenue from an increase in the progressivity of the income tax to provide a circuit breaker credit, it would also be better to use that revenue to avoid increases in regressive consumption taxes which dramatically impact low-income New Yorkers.

While an increase in the standard deduction can offset the impact of an increase in consumption taxes for many middle income taxpayers, it cannot do that for taxpayers who have little or no income tax liability but for whom consumption taxes represent a relatively high percentage of their income.

In other words, it would be better to use the revenue raised by the Klein bill's increased progressivity at the top end to (a) avoid cuts in services or having to repeal the clothing exemption on the sales tax and to avoid having to enact some of the new consumption taxes (like the soda tax) proposed by the Governor and (b) to pay for the implementation of a meaningful circuit breaker (that includes renters as proposed in the Omnibus Tax Relief and Reform Act- www.omnibustaxsolution.org).

Statement from Robert Frank on Senator Klein's Tax Proposal – Is It really Stimulus?
Economist, Cornell University

Senator Klein has proposed to stimulate New York's ailing economy by giving middle-income taxpayers a tax break in the form of a prepaid debit card. If this proposal could be financed with borrowed money, as will happen with the current federal tax cut, it would definitely provide short-term stimulus. But because New York State must operate on a balanced budget, money given to consumers in the form of tax cuts must be balanced by equal cuts in state government spending. Since we know that the state would spend 100 percent of any money not used to pay for tax cuts, whether Senator Klein's proposal will stimulate the economy depends on whether consumers will spend 100 percent of their tax cuts. If they'll spend some smaller proportion, the net effect will be negative.

With normal income tax rebates, the concern is that many consumers will choose either to save them or use them to pay down existing debt, in the very rational fear that tougher times may lie ahead. The debit card rebate's explicit purpose is to ensure that consumers will spend their entire rebate. Why, proponents argue, would consumers let their debit rebates expire without spending the entire amount?

This reasoning, however, ignores the fact that money is fungible. Debit card rebates can be used to buy groceries, for example, which would free up money they would have used for groceries to use in other ways. Not everyone will save this money or use it to pay down debt, but many will. The debit rebate scheme's overall effect on state spending is therefore almost certain to be negative.

A far more promising way to stimulate spending would be to increase tax rates on top earners and use the resulting revenue to limit the cuts in government services that would otherwise be necessary. Most top earners currently don't spend all of their income, so for most of them a slight increase in their current tax bill would just mean smaller bequests for their heirs some day.

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Professor Frank is a monthly contributor to the "Economic Scene" column in The New York Times. Until 2001, he was the Goldwin Smith Professor of Economics, Ethics, and Public Policy in Cornell's College of Arts and Sciences. He has also served as a Peace Corps volunteer in rural Nepal, chief economist for the Civil Aeronautics Board, fellow at the Center for Advanced Study in the Behavioral Sciences, and was Professor of American Civilization at l'Ecole des Hautes Etudes en Sciences Sociales in Paris. Frank's books include **Choosing the Right Pond, Passions within Reason, Microeconomics and Behavior, Luxury Fever,** and **What Price the Moral High Ground? The Winner-Take-All Society,** co-authored with Philip Cook, was named a Notable Book of the Year by **The New York Times,** and was included in **Business Week's** list of the ten best books for 1995. Frank holds a BS in mathematics from the Georgia Institute of Technology, an MA in statistics from UC Berkeley and a PhD in economics, also from UC Berkeley.

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