



NC Justice Center

*Opportunity
and prosperity for all*

BTC Brief

▶ NC BUDGET & TAX CENTER

May 2011

PRESERVING PUBLIC INVESTMENTS: A Better Strategy to Create Jobs

*Timely,
accessible,
and credible
analysis of
state and local
budget and tax
issues*

Author:
Edwin McLenaghan
919/856-3192
edwin@ncjustice.org

North Carolina
Justice Center
P.O. Box 28068
Raleigh, NC
27611-8068

www.ncjustice.org

KEY FINDINGS:

- State legislative leaders engaged the UNC Center for Competitive Economies (C³E) to estimate the economic and employment impact of proposed tax reductions totaling \$1.6 billion in fiscal year 2011-12 and \$2.0 billion in fiscal year 2012-13.
- The study used the IMPLAN analytical tool to assess the impact of tax reductions without any consideration of the requisite reduction in public investment and jobs that would be required with fewer tax dollars available.
- Evidence suggests that the model used grossly overstated the employment-related impact of cutting taxes. Some of the fiscal multipliers determined by the C³E IMPLAN analysis are up to five times higher than those used by mainstream economists.
- The House Budget proposal will result in a loss of jobs at a time when North Carolina must continue to maintain and create employment opportunities for its growing workforce. The direct loss of jobs will result in additional indirect job loss in communities across the state as cuts to services inevitably lead to further economic hardship.

OVERVIEW

A major focus in the state budget debate has been on how fiscal policies on spending and taxes will affect job preservation and creation. Recently, the House leadership and Senate appropriation chairs engaged the UNC Center for Competitive Economies (C³E) to estimate the economic and employment impact of proposed tax reductions totaling \$1.6 billion in fiscal year 2011-12 and \$2.0 billion in fiscal year 2012-13.

Using input-output analysis, the C³E researchers attempted to predict the likely impact on jobs—direct, indirect and induced jobs—from allowing the temporary sales tax and high-income surcharge to expire, cutting the corporate income tax rate and providing a substantial income-tax exemption on business income. However, a comparison between the IMPLAN study and similar projects from mainstream economists shows that the IMPLAN study greatly overestimates the number of jobs that would be created by the proposed tax cuts. In addition, this analysis ignores the requisite change that would be required in the level of public investments in schools, health care, courts and other public structures and services. Therefore, it provides no reliable estimate of the complete employment and economic impact of the House budget.

Evidence Suggests IMPLAN Model Overstates Impact of Tax Cuts on Jobs

IMPLAN models do not start with the specific assumptions about the magnitude of an economic impact from policy decisions (see box for more on IMPLAN methodology and multipliers), but they do return

fiscal multipliers that estimate the impact. The IMPLAN fiscal multipliers estimated in the C³E analysis are far above those determined by mainstream respected economists at the non-partisan Congressional Budget Office (CBO) and Moody’s Economy.com. For corporate and high-income tax cuts in particular, the multipliers returned by C³E’s analysis may overstate the economic impact by five times or more.

C³E’s IMPLAN analysis estimates fiscal multipliers of 1.73 for ending the personal income tax surcharge on high-income earners and allowing the one-cent increase in the retail sales tax to expire. Their analysis

estimates a fiscal multiplier of 1.61 for ending the corporate income tax surcharge, cutting the corporate income tax rate, and temporarily cutting taxes for limited-liability businesses. Based on these multipliers, C³E’s IMPLAN analysis suggests that the proposed tax reductions would generate more than 19,000 jobs at a two-year budgetary cost of nearly \$3.6 billion.

