FISCAL POLICY PROJECT

TAKING A CLOSER LOOK AT TAX AND BUDGET POLICIES AFFECTING NEW MEXICO'S QUALITY OF LIFE

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Personal Income Tax Cuts ≠ Economic Growth

Introduction

In 2003, newly- elected Governor Bill Richardson proposed, and the legislature passed, a personal income tax (PIT) cut to be phased in over the next 5 years. The PIT cut reduced the taxes of wealthier New Mexicans, but offered no assistance to more than 550,000 other New Mexico taxpayers. Governor Richardson assured taxpayers and the legislature that this reduction in personal income taxes, which will cost the state $360 million or 7% of its general fund, would result in job growth and an improved NM economy. The Governor continues to assert these claims.[1] This paper examines the reality.

If Not Tax Cuts, Then What?

The jobs of the future will be knowledge-intensive service jobs as manufacturing jobs continue to move off-shore. That's good news and bad news for New Mexico. The bad news is that our work force is not well-educated. We are 49th in the country in math and reading proficiency, and 41st in the country in high school completions. The good news is that New Mexicans have a strong entreprenuerial sensibility. Although New Mexico received an "F" in the 2004 Development Report Card for the States, the state received its highest grades for entreprenuerial assets (B) and for innovation assets (A).[2] New Mexico's leadership would do better spending our tax dollars shoring up our education system to improve math and reading proficiency scores and look to integrating hands-on entreprenuerial education in our schools. Entreprenuership should be a credit option in our post secondary schools and community colleges. We should stop using state resources to chase big business jobs that may not last, and instead offer incentives for home-grown business development.

Actual Job Growth No Greater Than What Was Anticipated Without Tax Cuts

In a December 2004 press release, the Governor stated "...New Mexico continues to be in the top ten in the nation in job growth and ahead of the national average in personal income growth ...because of our competitive tax structure and aggressive jobs strategy."[3] But job growth has been exactly what was predicted before Richardson took office - and not in response to his policies. Before Richardson took office, in October 2002, the University of New Mexico's FOR-UNM forecasting service at the UNM Bureau of Business and Economic Research[4] was expecting job growth in 2003 to be 1.0 percent, 2.0 percent in 2004, 1.9 percent in 2005 and 1.8 percent in 2006. The forecast job growth for 2003 and 2004 was almost exactly what the state experienced in actual job growth.

In addition, the 2002 predictions were that job growth in 2005 and 2006 would be close to the growth rates in 2003 and 2004. Those early predictions were revised slightly in 2004, but the rate of job growth has not increased. Table 1 presents the October 2002 projections in the second column and the 2003 and 2004 actual job growth figures and the revised forecasts for 2005 and 2006 in the third column of the table.

Table 1
Predicted and actual job growth, and numbers of jobs added, by year 2003 -2006

	Job Growth Forecast in October 2002	Actual Job Growth and November 2004 Forecast
2003	1.0 % (7,435)	1.2 % (9,383)
2004	2.0 % (15,018)	1.9 % (14,792)
2005	1.9 % (14,620)	2.2 % (17,316)
2006	1.8 % (14,164)	2.2 % (17,895)

Source: FOR-UNM: A Quarterly Forecast of the New Mexico Economy. October 2002 and November 2004 editions.

If the administration's tax cuts had resulted in jumped-up job growth, the actual performance of the economy would have been far better than the forecast of October 2002. But performance in 2003 and 2004 is roughly the same as the early predictions. The news gets worse. **The job growth forecast drops to 1.9 percent in both 2008 and 2009**, years in which the full impact of the tax cut should be felt. There is no evidence that the administration's tax cuts have boosted employment growth.

The same conclusion holds for personal income growth. The FOR-UNM forecasting service prediction for personal income growth before the administration took office in January 2003 was for 4.9 percent growth in 2003, 5.1 percent growth in 2004, 5.4 percent growth in 2005, and 5.4 percent growth in 2006. FOR-UNM reported actual growth of 4.4 percent in 2003, and revised forecasts of personal income growth to 6.6 percent in 2004, 5.3 percent in 2005, and 5.5 percent in 2006. See Table 2. Although the annual personal income growth pattern varies somewhat, a four year average shows that there is no supercharging effect apparent from the personal income tax cuts enacted in the 2003 legislative session.

Table 2

	Personal Income Growth October 2002 Forecast	Actual / Projected Personal Income Growth November 2004 Forecast
2003	4.9 % ($2.169 bn)	4.4 % ($2.007 bn)
2004	5.1 % ($2.386 bn)	6.6 % ($3.131 bn)
2005	5.4 % ($2.629 bn)	5.3 % ($2.706 bn)
2006	5.4 % ($2.796 bn)	5.5 % ($2.926 bn)
Four Year Average	5.2 % ($2.495 bn)	5.5 % ($2.692 bn)

Source: FOR-UNM: A Quarterly Forecast of the New Mexico Economy. October 2002 and November 2004 editions.

