

The Better Choice:  
Meeting New York State's Budget and  
Economic Challenges with Fair Fiscal Policies

James Parrott  
Deputy Director and Chief Economist  
FISCAL POLICY INSTITUTE

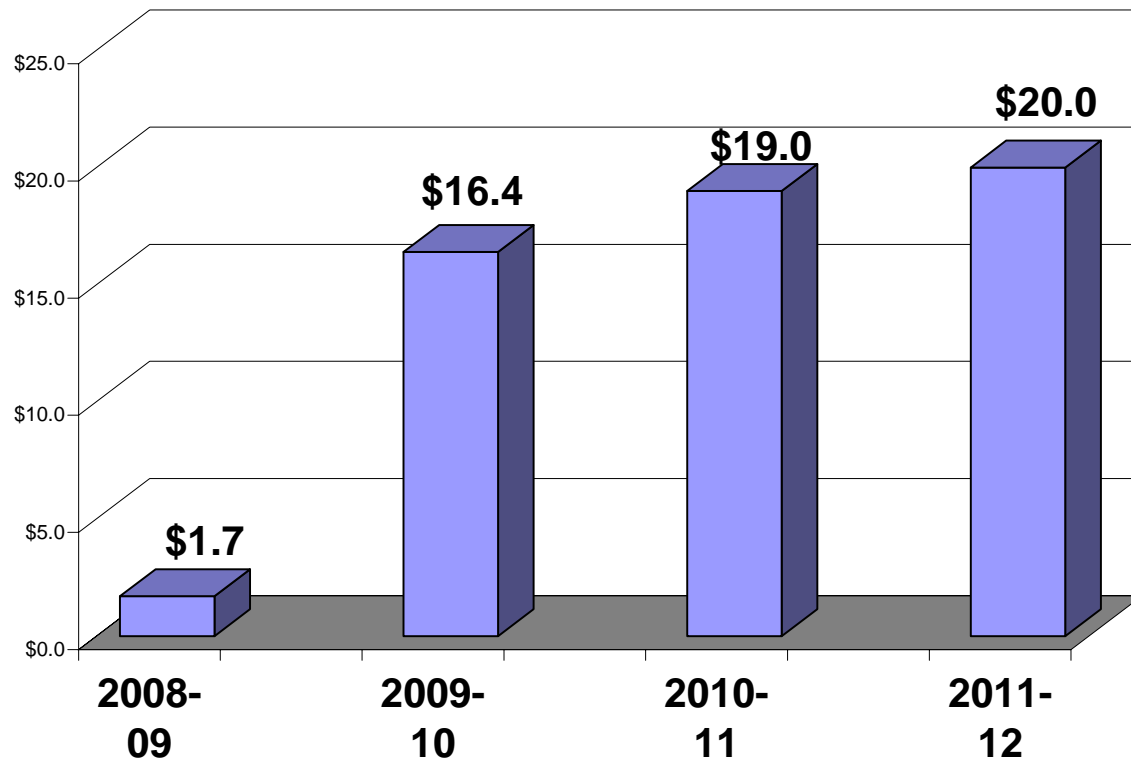
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**BALCONY**

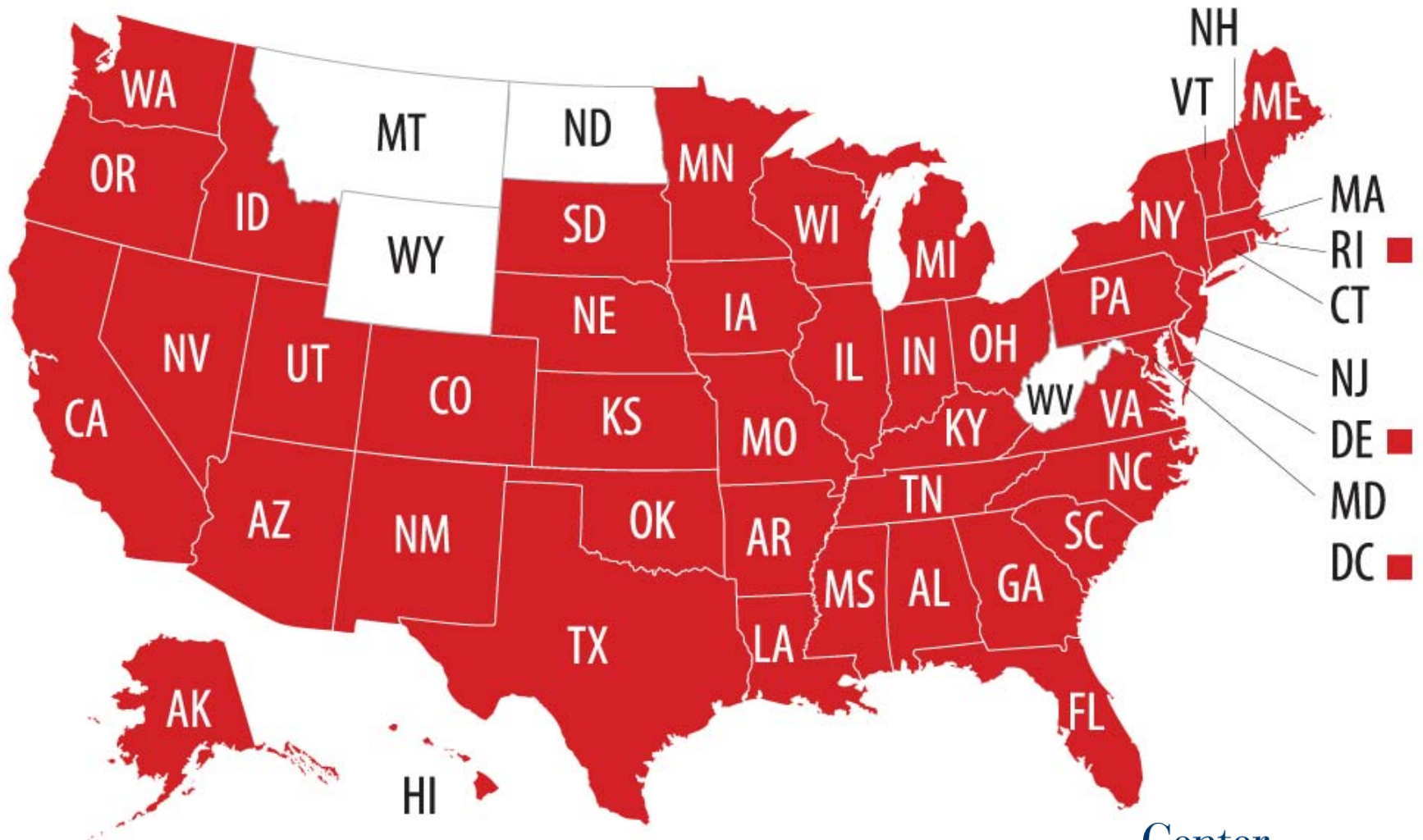
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# ***New York's Projected Budget Gaps***