Mainstream economists at Moody’s Economy.com, however, estimate the multipliers for similar policies—cutting income taxes and corporate income taxes—at only 0.32. The CBO has similar estimates for these fiscal multipliers: 0.3 for one-year tax cuts for higher-income individuals and 0.2 for temporary business tax cuts. In fact, both the CBO and Moody’s estimate that cutting personal income tax rates and corporate taxes created the lowest boost in job creation of nearly a dozen policy options aimed at creating jobs.¹ Neither the CBO nor Moody’s have published estimates of multipliers for sales tax changes, but their multipliers for broad-based tax cuts range from 1.02 (Moody’s)² to 1.05 (CBO).³

Using the multipliers employed by mainstream economists for the proposed tax cuts, including the multiplier for broad-based tax cuts for the sales tax, would yield fewer than half as many jobs as estimated by the C³E’s IMPLAN analysis.⁴

Furthermore, the interaction of state and federal taxes would blunt the impact of state-level tax cuts compared to equivalent federal tax cuts. Because state personal and corporate income taxes are deductible on federal tax returns, up to one-third of state-level tax cuts for high-income households and corporations end up in the federal treasury.⁵ This would suggest that the economic multipliers for these state-level cuts would be lower—not higher, as in C³E’s IMPLAN analysis—than those at the federal level.

Reduction in Public Investments Unaccounted for in Analysis

C³E’s analysis did not assess the employment or economic impact of spending cuts—a critically important part of any

tax change analysis. However, an examination of input-output analyses of fiscal proposals in other states provides insight into findings of such a broader approach.

Ohio’s governor has proposed \$2 billion in spending cuts to that state’s education system, with an estimated total loss of 47,000 jobs.⁶ Input-output analysis by Policy Matters Ohio found that:

As an example, a school district that is losing \$5 million in state funding may be expected to pink slip 80 employees – teachers, lunchroom workers, bus drivers, or maintenance workers. (The actual number affected may be much higher, as jobs lost may include part time workers.) Another five [full-time equivalent] jobs will be lost in companies that supply the

How Did Researchers Estimate the Impact of Tax Cuts on Jobs?

The C³E researchers used IMPLAN economic modeling software to estimate the effect of the proposed tax reductions on private-sector output and employment. Like all economic models IMPLAN relies on simplifying assumptions about the structure of the state’s economy and how local and regional economies adapt to changes. The theory behind economic models like IMPLAN is that when additional money is introduced into a region from an outside source, such as new investment or new sources of income, some of that money is spent and re-spent in the local economy.¹¹ This result is what’s known as an economic multiplier (or, in the case of changes in public policy, a fiscal multiplier).

These economic/fiscal multipliers represent an attempt to estimate the economic bang-for-a-buck of options available to policymakers. For example, a fiscal multiplier of 2.0 means that \$1 invested in a given policy would yield \$2 in economic output, whereas a multiplier of 0.5 implies that \$1 invested in a specific policy would yield only 50 cents in economic output.

school with cleaning solvents, HVAC repair, snacks and Band-Aids. Thirty-four more will be lost as reduced spending on household purchases is felt at Kroger's, JC Penney, Kindercare, GMC Theaters and Subway.⁷

Additional analyses conducted in other states estimated that job losses from spending cuts are usually 1.5 to 2 times higher than anticipated job losses from tax increases. In Arizona, an analysis estimated that a temporary sales tax package of \$918 million resulted in 7,383 jobs lost while cutting government expenditures of \$868 million resulted in 14,092 jobs lost; the net gain from keeping the sales tax would be more than 6,700 jobs.⁸ In Kansas, an analysis using IMPLAN estimated that a sales tax increase would result in 3,231 jobs lost but that an equivalent reduction in state expenditures would result in 5,177 jobs lost.⁹ Finally, in California, an IMPLAN analysis comparing closing the state's budget shortfall with spending cuts alone versus a balanced approach of spending cuts and progressive taxation to raise \$5.4 billion showed that the balanced approach would save 244,000 jobs compared to using a cuts-only approach.¹⁰

Evidence Favors Public Investments Over Tax Cuts to Create Jobs and Prosperity

Mainstream economists across the political spectrum have found that, during and after a recession, spending drives economic recovery. In 2001, Nobel-prize winning economist Joseph Stiglitz and Peter Orszag, who would later become head of the Congressional Budget Office, did analysis of government spending during a recession and found that:

Basic economic theory suggests that direct spending reductions will generate more adverse consequences for the economy in the short run than either a tax increase or a transfer program reduction. [...] Tax increases on higher-income families are the least damaging mechanism for closing state fiscal deficits in the short run. Reductions in government spending on goods and services, or reductions in transfer payments to lower-income families, are likely to be more damaging to the economy.¹²

Furthermore, the kind of public investments and services that comprise the vast majority of state spending—public schools, community colleges and universities, and health services—are critical to building a skilled, healthy workforce capable of competing in a global economy.