Further, the larger percentage growth in personal income predicted for 2004 is accounted for by increases in several non-wage categories: transfer payments (welfare, Medicaid, Medicare, and Social Security), nonfarm proprietor's income, employer supplement to wages and salaries and the Microsoft distribution. Personal income numbers are subject to far greater revisions than are the job growth estimates. Comparing the 2002 income growth estimates to the most recent predictions shows that personal income is estimated to continue to track the original forecasts.

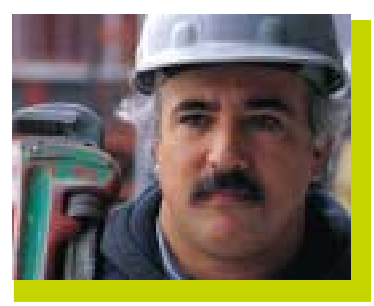
Job Quality Worse

Contrary to the implications in the Governor's press releases, job and personal income growth have performed only as well as pre-Richardson predictions. But the one thing that has changed between 2003 and 2004 is job quality. It's gotten worse.

The method for assessing whether job growth has resulted in improved or decreased job quality takes into account whether a given industry category is increasing (expanding) or declining (contracting).[5] The data are compared for the same period in different years in order to minimize distortion due to seasonal fluctuations in industries. The most recent data available is second quarter (April, May and June) 2004 data from the US Bureau of Labor Statistics Quarterly Census of Employment and Wages program.[6] The employment share of each industry category[7] in the second quarter of 2004 was compared to that sector's employment share in the second quarter of 2003. This comparison provides an assessment of which sectors are increasing, or expanding, and which are declining, or contracting, as a proportion of total state employment.

The contracting sectors included: agriculture, utilities, manufacturing, wholesale trade, transportation and warehousing, information, finance and insurance, professional and technical services, arts, entertainment and recreation, accommodation and food services, other services and public administration. For these contracting sectors, the weighted average weekly wage[8] was $674.

The expanding sectors between the second quarter of 2003 and the second quarter of 2004 included mining, construction, retail trade, real estate and rental and leasing, management of companies and enterprises, educational services, and health and social assistance. For these expanding sectors, the weighted average weekly wage is $623. The difference between the contracting sector wage at $674, and the expanding sector wage at $623 is $51 on a weekly basis or $2,652 per year.



What Businesses Really Want: A Better Workforce

A recent survey [9] designed as a tool for state business recruitment efforts in Louisiana collected information from a random sample of non-Louisiana based businesses on the importance of various factors in location decisions. Nine hundred forty five (945) businesses responded. They were asked to rate 26 items in terms of their importance to opening new locations or moving existing operations. Workforce issues were ranked at the most important, with labor productivity getting a favorable response from 78% of the business executives, and 76% ranking availability of skilled labor as important. State and local incentives were ranked 16th of the 26 items, and tax emptions were 18th. When asked what Louisiana could do to make it more attractive to businessess, the most frequent response was to improve public schools.

In short, job quality has declined: the jobs New Mexico has added are not as good as the jobs the state is losing. Per capita income in New Mexico ranked 47th in 2002 and still ranked 47th in 2003.

No Increase in Wage or Salary Levels Due to Tax Cuts

Median income of households in New Mexico was nearly unchanged between 2001-2 and 2002-3 at $35,300 and $35,700, respectively.[10] The percentage of the New Mexico population living below the federal poverty threshold was not noticeably different in these two periods- about 17.9 percent in 2001-2 and 18.0 percent in 2002-3. The proportion of people without health insurance was 20.9 percent in 2001-2 and 21.6 percent in 2002-3.

Personal income as measured by the US Bureau of Economic Analysis includes income from wages and salaries, dividends, interest & rent, and transfer payments such as Social Security, temporary assistance for needy families (TANF) and Medicaid. In New Mexico, personal income increased by 3.8 percent in 2002 and 4.3 percent in 2003. Population growth was about 1.25 percent in 2002 and 1.2 percent in 2003. When the increase in population and inflation are factored in (inflation has been near 3% in recent years), the growth in personal income is predictable, which belies assertions that New Mexico is ahead of the national average in personal income growth. In the second quarter of 2004, New Mexico personal income growth was 1.8 percent over the previous quarter, compared to a national growth rate of 1.4 percent. Wage and salary growth was 6 percent in 2004 and is expected to be 6.1 percent in 2005. After that, wage and salary growth will decay toward 5 percent, according to FOR-UNM. This is the time period when the PIT cuts are taking full effect. **If the tax cuts were a strong economic stimulus, predictions would show wage and salary growth accelerating – but they don't.**

The state is not making headway by using per capita income as a benchmark for economic success, either. Per capita income in a state is defined as total personal income divided by the state's population. Per capita income grew from $24,100 in 2001 to $24,730 (2.6 percent) in 2002 and by 3.1 percent to $25,500 in 2003. The 2003 per capita income in New Mexico was about 81% of the national per capita income of $31, 459, and New Mexico ranked 47th in the country in per capita income. New Mexico's personal income growth would need to be above the national average for several years in order to close the gap with the national per capita income level.

