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Soaking rich would hurt NY

By E.J. McMahon
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New York's public employee unions are spearheading a campaign to raise state income taxes on the wealthiest households as an alternative to Gov. David Paterson's proposed budget cuts. Joined by some legislators in both houses, the unions and their tax-hike coalition partners are justifying the proposal on both fiscal and moral grounds — claiming it's necessary not just to close the state's massive budget gap, but to restore "fairness" to the tax code.

To paraphrase the late Sen. Daniel P. Moynihan, they're entitled to their own opinion, but they're not entitled to their own facts. And the facts simply don't support the claim that New York's tax structure is tilted in favor of the rich. Nor does economic experience support the claim that we can adopt a soak-the-rich tax strategy without negative economic consequences in an already severe recession.

In 2007, at the peak of the last boom on Wall Street, the highest-earning 1 percent of New Yorkers generated 41 percent of the state's tax revenues. Even in the wake of the financial sector's collapse, the top 1 percent is expected to pay 36 percent of income taxes in 2010, according to the state Budget Division — compared to 30 percent in the mid-1990s.

While the increase in the taxes for the wealthiest New Yorkers tracks their income gains over the past decade, their larger share also reflects the impact of former Gov. George Pataki's 1995 income tax reform. Pataki targeted his biggest tax cuts to low- and middle-income New Yorkers — thus shifting more of the remaining burden to the upper end of the income scale.

Thanks to Pataki's policies, New York now also has the nation's most generous refundable earned income credit for 1.3 million low-income workers. For example, a single mom supporting two kids while working full time in an $8-an-hour job qualifies for a $1,559 tax refund from the state — a negative income tax rate of nearly 10 percent that offsets most of the other state and local taxes she would typically pay. Meanwhile, the average effective tax rate for millionaires is more than double the average effective rate for middle-income families.

The problem with New York's state and local tax structure is not that the wealthy are under-taxed, but that middle-class residents are badly over-taxed by national standards. But the right policy goal is to reduce tax rates on the middle, not increase them at the top.

While the state obviously can't afford a middle-class tax cut now, it can take a long-overdue step in that direction by immediately "indexing" its income tax brackets and exemptions to inflation, as the federal government does. This would have no fiscal impact in 2009-10, since the Consumer Price Index is now near zero, but will protect middle-class New Yorkers against "bracket creep" tax hikes when inflation inevitably rises again.

New York's high-income taxpayers tend to be its economic decision-makers, business owners and employers. They also are most capable of picking up and moving in response to punitive tax increases. Moreover, a definition of "wealthy" that dips down to $250,000, as some in Albany reportedly are now proposing, is not far beyond the outer bounds of "middle class" by downstate standards.

Some point to recent history as evidence an income tax hike would be harmless. After all, they say, the state temporarily raised income taxes in 2003 (on incomes as low as $150,000), yet the state's economy rebounded and high-income payers allegedly didn't "desert" New York over the next three years. But proponents of this argument fail to note those tax hikes took effect the same day as much larger federal tax cuts. At that point, the economy and the stock market were already poised for recovery. While the higher tax rates were in effect, Internal Revenue Service data show, the growth in high-income taxpayers was lower in New York than in 48 other states — a sure sign that many affected taxpayers did, indeed, find greener pastures elsewhere.

Economic conditions in New York now are far worse than they were at this time in 2003. While the federal stimulus package includes targeted individual and business tax cuts, massive federal tax increases are just over the horizon, aiming at the same wealthy households as Albany's "fairness" campaign.

The bottom line is that state can't tax its way back to prosperity. Reducing the size and cost of government will do far less damage in the long run than making New York even less competitive as a place to live, work and do business.

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This is the second of two commentaries on whether state income taxes should be raised on the wealthiest New Yorkers. The first article, which appeared Jan, 27, was written by James Parrott, deputy director and chief economist of the Fiscal Policy Institute.

What the wealthiest pay

Opponents of a higher income tax on New York's wealthiest say they already pay a big enough share of total state taxes.

1995 27%
1996 30%
1997 34%
1998 35%
1999 36%
2000 39%
2001 35%
2002 32%
2003 34%
2004 35%
2005 37%
2006 39%
2007 41%
2008 37%
2009 35%
2010 36%

1995-2006: Received
2007-2010: Projected

Source: NYS Budget Division