In times of economic distress, the economic evidence demonstrates that preserving public investments in education, health, and public safety is the right path to boost job creation in the short term and promote shared economic prosperity in the long term. Contrary to the conclusions drawn from the Center for Competitive Economies' report, cutting taxes will not only result in more job losses than keeping taxes at current levels and sustaining public investments, it will also undermine the gains made over past decades to build the highly skilled workforce and first-rate infrastructure necessary for the North Carolina and its people to compete for the jobs of tomorrow.

- 1 Douglas W. Elmendorf. "Policies for Increasing Economic Growth and Employment in the Short Term." Congressional Budget Office testimony before the Joint Economic Committee. February 23, 2010. Available at http://www.cbo.gov/ftpdocs/112xx/doc11255/Unemployment_Testimony.shtml and Mark Zandi. "Using Unemployment Insurance to Help Americans Get Back to Work: Creating Opportunities and Overcoming Challenges." Testimony before the Finance Committee of the US Senate. April 14, 2010. Available at <http://www.economy.com/mark-zandi/documents/Senate-Finance-Committee-Unemployment%20Insurance-041410.pdf>
- 2 Zandi testimony. April 2010.
- 3 Congressional Budget Office. "Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output from April 2010 Through June 2010." August 2010. Available at <http://www.cbo.gov/ftpdocs/117xx/doc11706/08-24-ARRA.pdf>
- 4 Applying a multiplier of 1.05 instead of the 1.67 employment multiplier for the 11,870 jobs the C³E's IMPLAN analysis presumes for the sales tax reduction in FY2012-13 and 0.32 instead of the 1.64 average employment multiplier used for the corporate and high-income tax reductions yields 8,940 jobs instead of the estimated 19,439 jobs.
- 5 Institute on Taxation and Economic Policy. "How State Tax Changes Affect Your Federal Taxes: A Primer on the 'Federal Offset.'" Policy Brief #7, 2009. Available at <http://www.itepnet.org/pdf/pb7off.pdf>
- 6 Wendy Patton. April 8, 2011. Budget Brief: Economic Impact of Education Cuts in Kasich's Proposal: An Input-Output Analysis. Policy Matters Ohio: Ohio.
- 7 Ibid, p. 2
- 8 Dr. Alberta Charney, "Sales tax increase versus expenditure cuts: An economic Impact Study", posted at the University of Arizona's Eller College of Management Website, March 19, 2010 at http://ebr.eller.arizona.edu/research/articles/2010/sales_tax_increase_vs_expenditure_cuts.asp. Note: Cutting state government expenditures matched by federal dollars resulted in even more job losses
- 9 John D. Wong. "Comparative Analysis of the Economic Impact on Kansas of a Sales Tax Increase and/or State Spending Reductions." Wichita State University Center for Urban Studies. April 2010. Available at http://media.lawrence.com/news/documents/2010/04/19/Sales_Tax_Study_2010_1.pdf
- 10 Ken Jacobs, Laurel Lucia and T. William Lester, May 2010. "The Economic Consequences of Proposed California Budget Cuts," Center for Labor Research and Education, University of California at Berkeley.
- 11 Alfie Meek. "Economic Models for Decision Making." University of Georgia Business Outreach Services and Small Business Development Center. November 2000. Available at <http://www.georgiasbdc.org/pdfs/models.pdf>
- 12 Nicholas Johnson. 2008. *Budget Cuts or Tax Increases at the State Level: Which is Preferable During an Economic Downturn?* Center on Budget and Policy Priorities: Washington, DC