



Who's Minding the Store? New Mexico's Income Tax Cut: Poor Performance, Wrong Choice

When the state government spends large amounts of money, the impact of the spending is usually clear. Health insurance plans are established for children and the elderly. Or, teacher's salaries are paid. Roads are built. Prisons are staffed.

Not so with tax cuts. Tax cuts reduce the state's income (revenue stream). Tax cuts are, therefore, an expense. Like other state expenses, the real impacts of a tax cut should be clear. We should be able to see what our tax dollars are buying or, failing to buy.

The Richardson administration has rationalized the personal income tax cut passed in New Mexico in 2003 – which disproportionately benefits higher income families – by claiming that they will 'buy' New Mexico jobs. If that is true, we would expect to see a greater number of jobs created *than were predicted to be created without the tax cut*. Unfortunately, this has not been the case.² And, the reality of the impact of the personal income tax cut is even more disturbing than simply the absence of job growth.

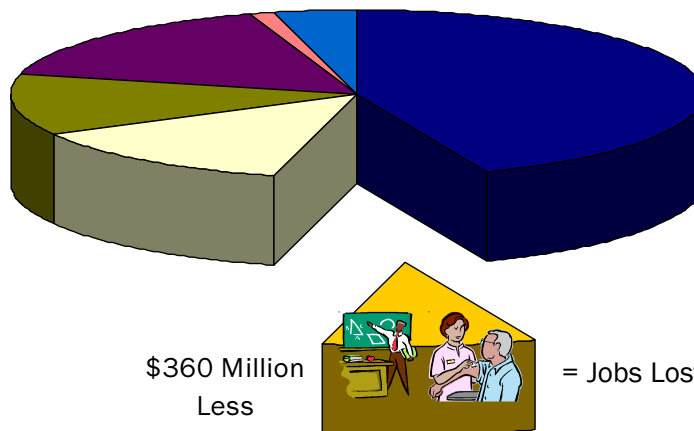
The Personal Income Tax Cut Has Had A Negative Impact on New Mexico's Economy

The price tag on this tax cut is very steep: \$166 million in the current year; \$360 million in 2008 when it is fully phased in. With this one policy decision we are losing more than it would cost to raise child care assistance to 200% of the federal poverty level (price tag: \$10M); fund pre-kindergarten (price tag \$10M); provide health insurance to a large portion of New Mexico's working poor (price tag: \$60M); fully fund Medicaid this year (price tag: \$100M); restore last year's Medicaid cuts (\$40M); and fully fund Medicaid next year (price tag: \$50M). After all that was taken care of, there would still be \$90 million more to spend on education, public safety and other needs. New Mexicans have been handed a net loss from these tax cuts.

Here's why. When state income (tax revenues) drop as a result of a tax cut, state spending must also be reduced *by an amount equal to the tax cut*. New Mexico, like many other states, has a requirement in its Constitution that New Mexico can only spend as much money as it takes in. The budget must be balanced. So, if we take money out of the budget by cutting taxes, we have to reduce spending.

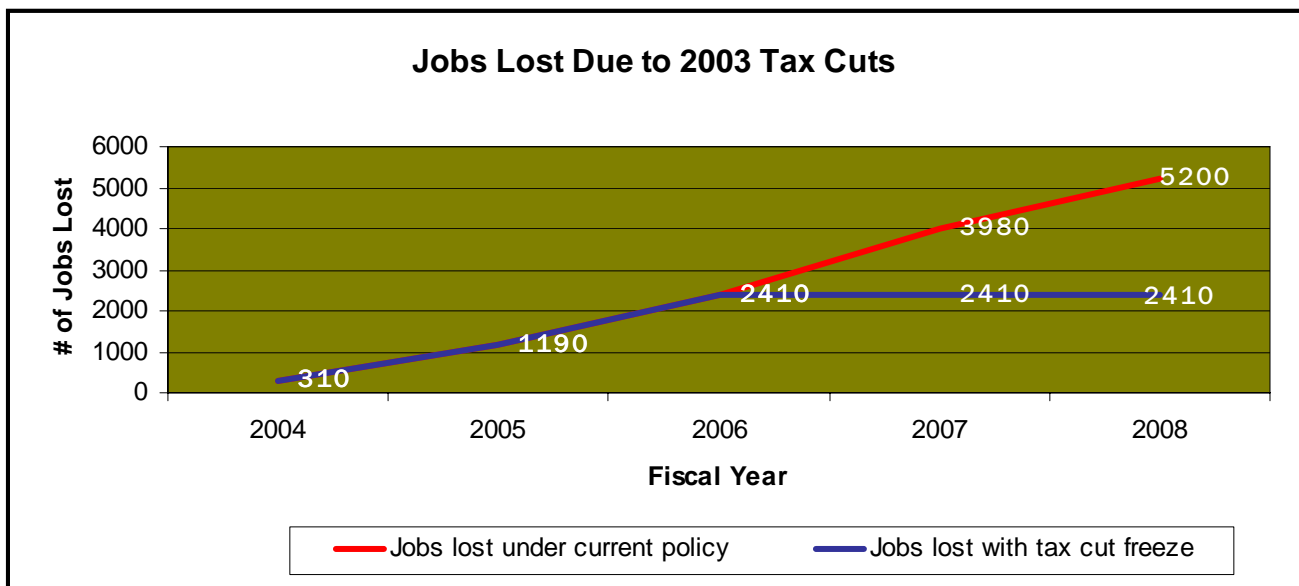
Direct appropriations by the legislature to state agencies create jobs in those agencies – teachers, prison guards, public health nurses, state police. A state spending cut, therefore, means reducing the budgets of state agencies to balance the cut with spending, which translates to losses in these public sector jobs.

