

Jamestown Post-Journal

"Millionaires Tax" is a Bad Idea

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February 10, 2009

Governor David Paterson is being pressured by some of his fellow Democrats to raise income taxes on the wealthiest households in response to New York States \$13 billion state budget gap.

Their view is typified by State Sen. Eric Schneiderman (D-Manhattan), who says higher state taxes on upper brackets are justified because "for the last 30 years we've been shifting the tax burden from the wealthy to middle-class families."

In fact, just the opposite is true.

The wealthiest 1 percent of New York taxpayers generated 41 percent of all state income taxes in 2007 - up from 26 percent in 1995, when the marginal tax rate was higher. Even with the steep economic downturn, the share of taxes paid by the wealthiest New Yorkers this year will be higher than it was in the mid-1990s.

And that's just the problem.

New York's growing dependence on high-income taxpayers - a form of fiscal addiction, really - is a major reason why we're in a deeper fiscal hole than any state except California (which is similarly dependent on taxes paid by wealthy households).

When investment banks were inflating their bonus bubbles in recent years, state lawmakers spent as if the Wall Street boom would never end. They kept right on spending even as the subprime mortgage debacle began to unfold in 2007 - and approved yet another big budget increase just a few weeks after Bear Stearns, one of New York's largest and oldest investment firms, collapsed last March.

It's no coincidence that the loudest chants for a tax on "the wealthy" - defined, in one proposal, as starting at \$250,000 - come from a coalition of public employee unions and health care providers who've been the chief beneficiaries of Albany's largess.

Their motives are obvious: Even in the teeth of an economic and fiscal crisis, the unions don't want to give up their scheduled pay and benefit increases, and the health-care industry doesn't want to see the nation's biggest Medicaid program cut down to more affordable size. So they hide behind the "fairness" banner to promote a massive tax hike aimed squarely at New York's economic decision-makers at a time of tremendous economic uncertainty, when the industry that was the source of one-fifth of the states tax receipts has effectively wrecked itself beyond repair.

Tax-hike advocates point to the state's record of temporarily increasing income taxes in 2003 as evidence that it's safe to raise taxes again. As Assembly Speaker Sheldon Silver put it last week: "We've done it before. There hasn't been a catastrophe."

But if the impact of New York's last tax hike was muted, it was only through sheer dumb luck. The temporary rates enacted in 2003 took effect at precisely the same time as much larger federal tax cuts, and a strong national economic recovery and bull market began sooner than anyone had predicted.

But we could and should have done better. During the three years the temporary rates were in effect, private sector job growth in New York was far below the national average and, according to the Internal Revenue Service, only one state experienced slower growth in the number of higher-income households filing federal tax returns.

Obviously, the economy is in far worse shape now than it was at this time in 2003. Within the next two years, federal law will require massive tax increases that will tap New York's own dwindling well of private capital.

The upstate economy, which was weaker to begin with, is even more vulnerable to the negative effects of higher income tax rates. This is the very worst time to give anyone a disincentive to work, save and invest in New York State.

New York's real problem is not that its taxes on the wealthy are too low but that taxes on the middle class are too high. While the state can't afford a middle class [tax cut] right now, it should act immediately to link income tax brackets, exemptions and deductions to the consumer price index. This would have no budgetary cost, because inflation at the moment is near zero, but it would protect millions of families from unlegislated tax increases in the form of bracket creep if inflation surges again which many economists consider inevitable. Further protection for taxpayers would come from enacting the school property tax cap proposed by Governor David Paterson last year.

Back in the late 1970s, New York's top-bracket income tax rates were more than twice as high as they are now. Subsequent rate cuts under Governors Hugh Carey, Mario Cuomo and George Pataki reflected a bipartisan consensus that high income taxes had nearly destroyed New York's economy. Must we learn the same lesson all over again?

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