Civic Report

No. 15 October 2000

Campaign 2000 Tax Proposals: What They Mean for New Yorkers

Edmund J. McMahon, Jr.
Senior Fellow
The Manhattan Institute for Policy Research

CENTER FOR CIVIC INNOVATION
AT THE MANHATTAN INSTITUTE

Table of Contents

Campaign 2000 Tax Proposals: What They Mean for New Yorkers

Introduction

Tax cuts emerged as a major issue early in the 2000 Presidential campaign, with George W. Bush and Al Gore each emphasizing the savings he would deliver to middle-class taxpayers. Tax policy is also a sharp point of contention in New York's Senate race, where Rick Lazio and Hillary Clinton have sparred over whether large scale tax relief is either desirable or affordable.

This is an especially important question for New York State, which bears a disproportionately heavy share of the nation's income tax burden. New York remains second only to California in federal income tax payments, in both absolute and relative terms, even though it has lost population, jobs, businesses, and political influence to other, faster-growing states over the past two decades. New York State's 18 million residents generate more federal income tax revenue than 19 million Texans; in fact, New Yorkers pay more income taxes than residents of Ohio and Pennsylvania *combined*. The Empire State's heavy federal income tax burden—23 percent above the national per-capita average—contributes to its persistent imbalance of payments with the federal government.[1]

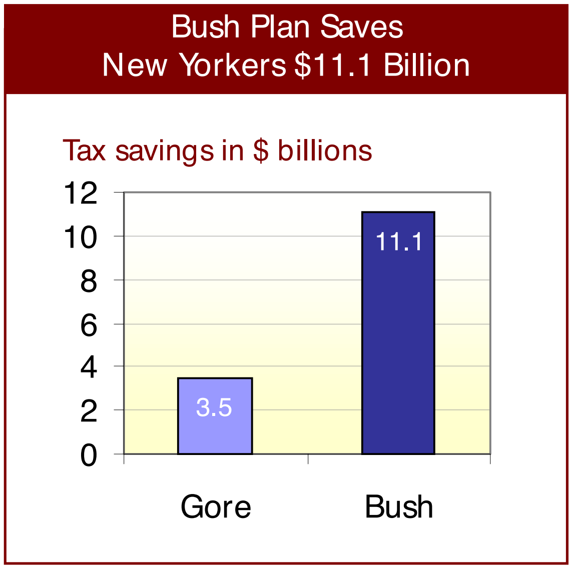
New York families, in particular, have a great deal at stake in the tax cut competition. Many of them earn more than the national family median income—at least 50 percent more in New York City's suburban counties—but that does not mean they are living any better. In addition to their high federal tax burden, New Yorkers bear one of the highest combined state and local tax burdens in the country.[2] Factor in the cost of living, and it's easy to see why New York's middle class, particularly in the City and its suburbs, feels just as squeezed as families in other states.

The candidates do not simply differ in the details of their plans: they offer totally different philosophies on how best to cut taxes. Governor Bush's plan relies on cutting tax rates for every taxpayer. In contrast, the Vice President opposes across-the-board rate cuts because they drive benefits to "the wealthy." Instead, he and and Mrs. Clinton both offer low- and middle-class families a series of targeted tax credits, which can be claimed only by families that behave in certain ways and have incomes below specified levels.

Which approach—cutting tax rates or providing income-targeted tax credits—would give more tax relief to New York State as a whole? And which is better for the individuals and families that work, live and pay taxes in New York?

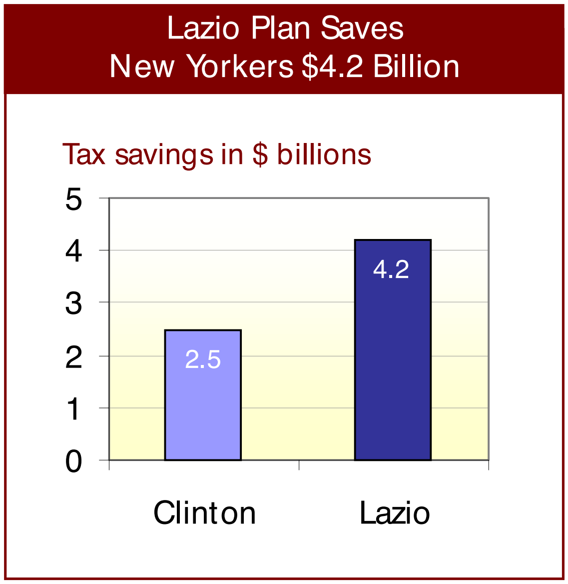
SUMMARY OF RESULTS

Gore v. Bush



Compared to current law, Bush's plan would provide over three times more aggregate tax relief to the state than does Gore's—$11.1 billion to $3.5 billion. Bush's plan delivers so much because New York residents earn more on average than people in other states, and because more taxpayers benefit from his across-the-board approach. Indeed, while all New York taxpayers would get at least a rate cut under Bush's plan, fewer than half would immediately qualify for one of the Gore-proposed tax credits—unless they opt into his retirement savings program.

Gore's plan, by relying on targeted tax credits whose value diminishes dramatically as family income rises, is biased against New York and other high-income states. Under Gore's proposal, millions of New Yorkers who qualify as middle class by regional standards are implicitly consigned to the realm of "the wealthy," and thus provided with much less tax relief than under Bush's plan, even when one makes assumptions about income levels and family circumstances highly favorable to the Vice President's specific proposals.



Clinton v. Lazio

Lazio's tax cut plan also reduces taxes for the state by a larger amount than do Mrs. Clinton's targeted proposals—$4.2 billion to $2.5 billion. This is because his plan permits most taxpayers to deduct Social Security taxes from their federal income tax bills and provides more generous relief from the marriage penalty—the quirk in the tax code that results in many spouses paying more as a unit than they would if they were single.

Middle-class taxpayers will also fare better under Lazio's plan than under Clinton's, although they will receive less tax relief than under Governor Bush's plan. Lazio's plan is particularly beneficial to families earning the median income or above in New York City's suburbs.

Methodology

These conclusions are based on a model we developed of the state's federal income tax base, augmented by other tax and demographic data relating to New York taxpayers. To illustrate the impacts of these proposals on New York as simply and fairly as possible, we applied each set of proposed individual income tax cuts to the state's 2000 tax base *as if effective immediately*, and compared the resulting tax liabilities to current tax law. Further information on our data sources and methodology can be found in Appendix B.

Analysis of the Tax Cut Proposals

Bush and Gore: Statewide Impact

This year's campaign debate over tax cuts has focused less on specifics than on 10-year projected national budgetary impacts—$1.3 trillion for Governor Bush and slightly under $500 billion for Vice President Gore, according to their respective campaign estimates.

But size isn't the only thing that separates the competing proposals. The income tax cuts advocated by Vice President Gore are structurally very different from the cuts proposed by Governor Bush, reflecting some fundamental philosophical differences over tax policy.

After studying the competing tax proposals, we found that their impact on New York State residents will differ far more than is apparent from the grossed-up, 10-year cost estimates that are commonly used to describe them.

Here is a summary of each tax cut proposal, along with our estimate of the proposal's total impact on New York State:

BUSH TAX CUTS: SUMMARY AND IMPACT [3]

- Allow a two-earner couple to deduct 10 percent, or up to $3,000, of the lower-earning spouse's income;
- Increase child credit from $500 to $1,000, and expand the starting point of the income phase-out range for credit from $110,000 to $200,000 for married couples, and from $75,000 to $200,000 for single parents; and
- Reduce marginal tax rates for taxpayers in every income bracket. (A comparison of the tax rates and brackets under current law and the Bush plan can be found in Appendix C.)

If effective immediately, **the Bush plan would save New Yorkers $11.1 billion,** including:

- $8.79 billion from rate reductions;
- $1.62 billion from the increase in the child credit; and
- $684 million from the dual-earner deduction.

GORE TAX CUTS: SUMMARY AND IMPACT [4]

- Education Opportunity Tax Credit—Expand the existing credit to 28 percent of college tuition expenses up to $10,000 and give taxpayers the alternative of claiming a deduction that would generate the same net savings as a credit; raise the maximum income eligibility from $100,000 to $120,000;
- Child and Dependent Care Credit—Expand existing credit from 30 percent to 50 percent of expenses up to $2,400, phasing down to a maximum of 20 percent for joint filers earning $60,000 or more; make the credit refundable; create a new nonrefundable credit for children under the age of one who are cared for at home;
- Earned Income Tax Credit—Increase the maximum refundable credit to 45% of earnings for families with three or more children and raise the maximum income eligibility level to a maximum of $35,636 for single-earner couples and $37,086 for two-earner couples, depending on family size;
- Long-Term Care Credit—Allow a $3,000 refundable credit to taxpayers who care for disabled relatives;
- Marriage Penalty Relief—Increase the standard deduction for all married couples, now $7,350, to $8,800 in current terms, which is twice the level of the standard deduction for single taxpayers. No marriage penalty relief is provided for families who itemize their deductions; and
- Retirement Savings Plus (RSP)—A new program under which the federal government would provide a tax credit geared to the size of a taxpayer's annual deposit in a private, long-term savings account modeled on existing Individual Retirement Accounts (IRAs). Under the RSP, the government would give $3 for every $1 saved to married taxpayers filing jointly with incomes up to $30,000; $1 for every $1 saved for couples with incomes between $30,000 and $60,000; and 33 cents for every $1 saved for couples with incomes between $60,000 and $100,000. The income cutoffs would be half the married-joint amounts for single taxpayers and 75 percent of the married-joint level for heads of households. The total amount deposited in any individual account would be limited to $2,000 a year.

If effective immediately, **the Gore plan would save New Yorkers $3.5 billion,** including:

- $2.480 billion from Retirement Savings Plus (assuming, as the Gore campaign reportedly does, that an average of one-half of eligible taxpayers claim the maximum credit);
- $244 million from the Long-Term Care Credit;
- $226 million from the College Opportunity Credit;
- $210 million from the increases in the standard deduction;
- $166 million from the Child and Dependent Care Credit; and
- $158 million from the expansion of the Earned Income Tax Credit.

Bush and Gore: How Their Plans Affect Middle-Class New Yorkers

Most national assessments of the impact of the Bush and Gore tax plans have discussed their relative impacts on "middle-class families." While this phrase appears to many to encompass a certain class of families, what constitutes a "middle-class family" in fact varies enormously across the United States.