**Projected NYS General Fund Deficits (\$ B)**



# 46 States Facing Budget Shortfalls



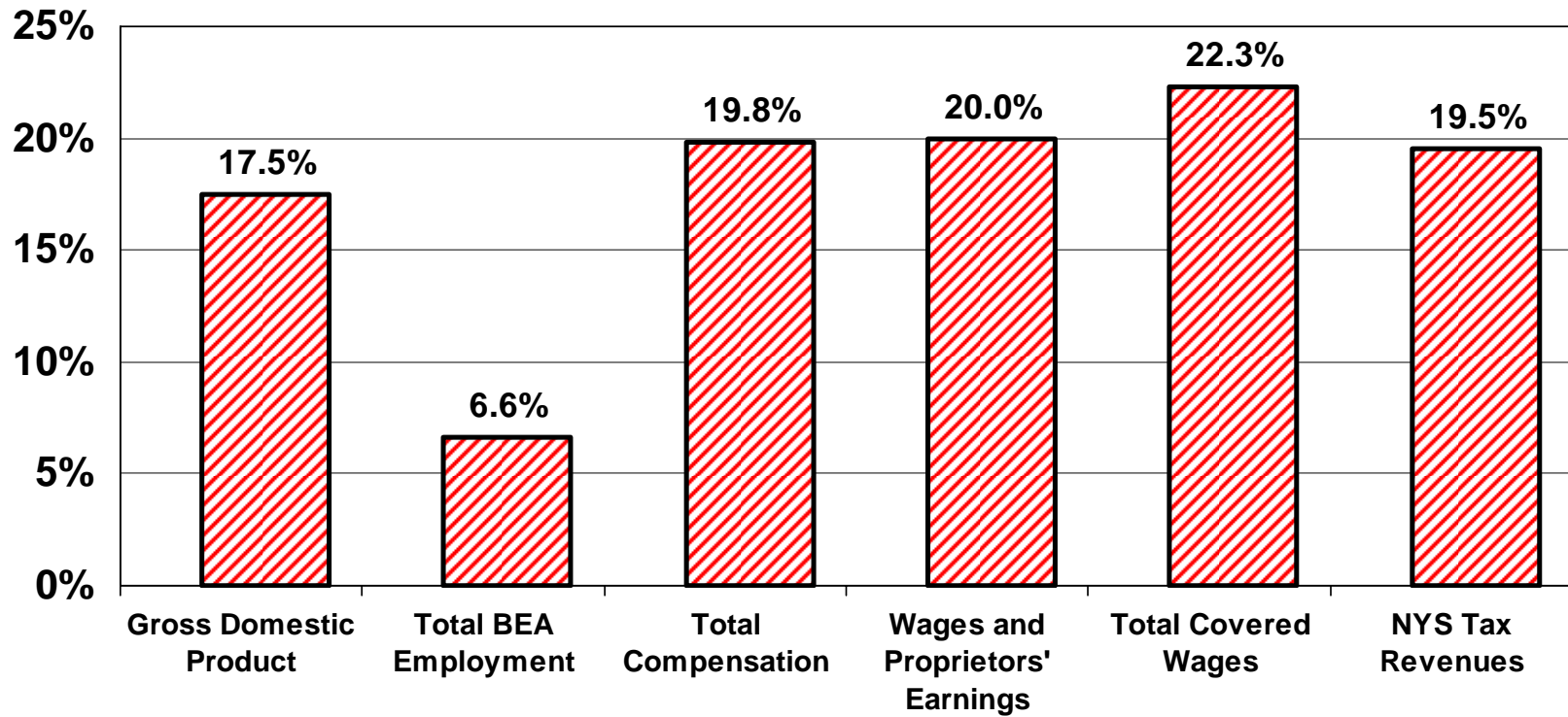
Note: Includes states with shortfalls in fiscal 2009 or projected shortfalls for fiscal 2010.