New Mexico's State Budget: Reduced by \$360 Million Due to Tax Cuts



The Governor's tax cut position is that jobs lost in the public sector as a result of a tax cut will be more than made up for by jobs created in the private sector. But, an examination of the number of jobs gained, compared to the number of jobs lost, reveals that the personal income tax cut is actually having a dampening, rather than a stimulating, impact on New Mexico's economy.

Table I



This chart shows jobs lost as a result of the tax cut. If there is a freeze of further implementation of the tax cut in 2005, job loss will level off (blue line); if not, job loss will continue to accelerate to over 5,000 lost in 2008 (red line).

The Personal Income Tax Cut Has Resulted in a Net Job Loss

The personal income tax cut is draining an enormous amount of money from the state budget. Consequently, a large number of jobs in state government are, and will continue to be, lost. The job growth in the private sector (not caused by the tax cut) has not compensated for the jobs lost. Nor will it. The job losses will only get worse the longer the tax cuts are in place.

The reason the income tax cut has had the unintended consequence of job loss is because when the money is returned to the taxpayers, they do not spend all of it in the state. Instead, they spend a significant part of it on things like clothes or other items *produced outside of New Mexico*. For example, even clothes purchased from Target are produced outside of New Mexico. Fully one-third of the money that is returned to taxpayers through the tax cuts (or \$350,000 of every \$1 million in tax cuts) leaves the state, with no economic benefit to our economy.

In the fiscal year that begins in July, 2005 *4,370 jobs will be lost due to cuts in state spending forced by the tax cut. Only 1,960 jobs will be created. The net effect is 2,410 fewer jobs in New Mexico as a direct result of the personal income and capital gains tax cuts.* This is true despite new jobs being created by companies such as Lowe's, Wal Mart, Tempu-Pedic Mattress and aircraft manufacturing plants. All the jobs these companies may create, combined, do not make up for the job loss caused by the tax cut.

Making the net loss even worse, many of the jobs added (like those at Wal Mart) do not pay as well as the jobs lost (like those in education). Nor do many of these jobs provide benefits such as health insurance or retirement.

Each million dollar reduction in state spending causes 26 jobs to be lost in education and healthcare. ***At the same time, each \$1 million in tax cuts creates only 12 jobs.*** The difference is 14 jobs lost for every \$1 million in personal and capital gains tax cuts. (See Table II)

This means that the 2003 personal and capital gains tax cuts are having a negative effect on New Mexico's job growth. They are a drag on our economy. Without these tax cuts, predictions of future job growth would be higher than they now are.

If the state had spent \$360 million instead of tax cuts, 9,400 new jobs would have been created in education and health care. For this investment we would have had a total job gain of 9,400 new jobs instead of the 5,200 fewer jobs we do have as a result of the tax cut, in 2008.

Table II - Net Job Loss per \$1 Million in Tax Cuts

State Government jobs lost	-26
Household sector ** jobs gained	+12
Net Job Loss per \$1 million dollars in Tax Cuts	-14

** "household sector" is payments by individuals/ households to industries for goods/ services used for personal consumption

Source: *New Mexico Voices for Children*

Freezing the 2003 Income Tax Cut Would Enable Real Job Growth

A freeze on further implementation of the personal income and capital gains tax cuts³ will not restore the jobs already lost. But, it would prevent further job loss. The \$193 million saved could be spent on education, healthcare, child care assistance or even on targeted tax relief for low and moderate income working families who need the help.

Legislation proposed in the 2005 legislative session by Senator Linda Lopez proposes freezing the personal income tax rate. Her proposal will not freeze the capital gains tax cut. Even so, stopping further implementation of the personal income tax cut – which has the largest impact on state revenue – would be a significant step toward reducing the negative effects of the tax cuts. A freeze would mean fewer jobs lost in the next two years.

Tax Cuts Should be Held Accountable to a Performance Standard

Tax cuts are a public expenditure of resources. They can cost the state budget more than major programs or functions such as public safety which funds state police and our prison system and costs about \$310 million each year. Yet, there are no accountability procedures in place to assess the impact of tax cuts. Should we continue tax cuts when the evidence proves they do not produce a return that justifies the investment? Are there more cost-effective ways to generate real economic growth? Businesses say that a quality work force is the key to decisions to locate a business in one state versus another. ⁴ We could have a much bigger bang for our tax buck by investing in the education component of our economic infrastructure.

Methodology

This analysis isolates the effects of the personal income tax cuts from job and income growth in the remainder of the New Mexico economy, enabling the analysis to be conducted for the PIT cuts alone, excluding allowing other economic events (such as, temporary windfalls of oil and gas revenues) to muddy the waters.

Input-output analysis is used to gauge the impact of a positive or negative change in income and expenditures for a given industry sector. In the present case the method is used to simulate the impact of a tax cut in the loss of revenues to state government, and the gain in income for the household sector. The software package used in this simulation of the effects of the tax cuts is Minnesota IMPLAN, a widely available proprietary software package. All results presented in this paper can be replicated by analysts with access to this software.

Endnotes

¹For full report, see www.nmvoices.org.

² See "Personal Income Tax Cuts \neq Economic Growth", by New Mexico Voices for Children, February 2005, available at www.nmvoices.org/fiscalpolicy.htm.

³ A freeze would hold the top rate of New Mexico's personal income tax at the current rate of 6% (it was 8.2% in 2003, so has already been significantly reduced). The capital gains tax cut would mean that 50% of capital gains are exempt from taxes.

⁴www.survey.lsu.edu/LouisianaBusinessImageReport2004.pdf A report conducted by the Public Policy Research Lab sponsored by the Committee of 100 for Economic Development in partnership with the Louisiana Governor's Office, January 24, 2005.

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