A good way to understand this is to look at how the median family income, that is, that income at which exactly 50% of all families earn more and 50% earn less, varies among urban areas. A median-income family of four in the Little Rock, Arkansas, metropolitan area would earn $47,100, while that same family in the San Jose, California metro area earns $87,000.[5]

Median-income families in New York State, especially in New York City and its suburbs, earn more than do median income families in the country as a whole. Consider these facts:

- The national median income for a family of four is $50,200;
- The same figure for New York State: $56,100;
- For New York City, the median family earns $56,200; and
- And in Westchester County, that same family earns $83,100.

Reflecting these differences, a recent article in *The New York Times* could quote a retired high school athletic coach in Nassau County as complaining that "he and his wife were barely making ends meet on a retirement income of $60,000 to $70,000."[6]

Jaws would probably drop at that statement among senior citizens living in most other parts of the country. Two senior citizens have trouble making ends meet—on $60,000 or $70,000 a year?

Given living costs on Long Island, however, the retired coach's plight is very real.

It takes more money—a lot more—to support a middle-class lifestyle in the City or one of its downstate suburbs. The cost of living in the Nassau-Suffolk region is 142 percent of the nationwide average; New York City's is 225 percent of the average.[7] As of mid-2000, the median home selling price in New York's downstate suburban counties ranged between $200,000 and $300,000—except in Westchester, where it topped $400,000—compared to a national median of just over $140,000.

Indeed, New York City officials have defined the core "middle class" as including any family of four making $112,000.[8]

Individually or in combination with their spouses, some 1.25 million New York State residents will earn over $100,000 or more of adjusted gross income (AGI) this year. This group includes nearly one out of every five married couples in the state. Roughly two-thirds live in New York City and neighboring suburban counties; the rest are concentrated in suburbs of the major upstate urban areas.

This is New York's six-figure middle class—suburban homeowners, mostly, but also many apartment dwellers and homeowners in New York City, whose relatively high incomes are consumed by the high costs of living in one of the most expensive regions in the country.

The higher median income levels in downstate New York need to be carefully considered in any analysis of how the candidates' tax plans affect the state's "middle class." From a New York State perspective, the acid test of any proposed federal income-tax cut is whether it is broad enough to take account of a wide range of middle-class families—Long Island families earning $100,000 as well as Jamestown families earning $50,000.

One example of how a New York perspective can affect the overall analysis can be found in the Vice President's approach to marriage penalty relief, which consists of increasing the standard deduction for married couples to double the amount for single taxpayers. Due to their higher mortgage interest and state and local taxes, more New York families choose to itemize their deductions than in the nation as a whole. Even in the $35,000 to $50,000 income range, nearly half of all New York couples itemize; for those earning between $50,000 and $75,000, the number of itemizers jumps to three-quarters of taxpayers, according to the most recent IRS data. Since the Vice President provides no marriage penalty relief for itemizers, most truly middle-class families get no benefit from this provision.

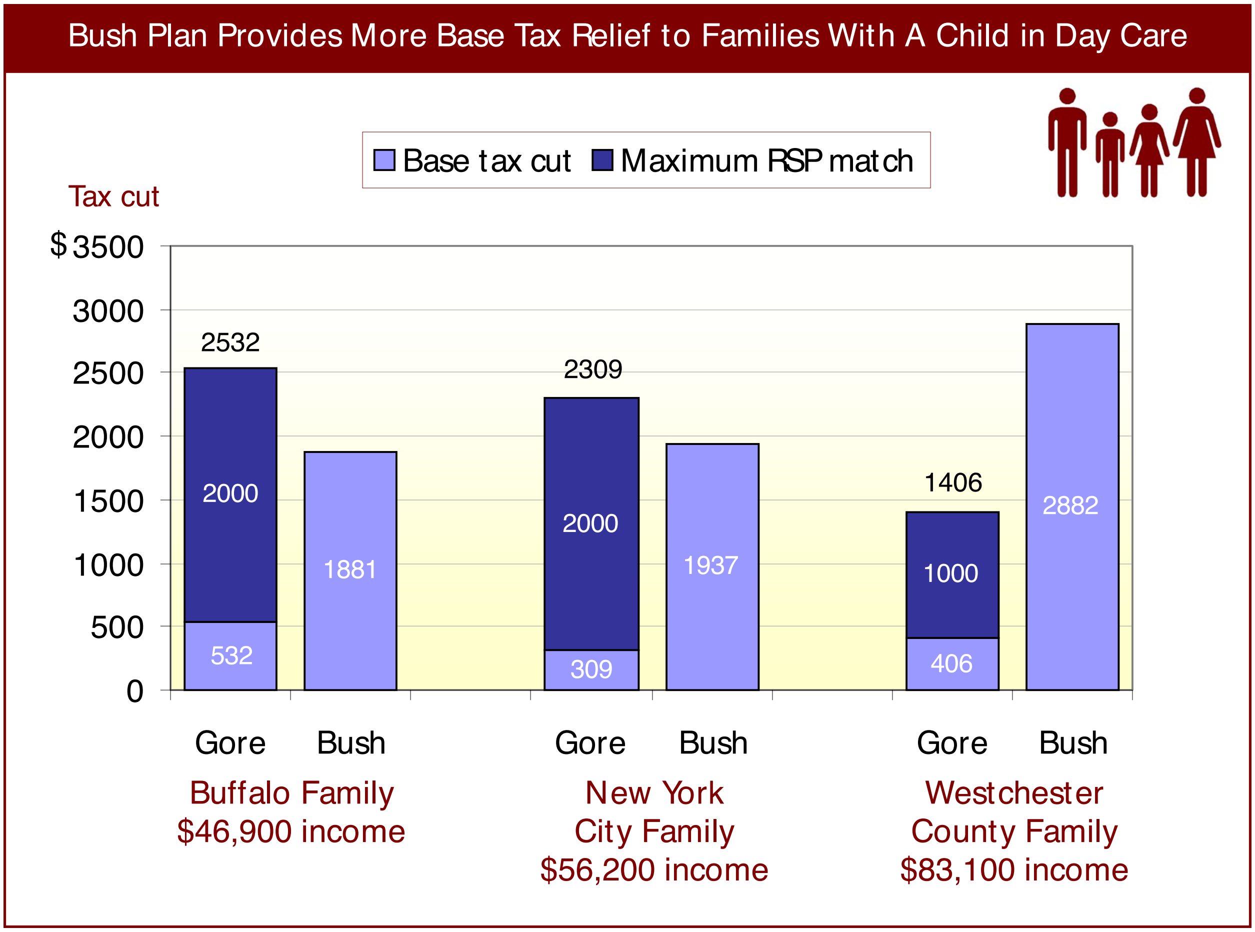
The income cutoffs and phase-outs for the Vice President's tax credits also tilt against New Yorkers. For married couples, the Gore plan treats $60,000 as something of a dividing line: Above that income, there's no increase in the child care credit, and his proposed retirement savings tax credit drops from 100 percent to 33 percent. But $60,000 is *below* the median family income for New York City suburbs, and only slightly above the median for the City and State as a whole.

In the comparative assessments that follow, we put Gore's proposals in the most favorable light by only modeling families with certain circumstances and behavior—such as children in day care, retirement savings, and college tuition expenses—that are targeted for special treatment under the Vice President's tax cut plan. This approach compares apples to apples and permits for an honest comparison of the two plans' relative benefits. For those interested in a more somewhat comprehensive review of the effects of the two plans on families and individual taxpayers, we have provided detailed tables containing these breakdowns in Appendix D.

Effects on Middle-Class Families With A Child in Day Care

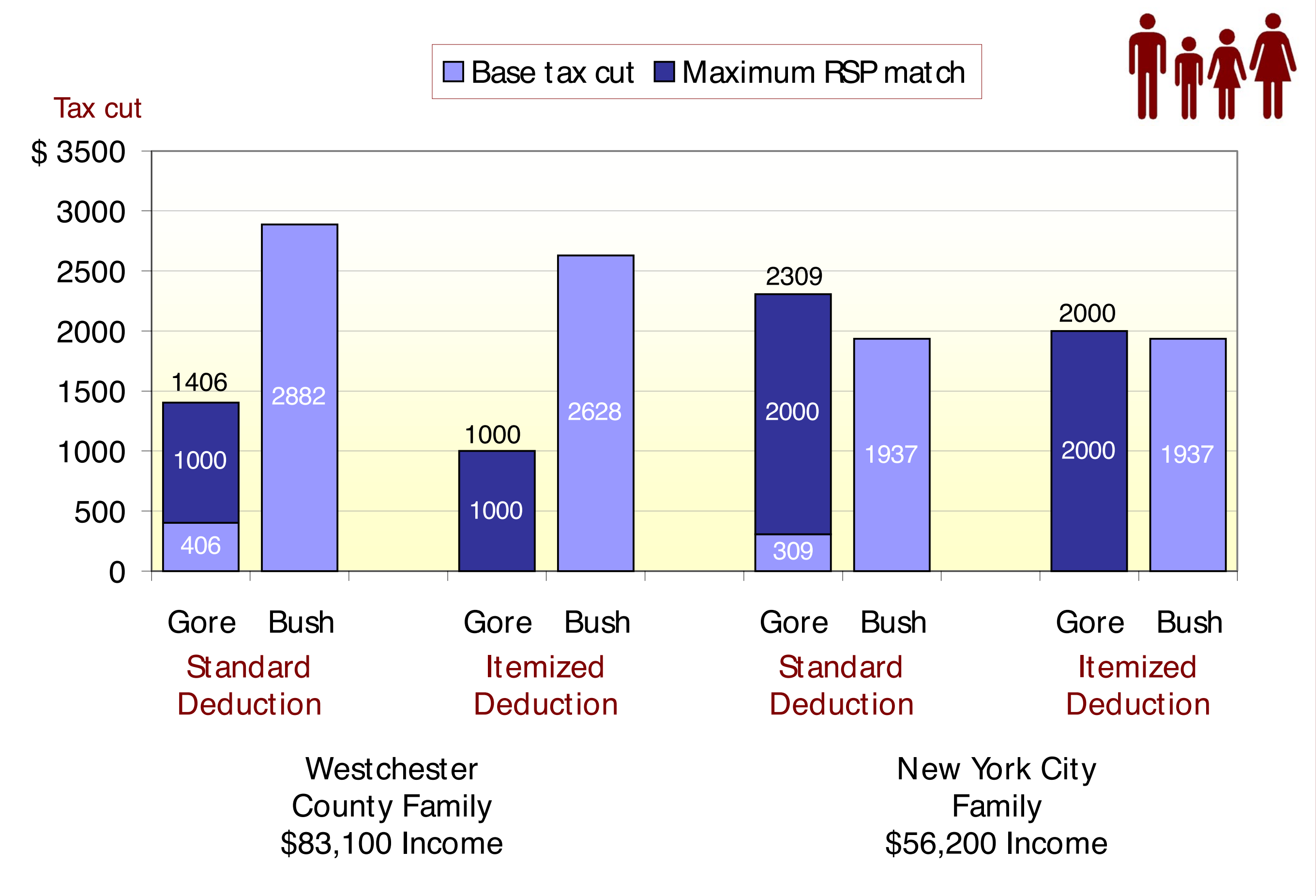
The Vice President's plan focuses on the needs of families with young children by providing enhanced tax credits for children in day care. Despite this emphasis, Governor Bush's tax plan provides substantially more tax relief to all but the poorest working families—*unless* they are able to save substantial amounts for retirement through Gore's proposed RSP program.