# ***Why Does New York State Have a \$16 Billion Budget Deficit?***

- Is New York's deficit due to “out of control” spending?
- Is it due to the “overly ambitious” tax cuts enacted in 1994 through 2000?
- What impact has the “meltdown” of the financial sector and the global recession had on state tax revenues?

# ***NYS's economic and fiscal dependence on the finance sector***

**Finance and Insurance Sector's Share of Key NYS Economic and Fiscal Measures**



***Spending on existing programs has grown at a modest rate but the state has made important new commitments without paying for them.***

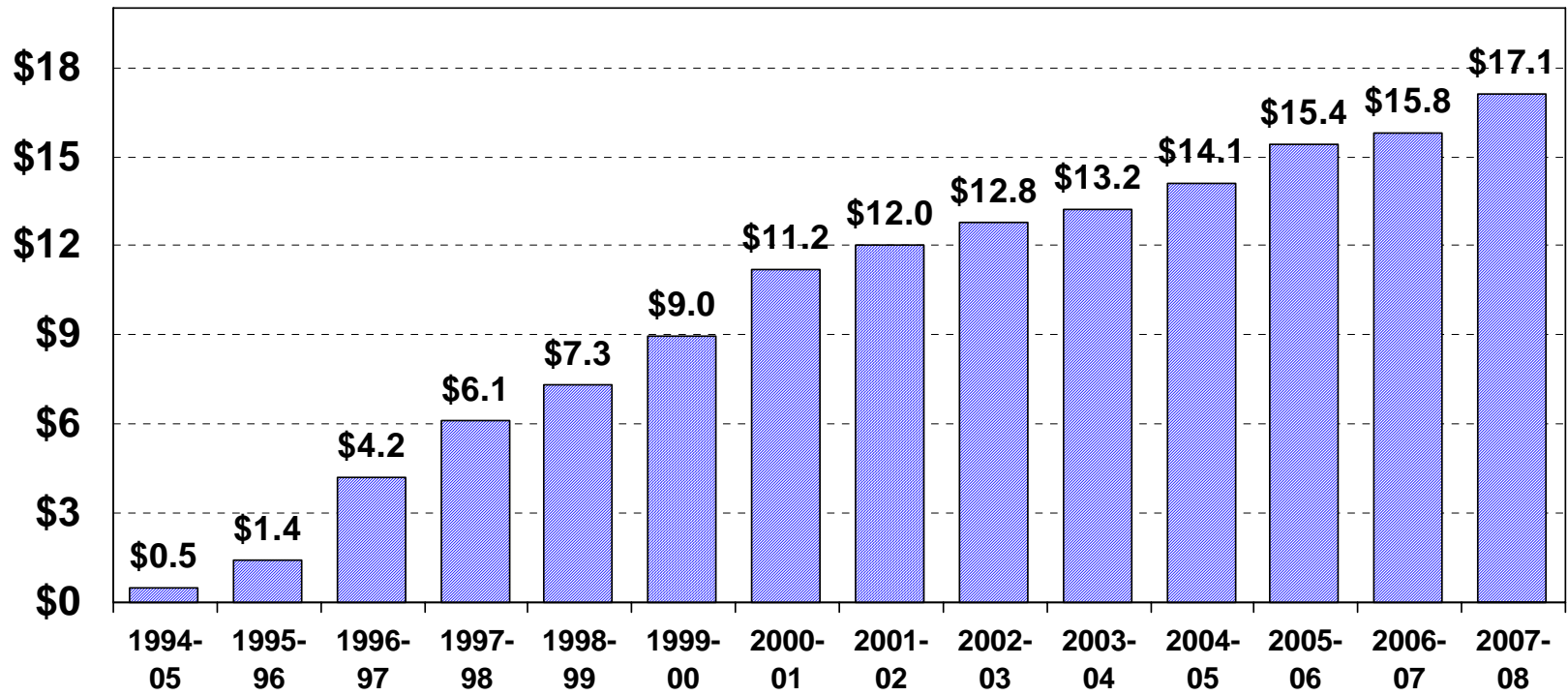
State spending in areas other than health, education, STAR, and transportation grew by less than 3% a year from 2004 to 2008.

Expensive (and mostly important) new commitments were made in the last several years without any new revenue streams to pay for them:

- Family Health Plus Takeover and Medicaid Cap - \$1 billion this year; \$1.35 next year and \$2.5 billion in 2010-11
- STAR – From \$2.5 billion in 2001-02 to \$6.0 billion in 2010-11
- CFE Settlement - \$5.5 billion in new foundation aid by 2010-11. Cost of facilities component (Excel Aid) adopted in 2006 grows annually.
- \$1.2 billion to AMD for Chip Fab Plant in Luther Forest

***The large multi-year tax cuts enacted between 1994 and 2005 are now reducing state revenue by over \$17 billion per year.***

**Revenue Impact in Billions, by State Fiscal Year, of Tax Cuts Enacted in 1994 through 2005**



# ***How should governments change their fiscal policies during economic downturns?***

- **There is a big difference between what the federal and state governments can do and should do during recessions.**
- **The federal government** can and does try to stimulate the economy with tax cuts and spending increases during bad times.
- **But state governments** have to balance their budgets in both good times and bad. So what should the states do during recessions?

