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March 27, 2008

Governor David A. Paterson
Majority Leader Joseph L. Bruno
Speaker Sheldon Silver
State Capitol
Albany, New York 12224

Honorable Leaders:

As you consider how to close a $4.6 billion budget gap in a slumping economy, I would like to offer my perspective on the relative merits of cutting spending versus the alternative of raising the top personal income tax bracket for taxpayers with incomes of one million dollars or more. Just as then-Governor Pataki argued in 2003 when the Legislature passed a temporary high-end income tax over his veto, editorial writers, certain elected officials, Donald Trump, and even at least one economist, have said that raising taxes on the richest among us would be "damaging," "reckless," "foolish," and "not a good idea" (the economist).

Eight years ago, President Bush tried to persuade America that tax cuts were the solution to all of America's problems. Much of the country's current woes are in fact a direct result of the poorly designed tax cut—the tax cut didn't stimulate the economy much. To make up for the deficiency and the further weakening of the economy brought on by the Iraq war and soaring oil prices, the Fed flooded the economy with liquidity and regulators looked the other way as credit standards plummeted.

New York, like most states, is now facing an unenviable choice: either taxes have to be raised, or expenditures cut. The state constitution effectively requires a balanced budget. New York is one of the many innocent victims of mismanaged economic policies at the national level. When faced with such an unpleasant choice, economic theory and evidence gives a clear and unambiguous answer: it is economically preferable to raise taxes on those with high incomes than to cut state expenditures.

The reasoning is straightforward: in a recession, you want to raise (or not decrease) the level of total spending – by households, businesses and government – in the economy. That keeps people employed and buying things, and makes it more likely that businesses will want to invest to serve that consumer demand. Budget cuts reduce the level of total spending. Raising taxes on high income households also will reduce spending, but by less than the amount of the tax increase since those with plenty of income typically spend only a fraction of their income—and some of what they spend is spent on luxury goods made abroad.

By contrast, every dollar of state and local government spending enters the local economy right away, generating a greater economic impact. The impact is especially large when the money goes for salaries of teachers, policemen and firemen, doctors and nurses and others that provide vital services to our communities. The local spending impact difference is even greater when you consider that most of the higher state income tax will be deductible against federal income taxes. The federal government should have taken responsibility for its mismanagement of the economy, and assisted states and localities in dealing with the shortfall in their income. It hasn't; but this is an indirect way in which the state can still get *some* assistance from the Federal government.

Raising high-end income taxes is also economically preferable to raising fees like the auto insurance surcharge since the burden of the latter will fall partly on those with modest incomes who are more likely to spend a higher percentage of their incomes than those higher up the income ladder.

Raising taxes and maintaining public expenditures (including investments) also helps America in meeting its long run needs. America today faces two major problems—inadequate investments, especially in infrastructure, and growing inequality. The poor are particularly dependent on government expenditures, and a cutback would almost surely hurt them.

Hurricane Katrina and the collapse of the bridge in Minneapolis provide dramatic illustrations of what happens if we don't invest in infrastructure. Recent lists of the world's top ten airports—in which there was not a single one from America—highlight our country's weakness in this area. Investments in infrastructure also increase the productivity of private investment—another important spillover.

The main effect of the proposed tax increase, by contrast, is to reduce (mildly) consumption; but every economist will tell you, America's long run problem is that we have been consuming too much—too much for our future well being, and too much for our environment. A tax cut would nudge us along in the right direction.

Critics picture a mass exodus of the rich from New York, forgetting the wonderful advantages that our state provides—benefits that might, in fact, be compromised if we have to cut back expenditures. Under the proposed increase of less than one percent in the top income tax rate, *less than one percent of New York taxpayers would pay more.* It is hard to imagine that many people would be prompted to pack up and leave New York because of that. After all, whether you look at the last five, 10 or 25 years, top earners in New York have fared extremely well at a time when the average family has seen modest income gains at best. In fact, who can point to an exodus in the wake of the similar high-end state (and New York City) income tax hike that was in place from 2003 to 2005? It didn't happen then and New York appears to be as attractive as ever.

New York State's overall tax structure is in need of overhaul. It is regressive generally in asking households of modest means to pay a greater share of their incomes in state and local taxes than the share paid by higher income households. And fiscal choices made in recent decades have put far too much pressure on the property tax by asking local governments to pick up the tab for things like Medicaid that the state is much better positioned to fund. The long-run solution is to look more to the broad-based state personal income tax, with a graduated tax structure, in order to lessen the burdens and inequities created by the property tax.

The "millionaires' tax" is an important step in that direction, and one that makes good economic sense given the state budget gap and an economy that is not firing on all cylinders and is headed uphill.

Sincerely,

Joseph E. Stiglitz
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(2001 recipient of the Nobel Memorial Prize in Economics)