Job growth, personal income, job quality, median income, percentage of the population in poverty, percentage of uninsured, per capita income - these measures have not budged in recent years. The PIT cut has not resulted in better economic or social health for New Mexico. The tax cuts enacted by the 2003 legislature at the behest of the Governor have not affected the trajectory of New Mexico's economy in any discernible way. The employment and income growth posted recently has been close to the forecasts made as far back as 2002. In addition, an analysis of the quality of the job growth shows that the sectors of the economy with expanding employment have lower average wages than the sectors with contracting employment.

Economic Development at a Crossroads

The decline in manufacturing jobs and the rise of a more knowledge-intensive service sector have upended traditional economic development strategies. Firms are not so easily sold on locating in a specific place because of its favorable business climate or tax incentives. What firms need more than anything is a well-educated workforce. The emergence of this new economy has done much to change state economic development policy.[11]

A Final Word on Methodology: The need to Compare the Same Month in Different Years (Apples to Apples)

The ramifications of the tax cut demand a fair and open discussion and assessment of their impact. So far, the press releases on the impact of the tax cuts have been deliberately skewed. The methodology from the Governor's office has been to compare apples and oranges. To get accurate pictures of employment growth and unemployment rates, one must compare the same month in different years. This is because there are seasonal changes in these rates caused by the school year cycle and other seasonal factors. Comparing employment growth between January 2003 and November 2004 yields different numbers than comparing November 2002 to November 2004. The more accurate comparison yields job growth of only 27,900 jobs, 12,000 less than the administration is claiming. The percentage growth over the correct two-year period is a relatively lackluster 3.6 percent, not the inflated 5.5 percent implied by the administration's figures.

Comparing unemployment rates between January 2003 and November 2004 is illegitimate for the same reason. According to the New Mexico Labor Market Report for November 2004, the seasonally adjusted unemployment rate in November 2002 was 5.7 percent. This can be compared to a seasonally adjusted November 2004 rate of 5.1 percent, a reduction of six tenths of a percentage point. The unemployment rate in New Mexico is expected to rise to 6.0 in 2005 and to remain in the 6.1-6.3 range through 2009. Using the correct comparisons, the unemployment rate has not "dropped dramatically" from 6.8% to 5.2% as the Governor claims. And, the unemployment forecast does not paint the picture of robust economic health that would make the loss of $360 million in state revenues worthwhile.

Endnotes

[1] "With help from the Economic Development Partnership, New Mexico continues to be in the top ten in the nation in job growth and ahead of the national average in personal income growth. This growth is happening because of our competitive tax structure and aggressive jobs strategy. Nearly 40,000 more New Mexicans are earning paychecks since Governor Richardson took office in 2003. The unemployment rate has dropped dramatically – from 6.8 percent to 5.2 percent – since the Governor was elected. The rate continues to be below the national average." [Press Release: 'Governor Bill Richardson Credits State's Recruitment Efforts for New Jobs' 12/29/2004.] On January 3, 2005, the Office of the Governor again claimed a causal relationship between tax cuts and economic growth "Governor Richardson said his tax relief package will help build on the success from tax cuts he successfully backed during his first two years in office." And on January 27, Gilbert Gallegos, spokesman for the Richardson administration, said "Our strong budget situation and job growth today are directly related to the governor's economic plan. Rolling back the governor's (personal income) tax cuts could stall economic growth and would send the wrong message to companies that are considering a move to New Mexico." Albuquerque *Tribune*.

[2] *www.cfed.org* 2004 Development Report Card for the States conducted by the Corporation for Economic Development.

[3] *Ibid*.

[4] FOR-UNM has been the premier economic forecasting service for the state of New Mexico since 1979. The FOR-UNM model has been managed for more than a decade by Dr. Larry Waldman at the UNM Bureau of Business and Economic Research. The FOR-UNM forecast is used each year as the basis for producing estimates of state revenues by the Consensus Revenue Estimating Group. The Consensus Revenue Estimating Group is composed of economists from the state departments of Taxation & Revenue and Finance & Administration and the Legislative Finance Committee.

[5] A national assessment of job quality constructed by the Economic Policy Institute was the basis of the method used here for determining job quality. The EPI study was published July 28, 2004 and is entitled Assessing Job Quality (available at www.epinet.org).

[6] US Bureau of Labor Statistics Quarterly Census of Employment and Wages program, Quarterly Census of Employment and Wages, New Mexico Department of Labor, Second Quarter 2003 and Second Quarter 2004.

[7] Each two digit industry North American Industry Coding System (NAICS) category was compared. Two digit industry categories are the second level of detail in the North American Industrial Coding System, the industry coding system used to classify all economic data reported in the United States, Canada, and Mexico.

[8] The weighted average weekly wage is a calculation of the change in each industry's employment share to the total of the contracting industries and applying that share to the sector's average weekly wage. The methodology used was developed by the Economic Policy Institute in the paper Assessing Job Quality. This paper is available at the Economic Policy Institute Internet site at www.epinet.org.

[9] www.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.

[10] US Census Bureau *Income, Poverty and Health Insurance Coverage in the United States: 2003*.

[11] Economic Development at a Crossroads, State Policy Reports, Vol. 23, Issue 1

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