## ***Tax increases vs. spending cuts at the state level: which is worse during a recession?***

- Economists Peter Orszag (now Pres. Obama's Budget Director) and Joseph Stiglitz (Columbia University Professor and Nobel Prize Winner) addressed this issue in a 2001 paper.
- "...tax increases on higher-income families are the least damaging mechanism for closing state fiscal deficits in the short run."
- "Reductions in government spending on goods and services, or reductions in transfer payments to lower-income families, are likely to be more damaging to the economy in the short run..."

## ***How should New York State address its projected \$16 B budget deficit for the fiscal year that begins on April 1, 2009?***

- New York should close its projected budget gap in a way that does the least harm possible to the state's economy. This means reducing spending and increasing revenue in ways that take the least demand out of the economy.
- The federal stimulus package includes \$135 billion that is explicitly intended to assist state governments in balancing their budgets while minimizing spending cuts and tax increases. New York's share of the \$135 billion is providing about \$6.5 billion that can be used to help balance the state's 2009-10 budget. That leaves about \$9.5 billion that has to be addressed through some mix of expenditure reductions and revenue increases.

# ***Suggestions for balanced budget balancing combining sensible savings and revenue and tax increases***

• Recoup and expand bottle deposits	\$ .2 B
• Prescription drug purchasing savings	\$ .1 B +
• Reform Empire Zones Program	\$ .3 B
• Tobacco tax enforcement	\$ .5 B
• Contract-in use of professional consultants	\$ .4 B
• Eliminate STAR rebate checks (and phase-in Circuit Breaker next year)	\$ 1.4 B
• Tax and fee increases proposed by Gov.	\$ 1.2 B
• High-end personal income tax increase	<u>\$ 5.0 B</u>
<b>TOTAL</b>	<b>\$ 9.1 B</b>