To illustrate, we looked at how the tax plans would affect two-earner families earning the median income for three areas in the state: Buffalo, New York City and Westchester County. In each case, our model family has two children, one of whom is in day care, and takes only the standard deduction. We also assume that the lower earning spouse earns 40% of the family's total income and that the family saves the same amount for retirement under the Bush and Gore plans.



As the graph above shows, the Bush plan provides much more base tax relief for every family. Core middle-income families do better under Gore's plan *only* if they can save a lot of money in an RSP account. And because Gore's RSP plan only provides a 33% match for contribution from families earning more than $60,000, the Westchester family gets twice as much tax relief under Bush's plan, even with the maximum RSP match.

Itemizers Get Less Under Gore Plan



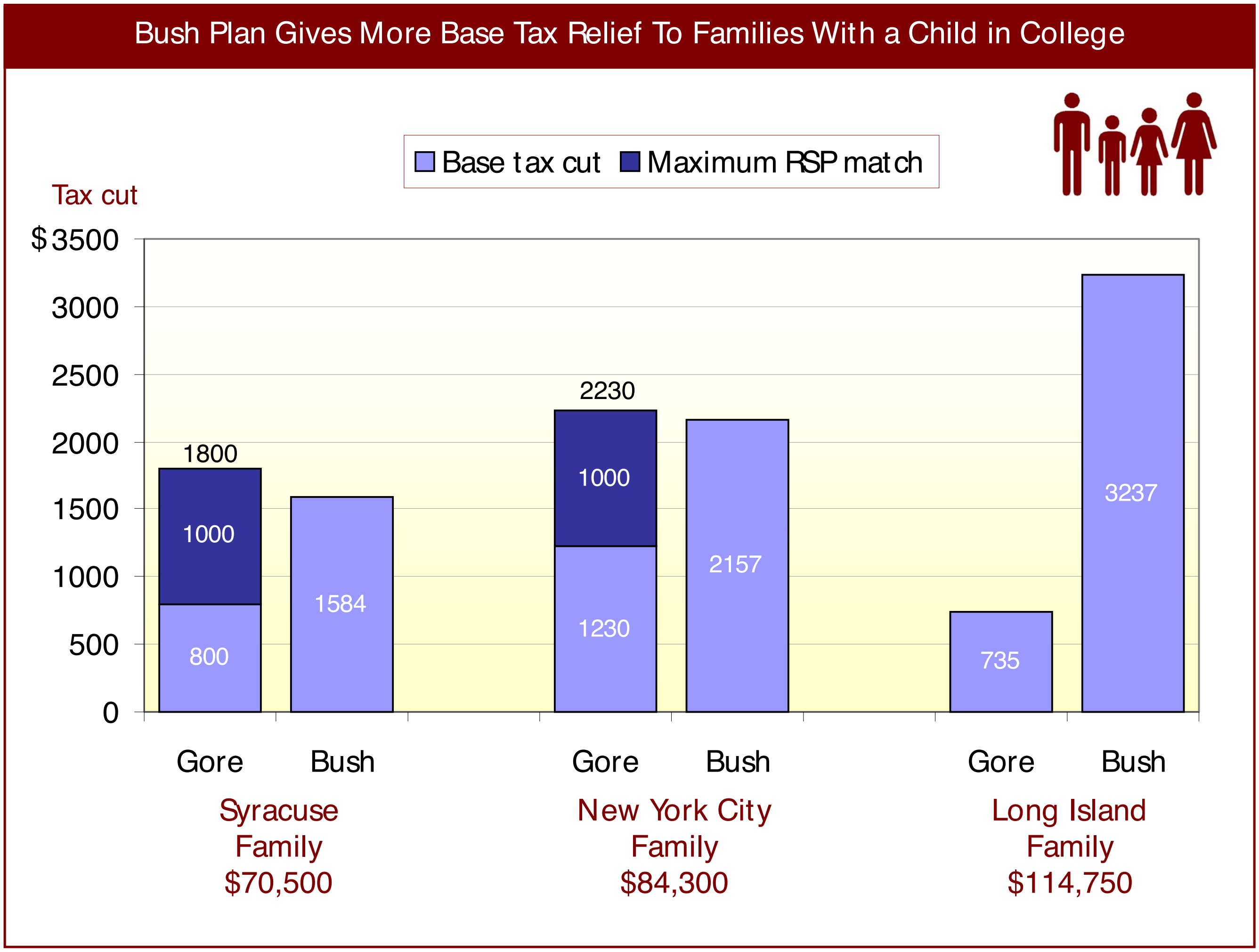
The Vice President's plan fares even worse if we assume that these families itemize their deduction, as most New York home and apartment owners do at these income levels. Because Gore's plan provides no marriage-penalty relief for itemizers, they receive hundreds of dollars less from Gore's plan simply because they pay New York State's high property and income taxes.

Effects on Middle-Class Families With A Child in College

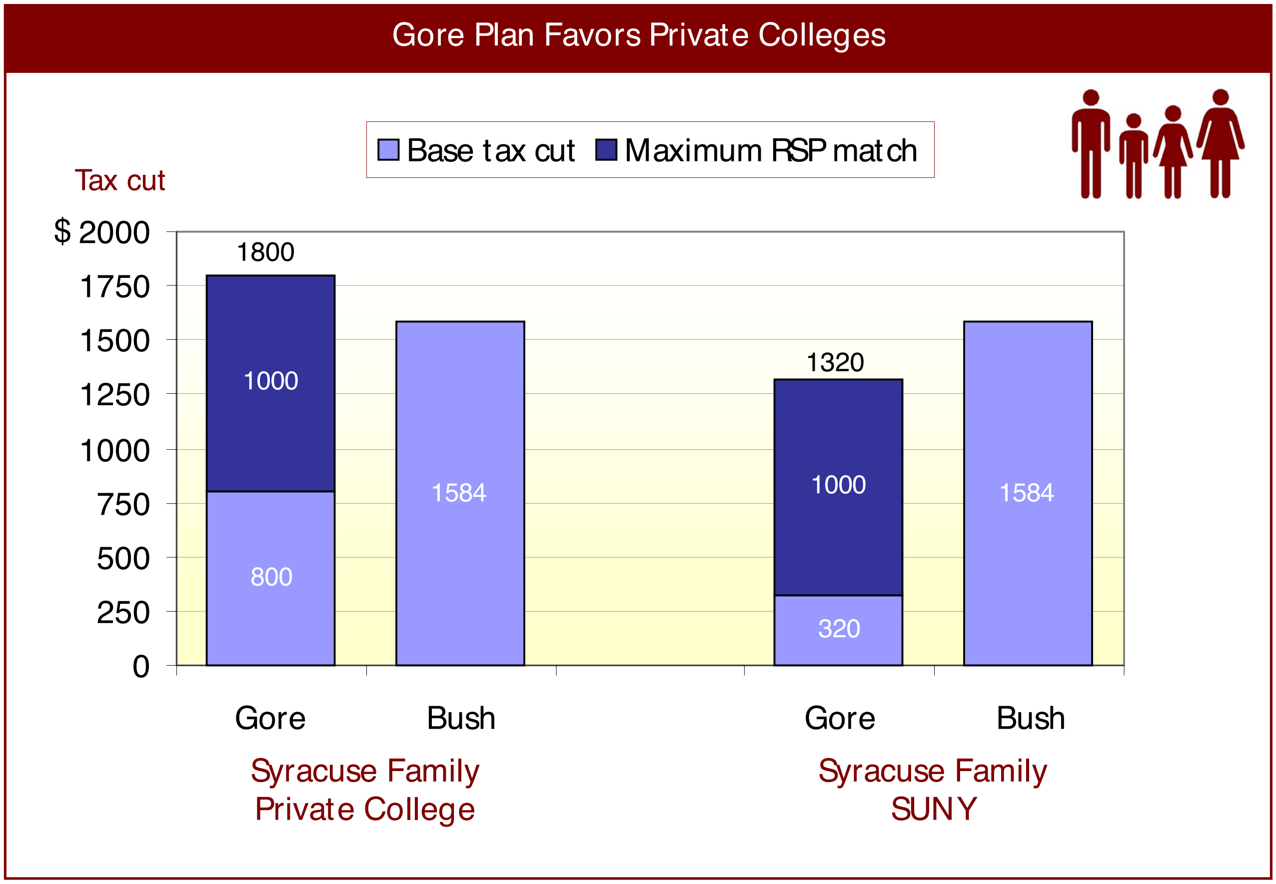
The Gore tax plan also gives special treatment to families with children in college. However, because his college credit is based on actual tuition expenses, it provides more tax relief to families with children in expensive private colleges than to those that send their children to the much less expensive SUNY and CUNY systems.

We looked at how the tax plans would affect two-earner families with dependents in private colleges and incomes of 150% of the median for three areas in the state: Syracuse, New York City and Long Island.[9]

In each case, the family has two children, one aged 19 and enrolled in college and the other aged 15 and attending public high school, and the family itemizes their deductions. To maximize the benefits of the Gore plan, we also assumed that these families would still be able to save enough for their retirement to receive the maximum allowable RSP benefit.

