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It's Elementary

A Monthly Column by EFAP Director John Yinger

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Middle Class STAR

This spring New York State passed a new property tax relief program called Middle Class STAR, which is an extension of the original STAR (School Tax Relief) program with some modifications. This column takes a look at Middle Class Star (MC STAR) and, in particular, asks whether it has the same shortcomings as the original, which have been explored in several of my previous columns.

MC STAR provides a dramatic boost in the STAR tax exemptions.¹ Many tax payers will receive a 60 percent increase in their STAR benefit in 2007-08, along with an additional 10 percent increase in 2008-09 and another 10 percent increase in 2009-10. These increases, like those passed in 2006, will be delivered in the form of a rebate check. The annual cost of these extensions is projected to be \$2.3 billion by 2009-10.

The new feature in MC STAR is that it conditions the increased STAR benefits on a taxpayer's income. The full benefit will be available only to taxpayers with incomes below \$90,000 in upstate school districts and below \$120,000 in downstate school districts. Benefits will gradually phase out as incomes rise above these limits, with no benefits for taxpayers with incomes above \$250,000. These limits will be increased over time to reflect average income growth.

As discussed in previous columns, STAR has two principal flaws. First, by lowering the "price" of additional school spending, STAR gives voters an incentive to raise their school property tax rate. Research by my colleagues and me finds evidence of this response to the original STAR program.² We estimate that STAR led to a 27 percent increase in the school property tax rate in the average school district. This increase is fully felt by business property, which does not receive a STAR exemption, and it has offset 42 percent of the initial STAR tax savings for homeowners. We also find that the STAR-

¹ The provisions of MC STAR are described <http://www.ny.gov/governor/press/0401072.html>.

² See T.H. Eom, W. Duncombe, and J. Yinger, "The Unintended Consequences of Property Tax Relief: New York's STAR program," Center for Policy Research Working Paper No. 71, Syracuse University. Available at <http://www-cpr.maxwell.syr.edu/cprwps/wps71abs.htm>.

induced school property tax increases have little impact on student performance in English and mathematics, but instead promote other types of school spending.

MC STAR simply magnifies this flaw. Combined with the STAR extension passed in 2006, MC STAR more than doubles the STAR price effect, so it is likely to at least double STAR's impact on school tax rates. Businesses and homeowners should brace for an extended period of increasing school tax rates and school district inefficiency throughout New York State!

The income conditioning in MC STAR is unlikely to modify this price effect outside of a few wealthy districts. The price effect is linked to the incentives facing the median voter, usually identified as the voter with median household income. I estimate that the median voter has an income above the MC STAR cutoff in only about 8 upstate districts and about 30 downstate districts. In every other district, the median voter has an income below the cutoff and therefore receives the full STAR extension—and faces the doubled STAR price incentive.

The second major flaw in STAR is that it is profoundly unfair, both across taxpayers and across school districts. Thanks to its income conditioning, MC STAR is not as unfair as the original STAR, but MC STAR does nothing to correct the existing STAR inequities, and it continues to make use of some of STAR's most inequitable provisions.

MC STAR is not as unfair as the original STAR because it does not provide any additional benefits to the wealthiest taxpayers and only provides full benefits to taxpayers with incomes below the above cutoffs. This design improves equity across taxpayers, because high-income homeowners do not receive larger STAR benefit increases than do poor homeowners. This design also improves equity across school districts, because wealthy school districts, which tend to be the home of many high-income homeowners, will receive a lower share of the benefits under MC STAR than they did under the original STAR. In other words, these extensions do not go as far in undermining equalizing state education aid programs as the original STAR did.

Nevertheless, MC STAR retains the least fair feature of the original STAR, the sales price adjustment factor (SPAF), and even extends the dubious principle on which it relies. As discussed in previous columns, SPAF provides for larger property tax exemptions in counties where the average sales price of a home is above the state average. This inappropriate provision subsidizes taxpayers who decide to move into high-cost locations—an approach that is both unfair and unwise. MC STAR retains the SPAF. Moreover, by setting different income cutoffs for upstate and downstate, MC STAR creates another type of subsidy for people who move into high-cost locations, which have high wages as well as high property values.

Overall, thanks to its income cutoffs, MC STAR is not as unfair as the original STAR. Nevertheless, MC STAR greatly magnifies the undesirable price effects in the original STAR program and will undoubtedly lead to further increases in property tax rates and school

district inefficiency. Moreover, MC STAR does not eliminate the profound unfairness in the original STAR design, and it retains, and even builds on, one of the original STAR's worst features, the SPAF.

In short, if they fully understood the issues, taxpayers would not be happy with MC STAR. New York State needs property tax relief, but some alternative approaches to property tax relief are much more equitable and do not have such troubling unintended consequences.