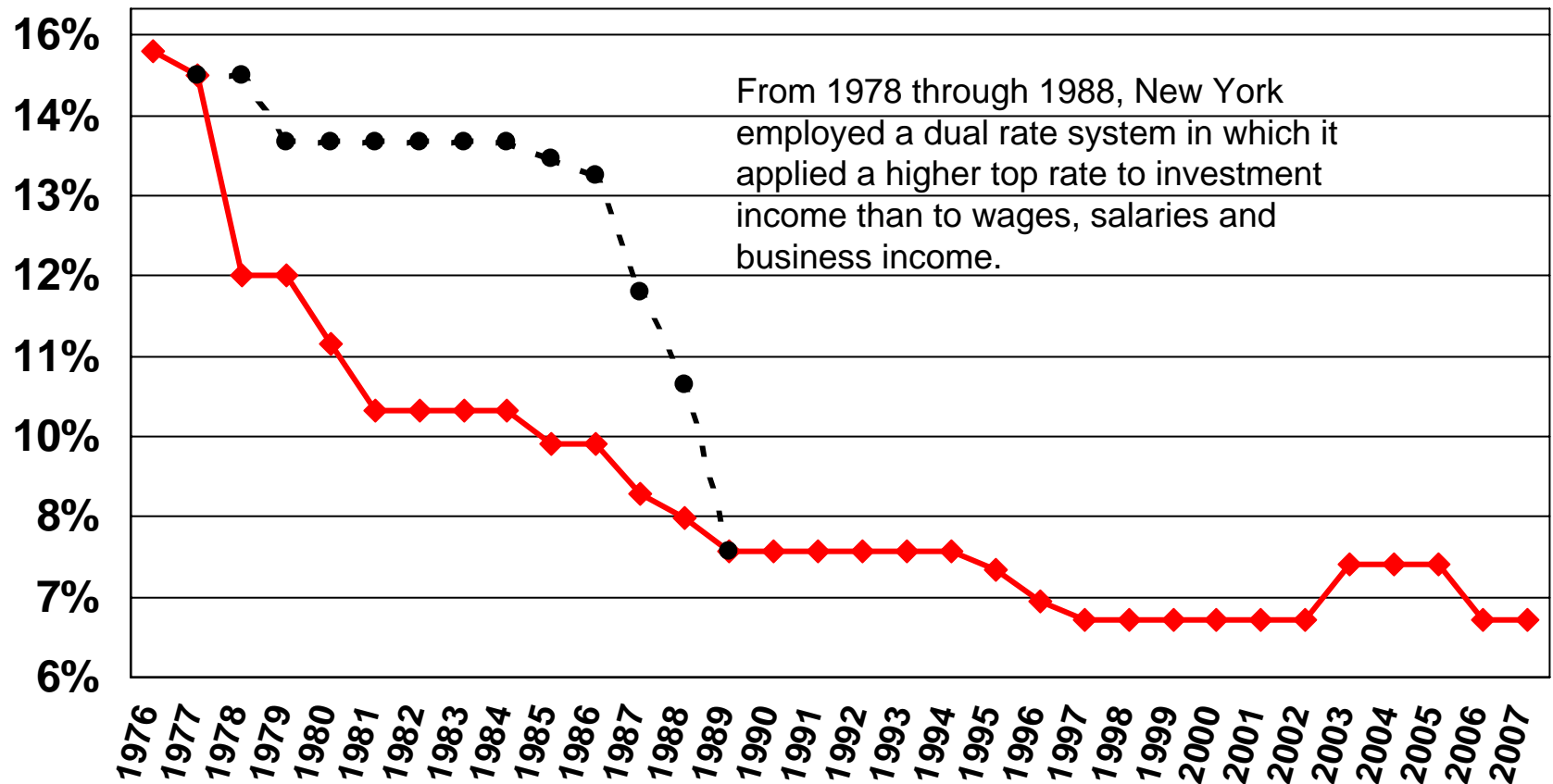
# ***Why progressive taxation?***

- By cutting the PIT, NYS has increased reliance on regressive property and sales taxes
- NYS has regressive overall tax structure
- Recent years have seen unprecedented concentration of income growth at the top
- High-end income tax increases are least harmful to the economy

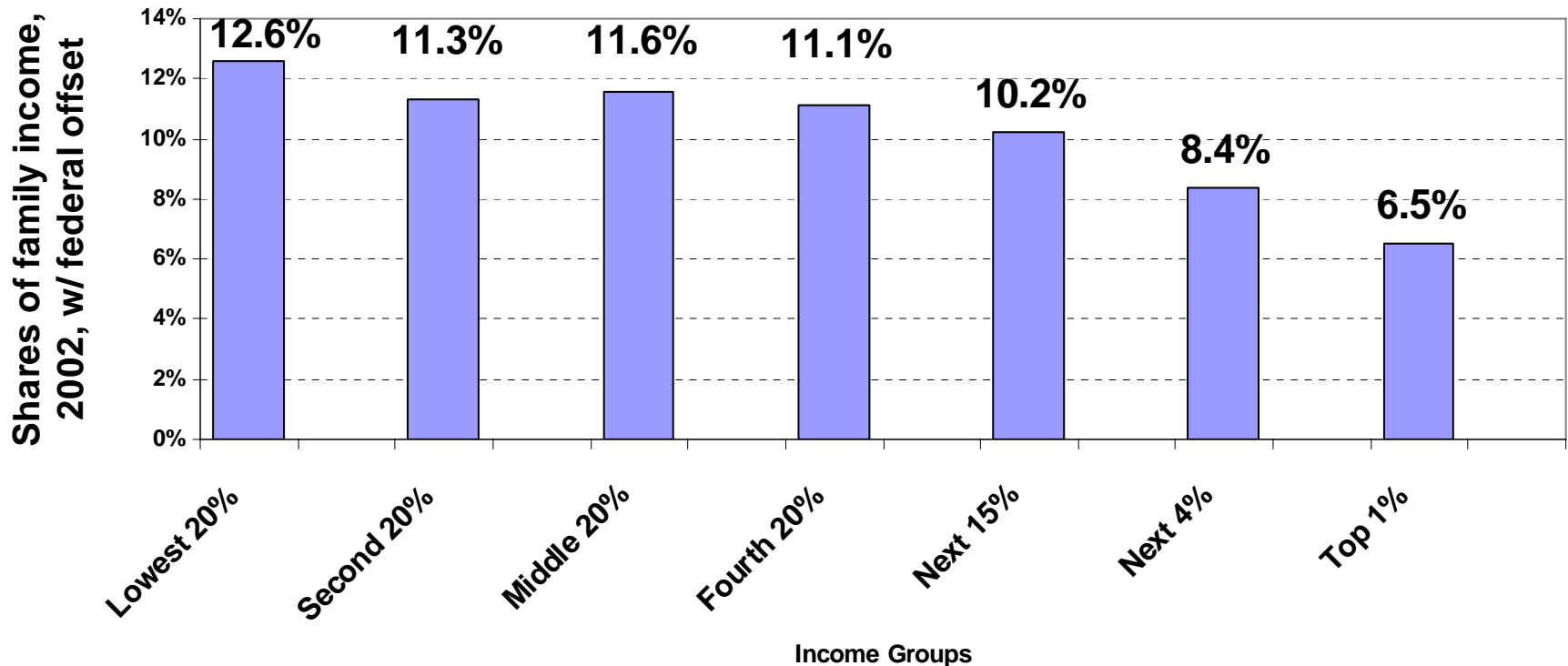
# ***Have the tax cuts of the last three decades made the NYS tax system fairer?***

- There have been some positive changes in the NYS income tax system such as the elimination of the marriage penalty and the adoption of an Earned Income Tax Credit that promotes work over welfare.
- But the state's income tax structure has become pretty flat. Taxpayers now reach the state's highest personal income tax rates when taxable income exceeds \$20,000 for single individuals and \$40,000 for married couples.