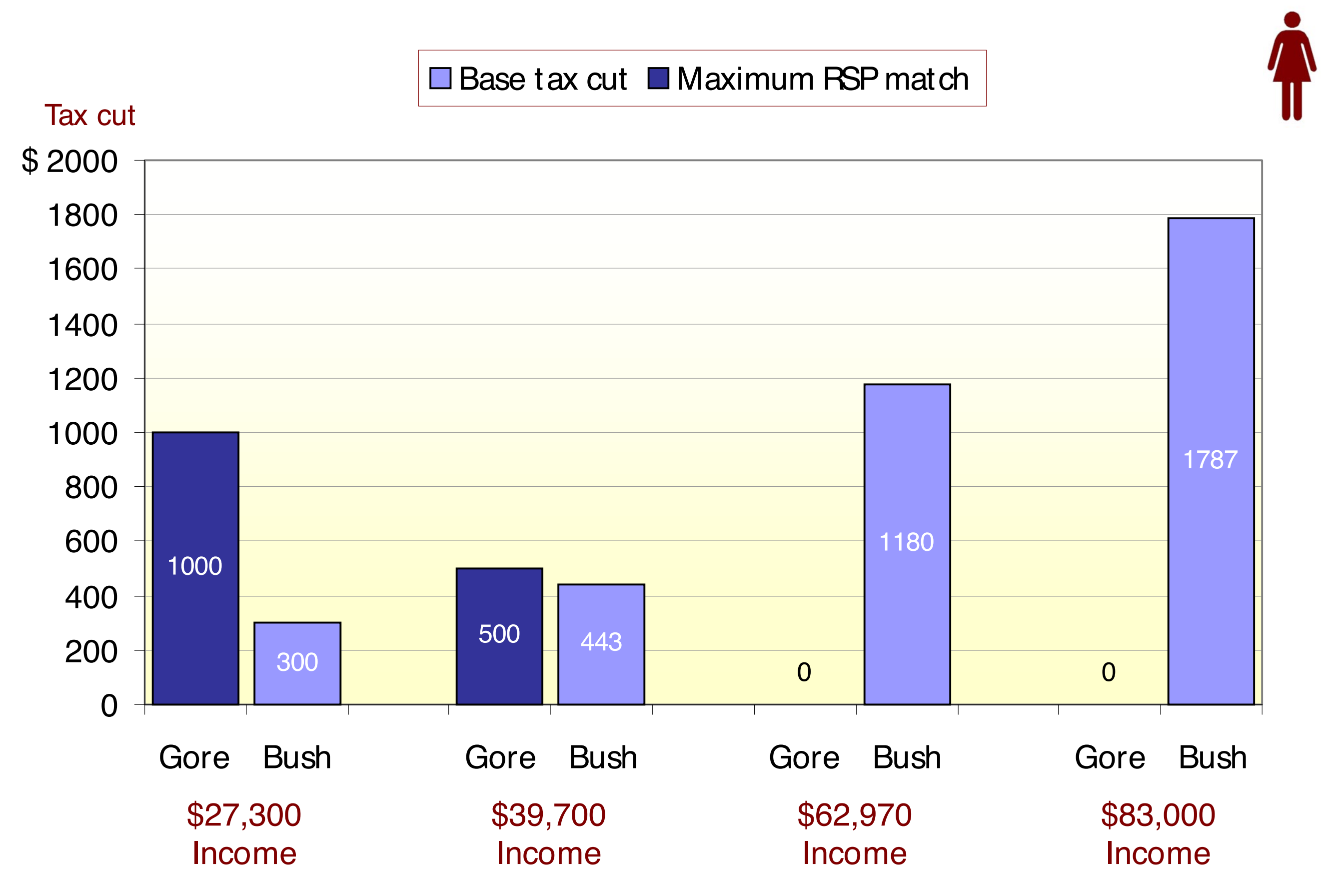


As the graph above shows, Governor Bush's plan provides about twice as much base tax relief to our first two families, while the Long Island family would receive almost five times as much tax relief—$3,237 to $735. The Syracuse and New York City families do roughly as well under Gore's plan only if they can save nearly $3,000 in an RSP account while paying private college tuition. Only families earning under $60,000 a year that can afford to pay private college tuition *and* simultaneously set aside thousands of dollars a year toward retirement in the RSP program would receive significantly greater benefits from the Gore plan.



Families that send their children to public colleges would be better off under the Bush tax plan. Comparing the same Syracuse couple analyzed above, we find that they would receive about $480 *less* in tax relief from Vice President Gore if they just send their child to a SUNY campus rather than a private college.

Singles Who Do Not Save for Retirement Get No Tax Cut from Gore Plan



Effects on Single Taxpayers

Whether single taxpayers benefit more from the Gore or Bush tax plan is entirely dependent upon how much they earn and how much they can save in an RSP account. Relatively low-income singles who save nothing will receive no tax cut from Gore and a small tax cut from Bush. Those low-income singles who can save for retirement will benefit more from Gore's plan, while those who cannot save benefit more from Bush's. Singles earning over $50,000 a year will benefit substantially from Bush's rate cuts and receive *no* tax cut from Gore because they are no longer eligible for any RSP match.[10]

Lazio and Clinton: Statewide Impact

There also are important and significant differences between the tax plans offered by New York's two major-party candidates for U.S. Senate. Here is a summary of each tax cut proposal, along with our estimate of its total impact on New York State:

LAZIO TAX CUTS: SUMMARY AND IMPACT [11]

- Permit the 6.2 percent Social Security tax, which now applies to wages and salaries up to $76,200, to be deductible for all taxpayers in 15 percent and 28 percent brackets. (The 28 percent bracket currently ends at taxable incomes of $105,950 for married couples.);
- Repeal an added tax on up to 85 percent of Social Security benefits for senior citizens with incomes over $44,000; and
- Eliminate the marriage penalty by increasing the standard deduction from $7,530 in current terms for married couples filing jointly to $8,800 in current terms, and expanding the 15 percent tax bracket from a top threshold of $43,850 to $52,500 (in current terms).

If effective immediately, **the Lazio plan would save New Yorkers $4.2 billion,** including:

- $2.36 billion from the payroll tax deduction;
- $1.2 billion from marriage-penalty relief provisions; and
- $667 million from the repeal of the added tax on Social Security benefits.

CLINTON TAX CUTS: SUMMARY AND IMPACT [12]

Mrs. Clinton's income tax cuts are nearly identical to the Vice President's, with three exceptions:

- She would increase the standard deduction to double the single deduction level only for dual-earner couples and increase the deduction by $500 for married, single-earner couples; she would also increase the standard deduction by $250 for single taxpayers and $350 for single parents;
- She has not endorsed the Vice President's Retirement Savings Plus (RSP) program; and
- Mrs. Clinton's supplemental retirement savings program, which she calls Retirement Savings Accounts (RSA), is the same as Gore's RSP program but with a maximum account size half as large—$1,000 per individual, compared to $2,000 under the Gore plan.

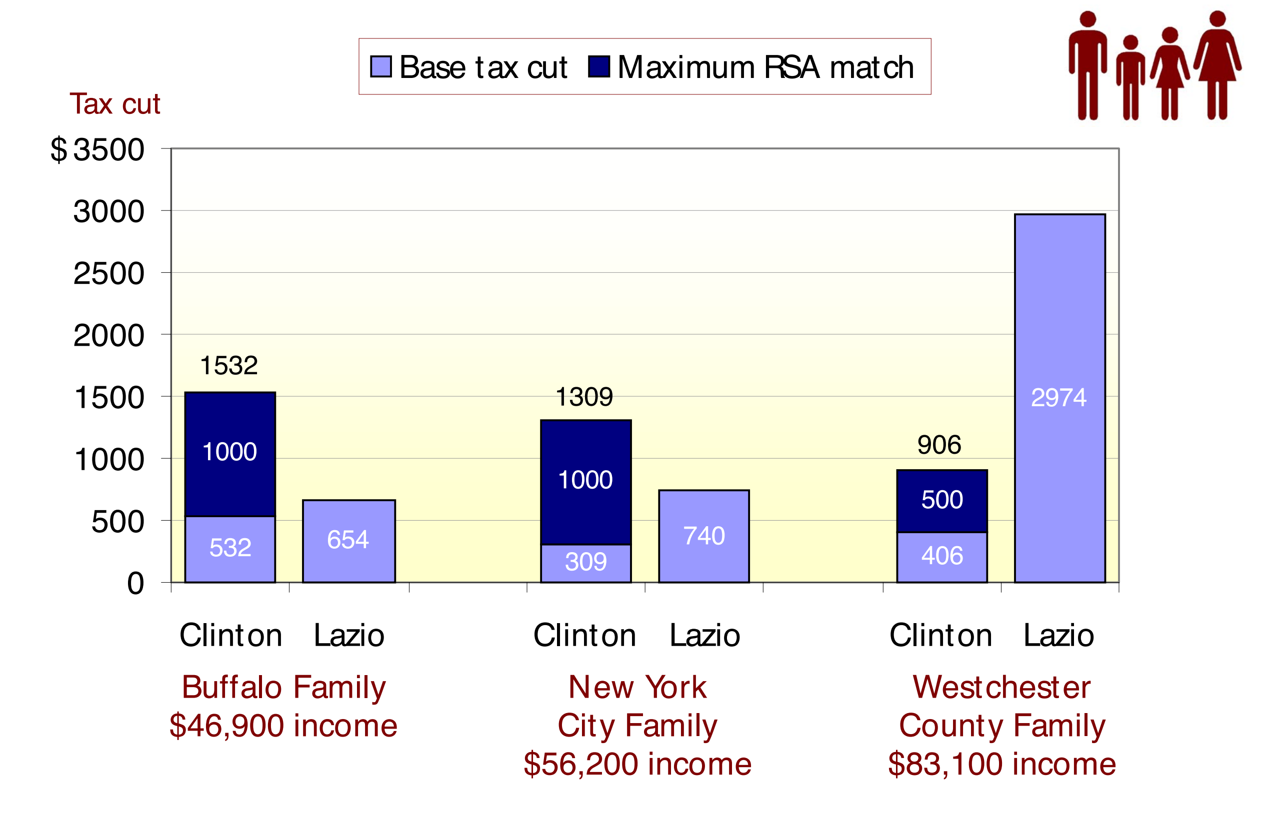
If effective immediately, **the Clinton plan would save New York $2.5 billion,** broken down as follows:

- $1.25 billion from Retirement Savings Accounts, reflecting the same participation rate assumed by the Vice President for his similar plan;
- $381 million from standard deduction increases;
- $244 million from the Long-Term Care Credit;
- $226 million from the College Opportunity Credit;
- $166 million from the Child and Dependent Care Credit; and
- $158 million from expansion of the Earned Income Tax Credit.

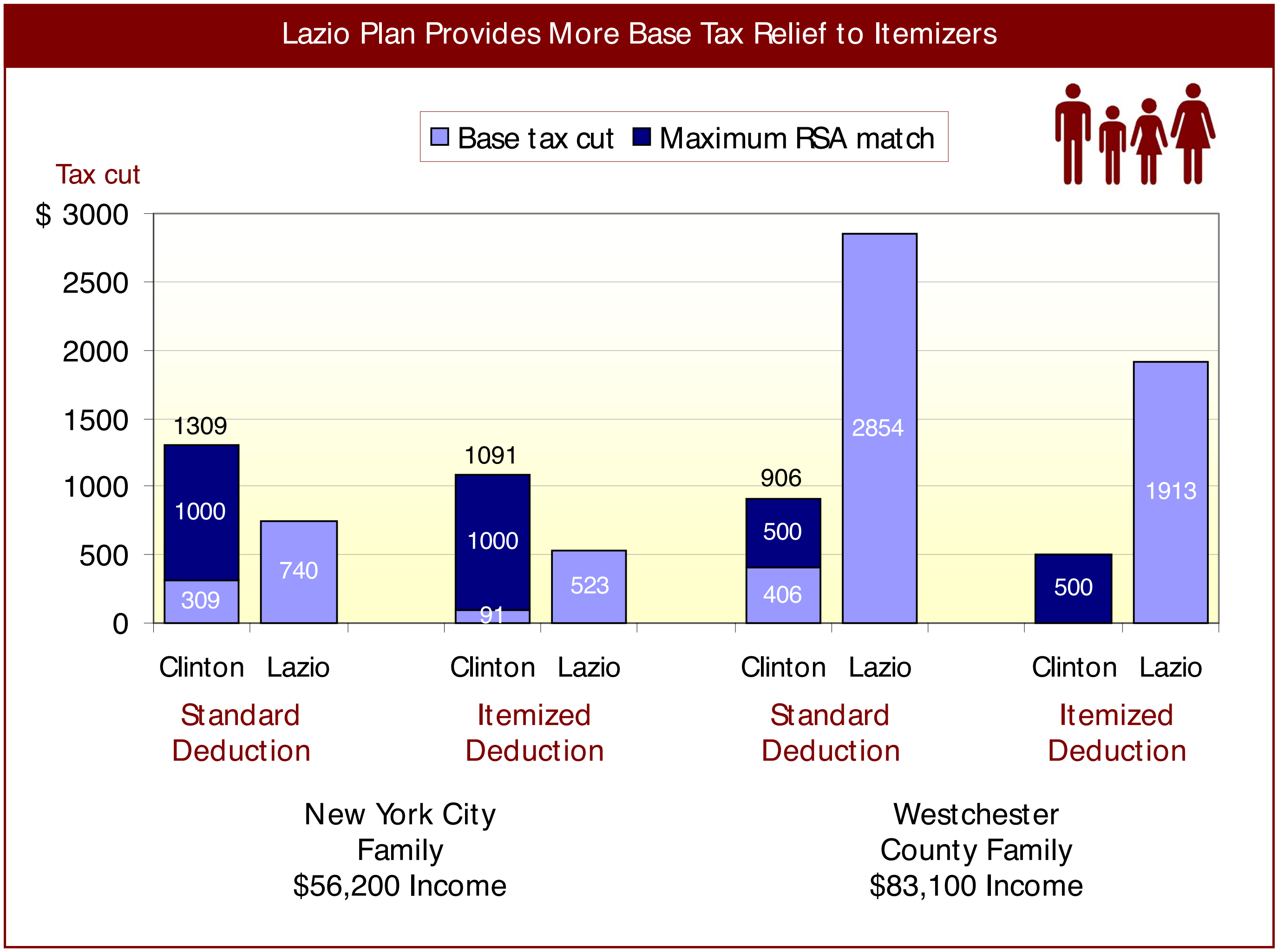
Lazio and Clinton: How Their Plans Affect Middle-Class New Yorkers

Effects on Middle-Class Families With A Child in Day Care

Families With A Child in Day Care Get More Base Tax Relief From Lazio Plan

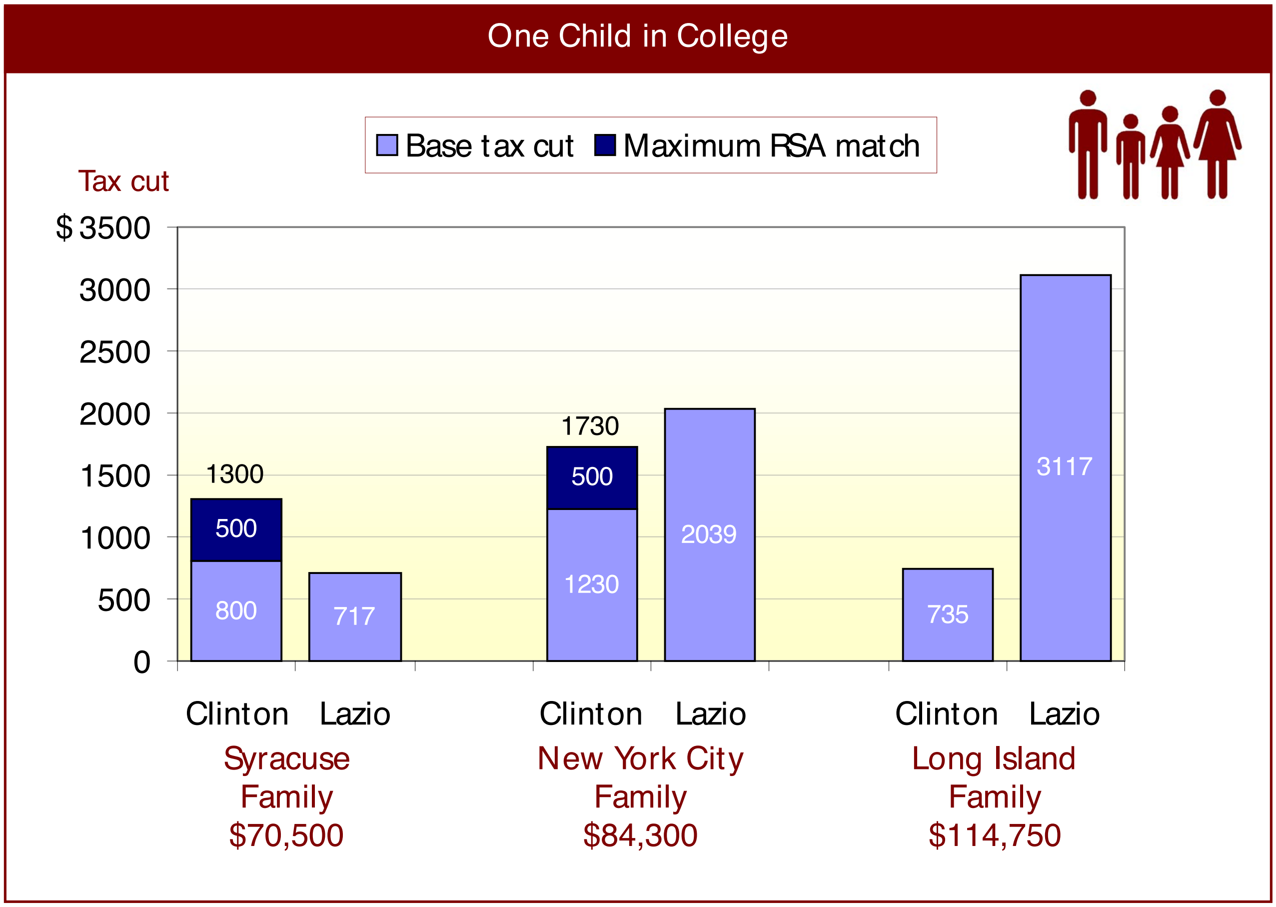


The effect of the two Senatorial candidates' plans on our three middle-class families with children is significantly different from the effect of the plans of the two Presidential candidates. Because Congressman Lazio does not call for across-the-board marginal rate reductions or increases in the existing child tax credit, as does Governor Bush, his plan provides only slightly more base relief to our lowest income family than does Mrs. Clinton's. However, as income rises, Congressman Lazio's tax cuts start to add up while hers remain relatively constant. Our other two families fare much better under Lazio's plan, particularly the Westchester family, which benefits from the Congressman's generous marriage-penalty relief, unless they set aside enough long-term savings to qualify for a matching retirement credit under Mrs. Clinton's plan.