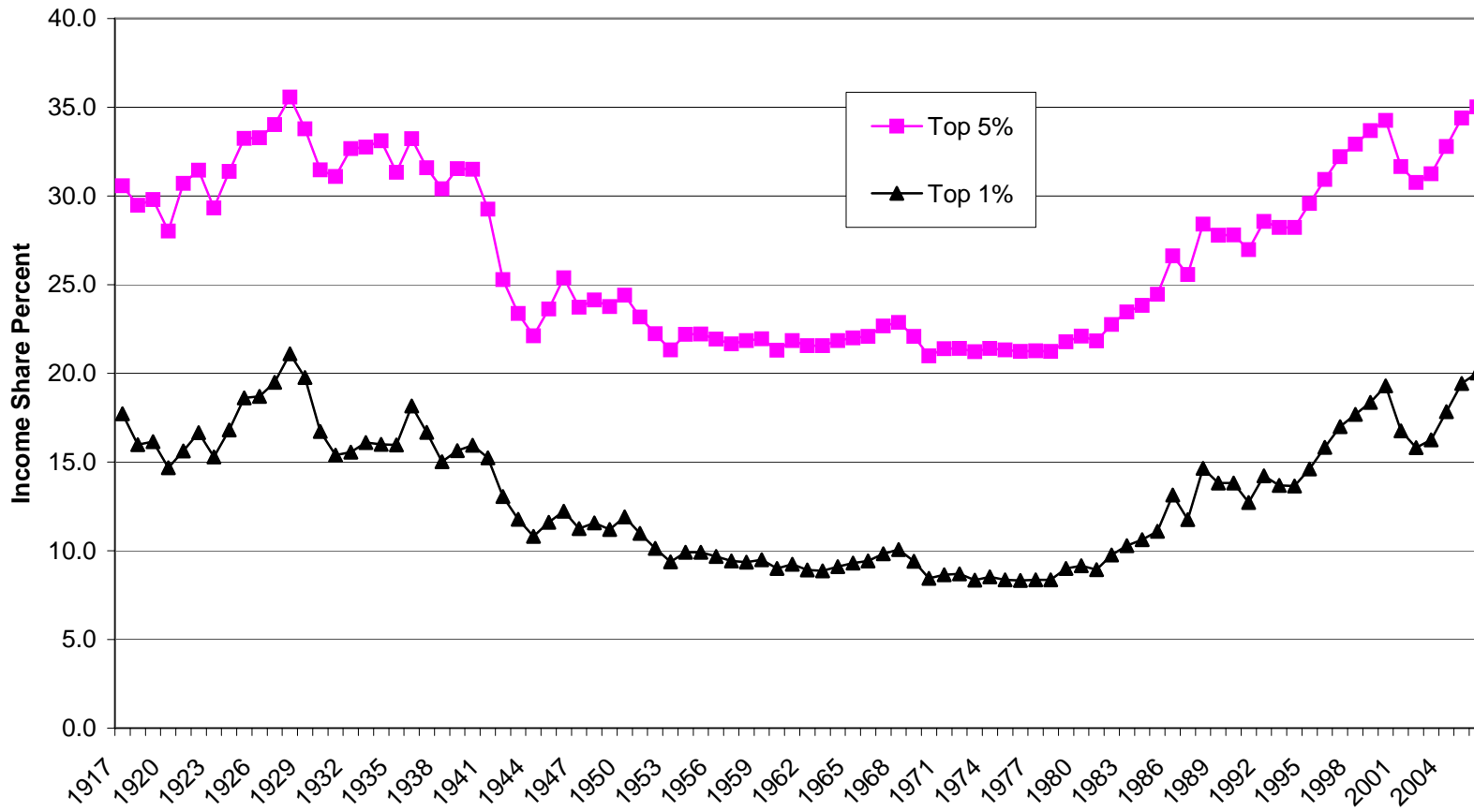
**Over the last 30 years, New York State has cut its top personal income tax rate by more than 50 percent, from 15.375% to 6.85%.**



**The overall tax burden in New York is regressive because of the state's heavy reliance on sales and property taxes.**



# Income shares (incl. capital gains), U.S., 1917-2006



Data source: Piketty-Saez data on the US income inequality (<http://elsa.berkeley.edu/~saez/>)

# *The Big Mismatch*

- While income is increasingly concentrated at the top of the income distribution, the state tax system has moved in the opposite direction:
- - - eliminating brackets from the top and the bottom of the rate structure, and
- - - moving to a virtual flat tax with 5 brackets in a very narrow range – from a low of 4% to a high of 6.85%

# ***New York did adopt temporary high-end income tax increases in 2003.***

- For taxpayers with incomes over \$500,000, the tax rate was increased from 6.85% to 7.7% for 3 years (2003, 2004 and 2005).
- For single taxpayers with incomes over \$100,000; heads of households with incomes over \$125,000; and married couples filing joint returns with incomes over \$150,000, the temporarily higher rates were 7.5% for 2003, 7.375% for 2004, and 7.25% for 2005.

## **New York's top state personal income tax rate is at an historical low relative to New Jersey and Connecticut.**

	<u>1976</u>	<u>1985</u>	<u>2003</u>	<u>2004</u>	<u>2006</u>
New York	15.375%	9.5%	7.7%	7.7%	6.85%
New Jersey	2.5%	3.5%	6.37%	8.97%	8.97%
Connecticut	0	0	5.0%	5.0%	5.0%

Note: The tax rates shown above are for wages, salaries and business income. Prior to 1991, Connecticut taxed the interest, dividends and capital gains of high income residents but it did not tax business income, wages, salaries and other income. From 1978 through 1988, New York employed a dual rate system in which it applied a higher top rate to investment income than to wages, salaries and business income. For 1985, the top rate applicable to investment income was 13.5%.