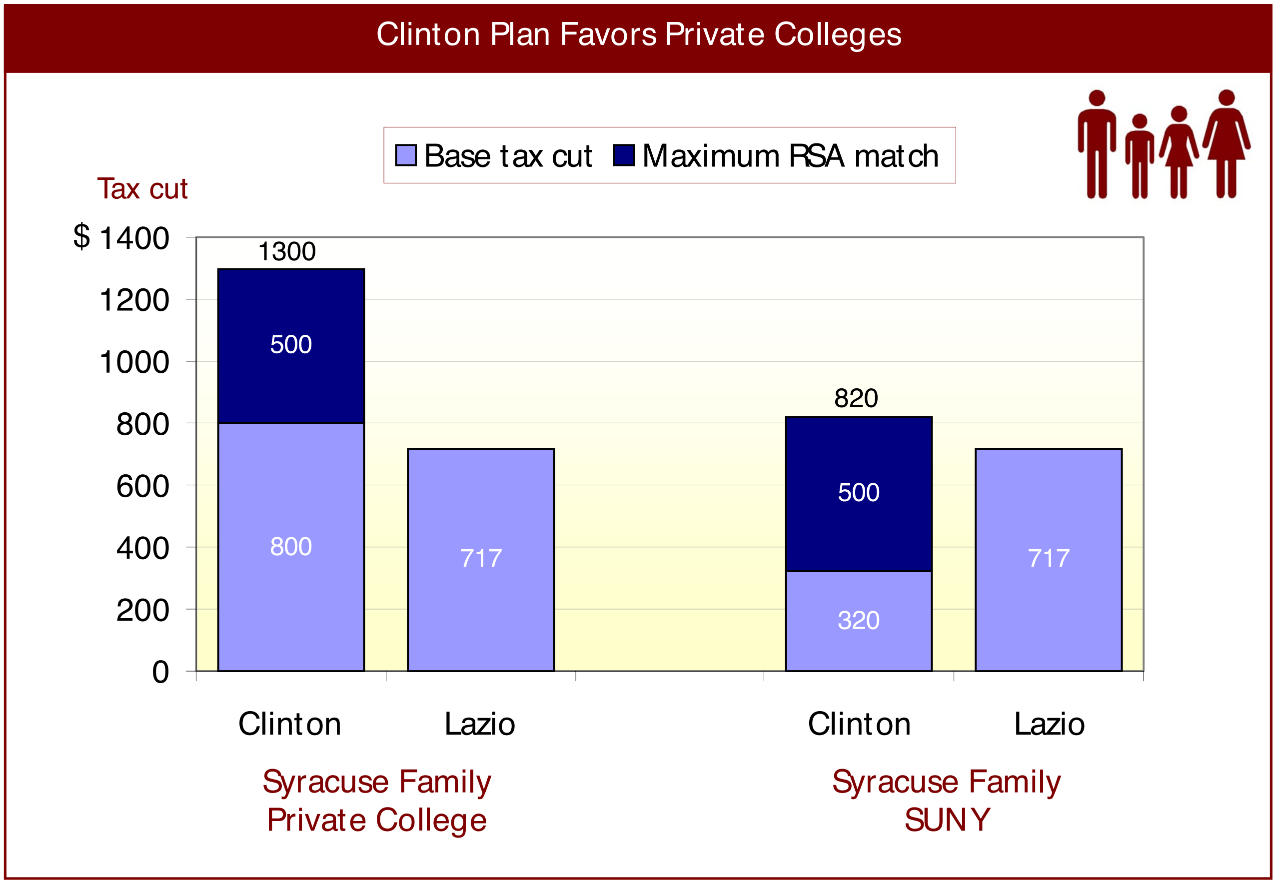


Mrs. Clinton's plan also suffers from the same bias against itemizing taxpayers as does the Vice President's. As the graph above demonstrates, her plan's lack of any marriage penalty relief for couples that itemize significantly reduces that family's prospective base tax relief, not including possible retirement credits.

Effects on Middle-Class Families With A Child in College

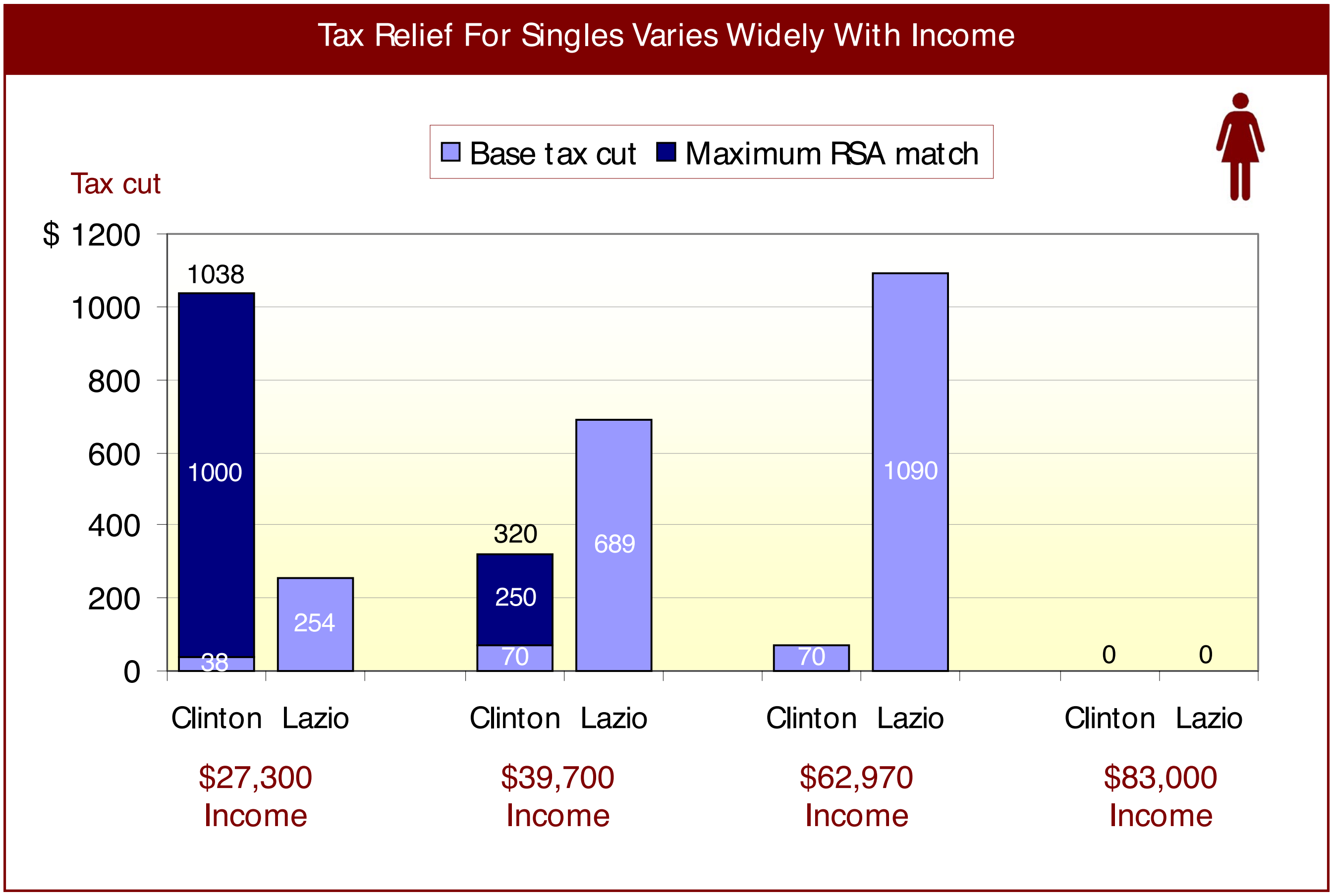


Mrs. Clinton's enhanced college tuition tax credit provides more base tax relief to our Syracuse family than does Lazio's deductibility of Social Security taxes. By saving $1,500 in a long-term account, this family also qualifies for a matching credit under Mrs. Clinton's plan. However, our Long Island and New York City families benefit from Lazio's marriage penalty repeal while the value of Mrs. Clinton's college tax credits declines as income increases. For these families, Lazio's plan provides more base tax relief than does Mrs. Clinton's.



Since her college tuition tax credit is identical to the Vice President's, Mrs. Clinton's plan also offers much less tax relief to families that send their children to a public university, unless they participate fully in her retirement savings program.

Effects on Single Taxpayers



Single taxpayers generally benefit much more from Lazio's plan than from Mrs. Clinton's even though neither plan has targeted its main features to these individuals. Mrs. Clinton offers singles a $250 increase in the standard deduction, worth $38 for those in the 15% tax bracket, plus a potential retirement savings credit that declines with income. Lazio's plan only helps singles by permitting deductibility of Social Security taxes, but even this small benefit is worth several hundred dollars to the average single taxpayer. However, since this benefit is no longer available to taxpayers in the 31% bracket, high-income singles receive no tax benefit from either Congressman Lazio or Mrs. Clinton. Of course, singles who choose to itemize their deductions would receive no base tax cut from Mrs. Clinton.

Conclusion

Our model demonstrates that New York State as a whole would be the beneficiary of a larger outright tax cut under Governor Bush's tax plan than under the plan of Vice President Gore. It also shows that Congressman Lazio, while offering much more modest tax cuts than Governor Bush, would cut taxes by much more than Mrs. Clinton. Just as important, our model also shows that an overwhelming majority of middle-class taxpayers in New York State would receive a larger tax cut from Governor Bush than from Vice President Gore, and from Congressman Lazio than from Mrs. Clinton.

Even for median-income New York families burdened by day care or college tuition expenses, the Governor's across-the-board cut would often deliver a bigger outright tax cut than the Vice President's targeted approach—and many would still get a bigger cut from the Bush plan even when the definition of "tax cut" is stretched to include Gore's proposed Retirement Savings Plus (RSP) accounts.

Indeed, our model also shows that Bush's plan would steer at least $3.5 billion to New Yorkers with incomes below $100,000. That represents about as much tax relief for core middle-income taxpayers as Gore's *entire* projected tax cut for New York State residents in *every* income category.

Congressman Lazio also offers many New York State and middle-income New York families a larger tax cut than does Mrs. Clinton. For a majority of middle-class taxpayers, his combination of broad marriage-penalty relief and payroll tax deductions will generate greater outright tax relief than Mrs. Clinton's cuts, even for those families that are carefully "targeted" to receive them.

None of the four plans will change the steep progressivity of the income-tax code, which ensures that the wealthiest New Yorkers will generate by far the largest share of tax. Taxpayers earning above $200,000 pay about 48 percent of the federal income taxes from New York; Bush's plan, if effective immediately, would not significantly change that. Lazio's plan would leave the wealthiest New Yorkers paying a slightly larger share.

The Gore and Clinton plans, by contrast, incorporate targets that are, by and large, too low and too narrow to benefit most New York middle-class families. The result will be to further increase the extent to which New York's taxpayers subsidize tax breaks for residents of lower-income states.

Given current budget surplus forecasts, reasonable people will continue to differ on the proper balance between spending increases, debt reduction and tax cuts in the years ahead. But as our analysis shows, whatever the size of the tax package, more New Yorkers are likely to derive greater benefits from broad-based tax cuts than from the targeted approach.

Appendix A:
The Income Tax and "The Fisc"

"A near quarter century of data analysis has pretty well established that New York's balance of payments deficits is structural… It is not the result of one administration, one party, one business cycle, whatever. In good times it only gets worse, owing to our high tax brackets which in measure reflect our high cost of living."

Senator Daniel Patrick Moynihan
In "The Federal Budget and the States"
Fiscal year 1998

As the state's then-junior U.S. Senator began documenting in detail nearly a quarter century ago, New York perennially sends billions of dollars more in taxes to the federal government than it gets back in the form of spending.

New York's "balance of payments deficit" with the federal government stood at $15 billion as of 1998, according to the latest version of Daniel Patrick Moynihan's annual study of the issue, now produced with the Taubman Center at Harvard University's John F. Kennedy School of Government.

The Empire State's gap, fourth largest in the nation, has gotten wider since Moynihan and his collaborators began assessing "the Fisc" on a consistent, 50-state basis in the early 1980s.

Real per-capita federal spending in New York actually increased by about 10 percent between 1983 and 1998—but federal taxes from New York grew almost twice as fast. Result: the state's balance of payments deficit nearly doubled.

Other comparative measures of income flows between the federal government and the states have consistently confirmed Moynihan's analysis. According to the most recent Tax Foundation estimate, the federal government spends 86 cents in New York for every dollar in taxes generated within the state.