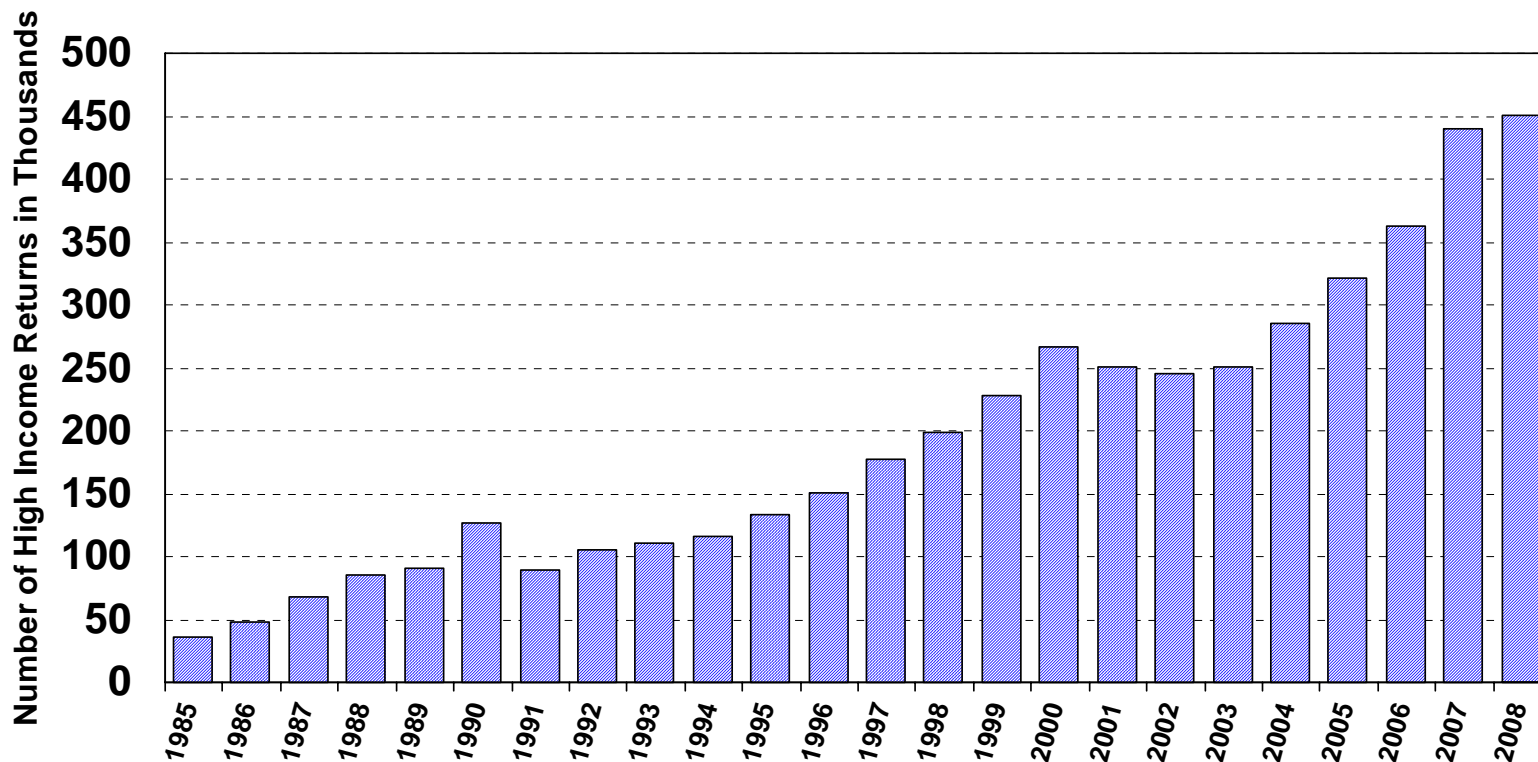
## Hypothetical Graduated Rate Options

<u>\$200,000 to \$500,000</u>	<u>\$500,000 to \$1 million</u>	<u>\$1 million to \$5 million</u>	<u>\$5 million to \$10 million</u>	<u>Over \$10 million</u>	Estimated Annual Revenue
<b>1.00%</b>	<b>2.00%</b>	<b>3.00%</b>	<b>3.00%</b>	<b>3.00%</b>	<b>\$4.3 Billion</b>
<b>1.50%</b>	<b>2.50%</b>	<b>3.50%</b>	<b>3.50%</b>	<b>3.50%</b>	<b>\$5.2 Billion</b>
<b>1.00%</b>	<b>2.50%</b>	<b>4.00%</b>	<b>4.00%</b>	<b>4.00%</b>	<b>\$5.5 Billion</b>
<b>1.00%</b>	<b>2.00%</b>	<b>3.00%</b>	<b>4.00%</b>	<b>5.00%</b>	<b>\$5.1 Billion</b>
<b>1.50%</b>	<b>2.50%</b>	<b>3.50%</b>	<b>4.50%</b>	<b>5.50%</b>	<b>\$6 Billion</b>

# ***This year's budget debate sounds like "Déjà Vu All Over Again"***

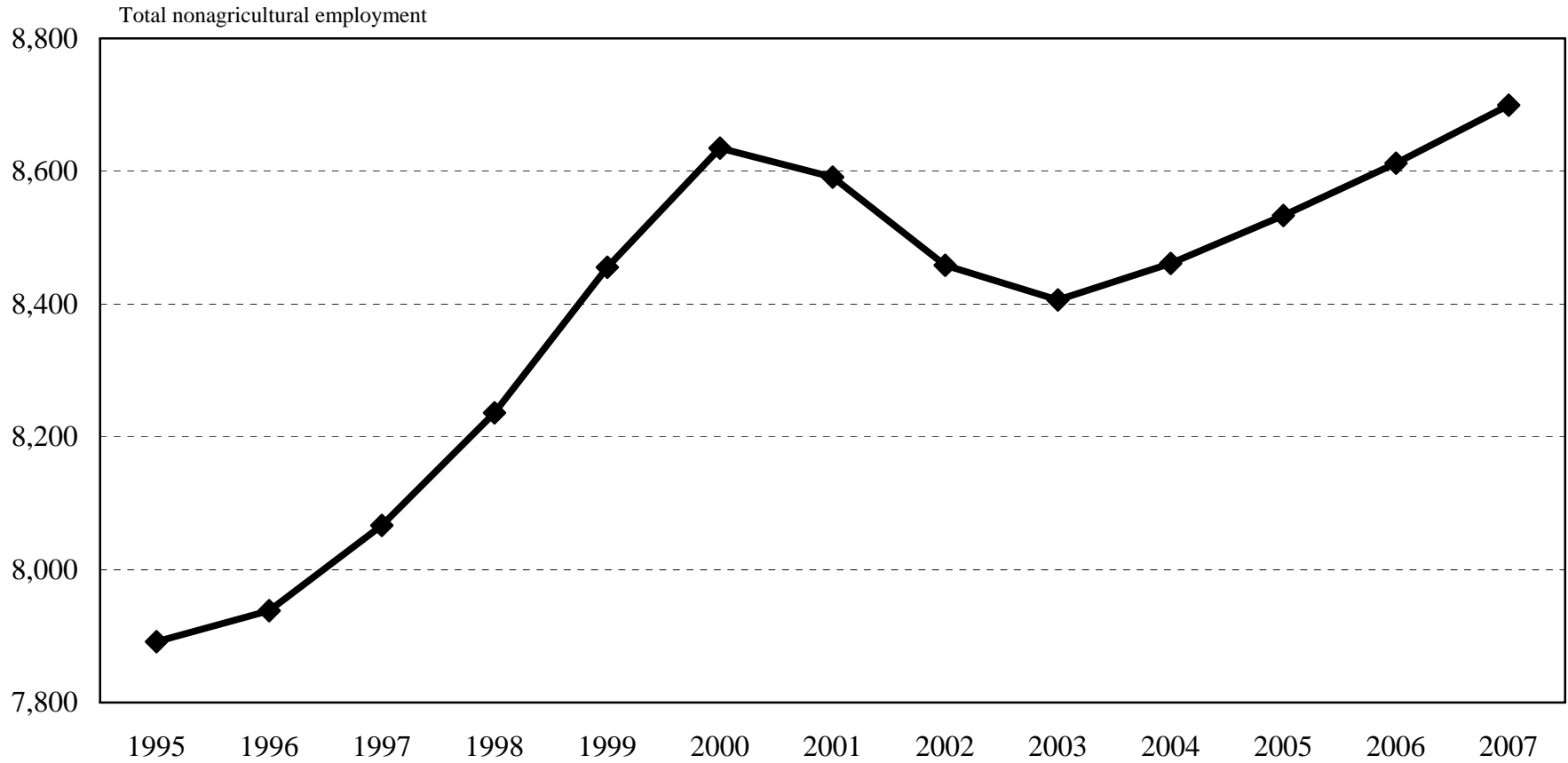
- In the 1990s recession, Governor Cuomo said “No broad based tax increases.” So, NYS relied overwhelmingly on massive budget cuts. This lengthened the recession in NY.
- In January of 2003, New York State faced a deficit of \$11.5 billion for the upcoming 2003-04 fiscal year and the close-out of 2002-03. Governor Pataki proposed closing that gap primarily through budget cuts – suggesting a re-run of the state's early 1990s strategy.

*Following the adoption of the 3-year temporary increase in the top rate on NY's PIT, over Gov. Pataki's veto, the number of high-income returns and the income reported on those returns both grew significantly.*



Source: New York State Executive Budget for 2008-09, Economic and Revenue Outlook, Figure 57

# The 2003 tax increases did not have the negative economic effects that Governor Pataki predicted.



Source: US Department of Labor. 2007 annual employment level projected based on 11-month change.

# ***Usual arguments against a high-end PIT increase***

1. State spending is out of control
2. Wealthy New Yorkers will move out
3. Wealthy New Yorkers paying lion's share of income tax already
4. A recession is the wrong time to raise taxes—it will hurt the economy
5. Financial market turmoil have high rich very hard
6. Will hurt small business

# ***The reality ...***

1. Spending on existing programs has grown at modest rate, but state made new commitments
2. No evidence that wealthy leave
3. All of income growth concentrated at the top
4. States have to balance budgets; spending cuts more harmful to the economy than high-end tax increases
5. Even with projected declines in high incomes, top 5% still far ahead of 2002; everyone else worse off
6. 98.6% of small business owners have incomes under \$250,000.