A major explanation for this trend has been the increasing progressivity of the federal income tax—which accounts for over 40 percent of federal receipts, including most federal revenue in the non-Social Security, "on-budget" category.

Tracking the Trend

New York's share of the nation's population, employment and personal income all declined between 1978 and 1998. But its share of the federal income tax burden did not drop; after peaking at just over 9 percent in the late 1980s, it remained above 8 percent as of 1998. For much of this 20-year period, New York's share of personal income taxes exceeded its share of the nation's personal income (a trend explained only in part by occasional bursts in capital gains, which are not measured as part of personal income).

On a per-capita basis, New York's federal income tax burden was virtually equal to the national average in 1978; by 1998, it was 23 percent above average.

New York's relative tax burden grew considerably heavier with the enactment of President Reagan's historic tax cut, the Economic Recovery Tax Act (ERTA) of 1981. The resulting increase in tax receipts from New York was part of what the Congressional Budget Office later called "a very significant revenue response among taxpayers at the very highest income levels" to the reduction of the top rate from 70 percent to 50 percent. High-income taxpayers began working harder and abandoning otherwise unproductive activities to earn more income in taxable forms—all of which tended to increase revenues from New York.

Five years later, as the Reagan Administration and Congress worked to hammer out a major reform of the Internal Revenue Code, congressional representatives from New York and neighboring northeastern and industrial states were able to block proposals to repeal the deductibility of state and local taxes. The resulting Tax Reform Act of the 1986 simplified the Internal Revenue Code, eliminating many tax shelters and loopholes while dropping the top rate to 28 percent. However, the law also introduced a quirk that became known as "the bubble"—a higher effective marginal rate of 33 percent, designed to phase out the benefits of lower brackets for the wealthiest taxpayers ("wealth" in this case, being defined as taxable income of $78,400 for joint returns, in 1989 dollars).

Unfortunately, the 1986 law also increased taxes on capital gains—a classic goose-strangling exercise that arguably choked off part of a strong revenue source while undermining New York's vital financial sector and its exceptionally large and active investor class.

Subsequent federal income tax changes, enacted in the name of deficit control, were explicitly designed to wring even more revenue out of high-income taxpayers.

The Omnibus Budget Reconciliation Act of 1990 imposed a higher top marginal rate of 31 percent[13] and new limits on itemized deductions and personal exemptions for high income taxpayers.

President Clinton's first budget package featured the Omnibus Budget Reconciliation Act of 1993, which tacked on two more upper-income tax rates of 36 percent and 39.6 percent[14] and increased the taxable portion of Social Security benefits. It was the largest peacetime tax hike in the nation's history—and it was targeted like a laser at high-income states.

The 1990 and 1993 tax increases couldn't have come at a worse time for New York. While the nation was enduring a relatively brief and shallow recession in 1991, New York State experienced its most severe economic downturn since the Great Depression.

Between 1989 and 1993 New York State lost 500,000 private sector jobs, many of them in and around New York City. Compounding the impact of federal tax hikes, both New York State and New York City enacted significant tax increases of their own during this period. The state under Governor Mario Cuomo repeatedly postponed scheduled income tax rate reductions and imposed a special higher marginal rate on incomes above $100,000; the city under Mayor David Dinkins enacted a pair of surcharges that further raised its local income-tax rate by 26 percent.

Beyond their macroeconomic effects, the federal, state and local tax hikes of the early 1990s did not represent a seamless, dollar-for-dollar revenue boost for government. After all, the Reagan tax cuts had conclusively demonstrated the link between marginal rate changes and taxpayer behavior, especially at high income levels. Indeed, many economists concluded that even relatively small rate increases can have pronounced negative effects on the tax base.[15] And just as the 1981 tax cut spurred an increase in receipts from high-income taxpayers, the 1990 and 1993 federal tax increases almost surely *suppressed* growth at the upper ends of the tax base.

According to one of the more conservative estimates of such effects, presented in a recent working paper by U.S. Treasury Department staff, changes in taxpayer behavior may have reduced revenue federal gains from the 1993 tax hike by as much as 39 percent.[16] Since the New York State and City income taxes conform closely to the federal tax, it is likely that their revenues also suffered.

In purely static terms, with no accounting for behavioral changes, our tax model indicates that New York State's federal income-tax burden today is at least **$6.7 billion higher**—an 8 percent premium—as a result of the 1990 and 1993 tax hikes.

Fixing "The Fisc"

Confronted each year with fresh evidence of the state's balance of payments deficit, New York's elected officials usually react by pledging to work that much harder to bring home more federal dollars. But history suggests they are spinning their wheels—and probably making things worse for their constituents in the bargain. At current distribution ratios, every added dollar in spending for New York comes at a tax *cost* of $1.16.

"Anything that grows the size of the Federal government will grow the deficit of New York and other such states," Senator Moynihan points out. "Hence Political Economy 101—when you are in a hole stop digging."[17]

Moynihan has suggested "a Grand Compromise" between liberals and those congressional conservatives who, in his view, are content to denounce liberal spending programs while diverting New York's federal tax dollars to their own favored constituencies:

> The Compromise goes as follows. Liberals must somehow come to see that the Federal government is draining resources from just those regions and states which were the source of so much liberal social policy. As these states and regions decline, so does the vitality of liberalism. Anyone wishing to deny that? … It is time to trade. Less activism in Washington in return for more revenue at home, for whatever active measures recommend themselves to the state or municipality in question. Conservatives can then bring about or watch being brought about a genuine shrinkage in the size of the national government."[18]

Backfilling the Hole

Once we stop the digging, how about doing something to fill the hole back in?

A good place to start is by recognizing how different approaches to income-tax policy affect the balance of "the Fisc" and its impact on New York.

Assuming surpluses materialize as projected, some sort of federal income tax cut is inevitable in the coming years. But all tax cuts are not created equal, from New York's standpoint. Indeed, the wrong kind of tax cut could simply make the hole deeper.

Appendix B:
Methodology and Sources

We used the most recent IRS Public Use File, which is based on a statistical sample of all taxpayers, as the foundation for a model of the taxpaying population in New York. The model was grown to 2000, based on official indicators of economic growth and growth trends for specific components of New York adjusted gross income (AGI) reported in the *2000-01 New York State Executive Budget*. Tax variables were further checked against more detailed data reported for resident taxpayers in *The Analysis of Personal Income Tax Returns for 1997*, published by the state Department of Taxation and Finance, and against data in the March 1999 Current Population Survey of the U.S. Census Bureau.

The model was used to calculate current New York income-tax liability and the impacts of changes in rates and deductions proposed by the candidates. Since most of the new or expanded targeted tax credits proposed in the Gore and Clinton plans originated in President Bill Clinton's FY 2001 budget, official estimates of these proposals by the Office of Management and Budget (OMB) were used to extrapolate New York share, based on the state's proportion of the relevant taxpaying population. An official 10-year "scoring" of Bush's plan by Congress' Joint Committee on Taxation was the basis for our estimates of the likely New York share of his proposed spousal-income exemption and increase in the child credit. The Tax Expenditures section of the President's FY 2001 Budget also provided an important reference point for computing and checking estimates of tax-cut values.

It should be emphasized that none of the tax-cut proposals examined in this report are actually supposed to go into effect all at once; each, in fact, presents a moving target, heavily dependent on shifting taxpayer behavior over a period of years. The Bush income–tax-cut plan is to be phased in starting in 2001 and would not be fully effective until 2006; the Retirement Savings Plus provisions that make up the bulk of Gore's plan would not be fully implemented until 2010. Similarly, Mrs. Clinton's plan contains provisions that would not be fully effective until 2005, while the payroll-tax deduction that is the single most important element of Congressman Lazio's plan would not be fully effective until 2011. Any attempt to project the impact of these plans on New York State in line with their actual implementation schedules over the next decade would require a complicated and elaborate set of projections that would make direct comparisons difficult, if not impossible. Since it is commonly accepted practice to illustrate impacts on representative taxpayers compared to current law, as if effective all at once, we took the same approach to illustrating their impacts on an entire state. We defined current law to include both provisions effective in 2000 and provisions scheduled to go into effect in the future, such as the expansion of the learning credit.

Appendix C:
Tax Rates Under Current Law and Bush Plan

Current Code			Bush Plan		
Single Taxpayers					
For taxable incomes between		**Tax rate is**	**For taxable incomes between**		**Tax rate is**
0……….	…….26,250	15%	0…………..	……...6,000	10%
26,250…	…….63,550	28%	6,000……...	…….26,250	15%
63,550…	……132,600	31%	26,250…….	…...132,600	25%
132,600..	……288,350	36%	Over 132,600		33%
Over 288,350		39.6%			
Heads of Household					
For taxable incomes between		**Tax rate is**	**For taxable incomes between**		**Tax rate is**
0……….	…….35,150	15%	0…………..	…….10,000	10%
35,150…	…….89,150	28%	10,000…….	…….35,150	15%
90,800…	…...147,050	31%	35,150…….	…...147,050	25%
147,050..	…...288,350	36%	Over 147,050		33%
Over 288,350		39.6%			
Married Couples Filing Jointly					
For taxable incomes between		**Tax rate is**	**For taxable incomes between**		**Tax rate is**
0………...	…….43,850	15%	0…………..	…….12,000	10%
43,850….	…...105,950	28%	12,000…….	…….43,850	15%
105,950…	…...161,450	31%	43,850…….	…...161,450	25%
161,450…	…...288,350	36%	Over 161,450		33%
Over 288,350		39.6%			

Sources: Congressional Research Service for current law; Bush 2000 campaign for proposed law

Appendix D:
Extended Analysis of Tax Cut Plans

Single Taxpayers
No Dependents or College Tuition Expenses

		Total Tax Cut					
Income[ab]	Tax Liability Under Current Law[c]	Gore		Bush	Lazio	Clinton	
		Base	RSP*			Base	RSA*
25,000	2,520	-	1,000	300	233	38	500
30,000	3,270	-	1,000	300	279	38	500
35,000	3,952	-	500	302	333	45	250
40,000	5,352	-	500	452	694	70	250
45,000	6,752	-	500	602	781	70	250
50,000	8,152	-	-	752	868	70	-
55,000	8,166	-	-	753	955	-	-
60,000	9,748	-	-	923	1,042	-	-
65,000	10,910	-	-	1,047	1,128	-	-
70,000	12,072	-	-	1,172	1,215	-	-
75,000	12,814	-	-	1,251	1,302	-	-
80,000	13,948	-	-	1,373	1,323	-	-
85,000	15,157	-	-	1,569	1,353	-	-
90,000	16,413	-	-	1,812	-	-	-
95,000	17,668	-	-	2,055	-	-	-

a. Assumes all taxpayers under $55,000 use standard deduction; all others itemize.
b. Assumes all taxpayers make tax-deductible savings deposit commensurate with maximum RSP credit; for current law and other candidates, savings are presumed to be in IRA.
c. Current Law assumes full implementation of scheduled expansion of Learning Credit for college tuition.
* Gore Retirement Savings Plus and Clinton Retirement Savings Accounts matching tax credit.

Heads of Households
Two Children, Ages 8 and 4
Youngest Child in Day Care

		Total Tax Cut[d]					
Income[ab]	Tax Liability Under Current Law[c]	Gore[d]		Bush	Lazio	Clinton[d]	
		Base	RSP*			Base	RSA*
25,000	(1,296)	1,194	1,500	-	-	1,523	750
30,000	400	1,066	1,500	400	400	1,395	750
35,000	1,393	600	1,500	1,393	326	653	750
40,000	2,143	480	1,500	1,740	372	533	750
45,000	2,893	360	500	1,770	419	413	250
50,000	3,568	240	500	1,800	465	295	250
55,000	3,961	120	500	1,909	590	120	250
60,000	5,123	-	500	2,243	1,042	-	250
65,000	6,285	-	500	2,418	1,128	-	250
70,000	7,447	-	500	2,592	1,215	-	250
75,000	8,609	-	-	2,767	1,302	-	0
80,000	9,743	-	-	2,888	1,323	-	0

a. Assumes all taxpayers under $55,000 use standard deduction; all others itemize.
b. Assumes all taxpayers make tax-deductible savings deposit commensurate with maximum RSP credit; for current law and other candidates, savings are presumed to be in IRA.
c. Current Law assumes full implementation of scheduled expansion of Learning Credit for college tuition.
d. Gore and Clinton tax cuts as shown in excess of tax liability are refundable or increase existing refund.
* Gore Retirement Savings Plus and Clinton Retirement Savings Accounts matching tax credit.

Working Couples
Two Children, Ages 15 and 19
Oldest Child in Private College

		Total Tax Cut					
Income[ab]	Tax Liability Under Current Law[c]	Gore[d]		Bush	Lazio	Clinton[d]	
		Base	RSP*			Base	RSA*
45,000	1,168	1,018	2,000	1,168	636	1,018	1,000
50,000	1,918	1,018	2,000	1,400	683	1,018	1,000
55,000	2,368	800	2,000	1,430	512	800	1,000
60,000	2,840	800	1,000	1,460	558	800	500
65,000	3,463	800	1,000	1,490	605	800	500
70,000	4,092	800	1,000	1,527	658	800	500
75,000	4,834	800	1,000	1,902	1,049	800	500
80,000	5,968	800	1,000	2,053	1,622	800	500
85,000	7,602	1,300	1,000	2,175	2,195	1,300	500
90,000	9,236	1,800	1,000	2,296	2,687	1,800	500
95,000	10,870	2,300	1,000	2,418	2,774	2,300	500
100,000	12,504	2,800	-	2,539	2,861	2,800	-
105,000	14,478	2,100	-	2,751	2,948	2,100	-
110,000	15,612	1,400	-	2,872	3,035	1,400	-
115,000	16,996	700	-	3,244	3,121	700	-
120,000	18,380	-	-	3,615	3,208	-	-
125,000	19,764	-	-	3,987	3,295	-	-

a. Assumes all taxpayers under $55,000 use standard deduction; all others itemize.
b. Assumes all taxpayers make tax-deductible savings deposit commensurate with maximum RSP credit; for current law and other candidates, savings are presumed to be in IRA.
c. Current Law assumes full implementation of scheduled expansion of Learning Credit for college tuition.
d. Gore and Clinton tax cuts as shown in excess of tax liability are refundable or increase existing refund.
* Gore Retirement Savings Plus and Clinton Retirement Savings Accounts matching tax credit.

Working Couples
Two Children, Ages 8 and 4
Youngest Child in Day Care

		Total Tax Cut					
Income[ab]	Tax Liability Under Current Law[c]	Gore[d]		Bush	Lazio	Clinton[d]	
		Base	RSP*			Base	RSA*
25,000	(1,296)	2,243	3,000	-	305	2,243	1,500
30,000	(243)	1,623	2,000	-	305	1,623	1,000
35,000	688	818	2,000	688	543	818	1,000
40,000	1,438	698	2,000	1,438	590	698	1,000
45,000	2,188	578	2,000	1,870	636	578	1,000
50,000	2,938	458	2,000	1,900	683	458	1,000
55,000	3,388	120	2,000	1,930	512	120	1,000
60,000	3,860	3268	1,000	1,960	558	-	500
65,000	4,483	-	1,000	1,990	605	-	500
70,000	5,112	-	1,000	2,027	658	-	500
75,000	5,854	-	1,000	2,402	1,049	-	500
80,000	6,988	-	1,000	2,553	1,587	-	500
85,000	8,122	-	1,000	2,675	2,113	-	500
90,000	9,256	-	1,000	2,796	2,687	-	500
95,000	10,390	-	1,000	2,918	2,774	-	500
100,000	12,364	-	-	3,129	2,961	-	-

a. Assumes all taxpayers under $55,000 use standard deduction; all others itemize.
b. Assumes all taxpayers make tax-deductible savings deposit commensurate with maximum RSP credit; for current law and other candidates, savings are presumed to be in IRA.
c. Current Law assumes full implementation of scheduled expansion of Learning Credit for college tuition.
d. Gore and Clinton tax cuts as shown in excess of tax liability are refundable or increase existing refund.
* Gore Retirement Savings Plus and Clinton Retirement Savings Accounts matching tax credit.

ENDNOTES

[1] According to the most recent Tax Foundation estimate, New York receives only 86 cents in federal spending for every dollar New Yorkers pay in federal taxes. As this study points out, a major reason for this persistent imbalance is not New York's purported inability to get its "fair share" of federal spending. Instead, New Yorkers make more money on average than residents of other states and consequently pay much more in income tax per capita because of the progressive income tax. An explained description of this phenomenom can be found in Appendix A.

[2] *Governing State and Local Sourcebook 2000*, p. 12.

[3] Other components of the Bush income-tax plan include a provision allowing non-itemizers to claim a deduction for charitable contributions and an expansion of education savings accounts, neither of which are evaluated here. Bush also supports repeal of the estate tax.

[4] Gore's income-tax cuts also includes a health insurance tax credit for people who are not covered through their employers and several new savings programs for education and training (which are not evaluated in this report). Gore also supports an estate tax cut aimed at family-owned farms and businesses.

[5] The source for all median family income figures cited herein is *FY 2000 Income Limits and Section 8 Fair Market Rents*, a U.S. Department of Housing and Urban Development (HUD) report. This report can be found at www.huduser.org.

[6] "As Nassau Sinks, Suffolk Gloats," *The New York Times*, Sept. 26, 2000, page B-1.

[7] U.S. Census Bureau, *Statistical Abstract of the United States*: 1999, Table 779, p. 499.

[8] See *Hollow at the Middle*, a 1996 report issued by the New York City Finance Committee, which suggests that "middle class" ranges up to 200 percent of the size-adjusted family median income.

[9] The income levels increase for families in this set of examples because families who can afford private college tuitions are likelier to have higher incomes than those who send their children to public colleges.

[10] Our singles example assumes the taxpayer takes the standard deduction. Singles who itemize will see a smaller tax cut under the Bush plan. Single itemizers see no change in the benefits from the Gore tax plan because Gore provides no base tax cut to any singles.

[11] Lazio's income tax package also includes a tax deductible savings program for K-12 education, a college tuition savings program, and a further reduction in the capital-gains tax, none of which are evaluated in this report. Lazio also supports the repeal of the estate tax.

[12] Mrs. Clinton's income-tax cuts also include a provision allowing non-itemizers to claim a deduction for charitable contributions which is not evaluated in this report. Significantly, Mrs. Clinton also supports a provision that would at least lessen part of the impact of federal Alternative Minimum Tax provisions, which is on a path to raise taxes for a growing number of New Yorkers in future years. She also supports an estate-tax cut proposed by Senate Democrats which falls short of repeal but is more expansive than the estate-tax cuts supported by Gore.

[13] At the time, the 31 percent applied to taxable incomes of $82,150 for married couples, $49,300 for singles and $70,450 for heads of households. As of 2000, the rate kicks in at taxable income levels of $105,950, $63,500 and $90,800, respectively.

[14] For married couples, these rates as of 2000 will kick in at taxable income levels of $161,450 and $288,350, respectively.

[15] Lawrence B. Lindsey, *The Growth Experiment: How the New Tax Policy is Transforming the U.S. Economy*, Basic Books 1990, p. 142.

[16] Robert Carroll, U.S. Treasury Office of Tax Analysis, "Do Taxpayers Really Respond to Changes in Tax Rates?" *OTA Working Paper 79*, November 1998.

[17] "The Federal Budget and the States, Fiscal Year 1998," 23rd Edition, Dec. 9, 1999, Taubman Center of John F. Kennedy School of Government, Harvard University, and Office of Senator Daniel Patrick Moynihan, p. 9.

[18] Ibid., p. 15.

Would you prefer to receive this publication via e-mail? If so, please supply us with your e-mail address by contacting us at mi@manhattan-institute.org or 212-599-7000. Previous publications are also available.

The Center for Civic Innovation's (CCI) purpose is to improve the quality of life in cities by shaping public policy and enriching public discourse on urban issues.

CCI sponsors the publication of books like The Entrepreneurial City: A How-To Handbook for Urban Innovators, which contains brief essays from America's leading mayors explaining how they improved their cities' quality of life; Stephen Goldsmith's The Twenty-First Century City, which provides a blue-print for getting America's cities back in shape; and George Kelling's and Catherine Coles' Fixing Broken Windows, which explores the theory widely created with reducing the rate of crime in New York and other cities. CCI also hosts conferences, publishes studies, and holds luncheon forums where prominent local and national leaders are given opportunities to present their views on critical urban issues. *Cities on a Hill*, CCI's newsletter, highlights the ongoing work of innovative mayors across the country.

MANHATTAN INSTITUTE FOR POLICY RESEARCH
52 Vanderbilt Avenue • New York, NY 10017
www.manhattan-institute.org

Non-Profit
Organization
US Postage
PAID
Permit 04001
New York, NY