Fiscal Policy Project

Taking a closer look at Tax and Budget Policies affecting New Mexico's Quality of Life

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Full Report

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

By Gerry Bradley, Fiscal Policy Project Director

In a recent paper, New Mexico Voices for Children showed that the personal income tax (PIT) cuts passed by the 2003 Legislature at the behest of the Richardson administration had no discernible positive effect on job growth and personal income: the crucial metrics of economic success in the New Mexico economy. That paper showed that the actual performance of the New Mexico economy since the tax cuts took effect has been the same as that forecast before the Richardson administration took office. The focus of the earlier paper was on the overall performance of the economy as compared to the performance forecast before the tax cuts were implemented. That paper opened the question as to why the PIT cuts had no surface impact on the economy. The current paper will isolate the effects of the personal income tax cuts from job and income growth in the remainder of the New Mexico economy. This will enable the analysis to be conducted for the PIT cuts alone, without allowing other economic patterns to muddy the waters.

Table I - Static Analysis of Income Tax Reductions (in millions of dollars)

General Fund Revenue	Fiscal Year 2004	Fiscal Year 2005	Fiscal Year 2006	Fiscal Year 2007	Fiscal Year 2008
Interest on Refunds	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Personal Income Tax Reductions	(17.1)	(72.2)	(151.1)	(254.4)	(332.4)
Capital Gains Reduction	(4.2)	(10.3)	(15.6)	(20.3)	(27.4)
Total Fiscal Impact	(21.8)	(83.0)	(167.2)	(275.2)	(360.3)

Source: 2004 Post-Session Fiscal Review, NM Legislative Finance Committee, May 2004

The current paper will go beneath the surface of the economy to show that the PIT tax cuts have had a negative impact on the economy. We will describe the results of a simulation that shows that the effect of the PIT tax cut on the economy leads to more jobs lost in state government than jobs gained in the private household sector. The procedure adopted is to compare jobs lost in the government sector due to revenue loss compared to jobs gained due to increased income for households from the tax cut. Job growth and personal income growth are both net concepts, i.e. they measure the change in employment and personal income over a time period, usually over a year. Job growth and personal income growth measure the net change in these two variables, but there are other analytical tools that allow economists to arrive at a better understanding of the gross patterns of the economy. One of these methods is input-output analysis.

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 can be 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 effect 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.

Table II below shows the employment impact of a $1 million expenditure increase or decrease for the state government education and non-education sectors, as well as the household sector with several income levels broken out. The scenario shows that an increase or decrease of $1 million in the state government education sector has by far the largest employment impact, followed by the state government 'health and other' sector. The household sector, which benefits directly from the income tax cuts, shows a far smaller employment impact.

Table II - Employment Impact of a $1 Million Increase in Sector Income

State Government-Education	-23.2 Jobs Lost Per $ 1 million	-6.1 Jobs Lost Per $1 million	-29.2 Jobs Lost Per $1 million
State Government-'Health and Other'	-16.2 Jobs Lost Per $1 million	-5.3 Jobs Lost Per $1 million	-21.5 Jobs Lost Per $1 million
Household Income $75 K +	+8.1 Jobs Gained Per $1 Million	+3.6 Jobs Gained Per $1 Million	+11.7 Jobs Gained Per $1 Million

Source: Minnesota IMPLAN - Analysis performed by NM Voices for Children

Table III provides estimates of the negative impact of the PIT tax cuts on employment created in the state government sector for a breakout of education and non-education activities. The table also provides an estimate of the positive employment impact of the tax cuts on the household sector. The final line of the table shows that, under this simulation model, the negative employment impact of the tax cuts on the state government sector outweighs the positive employment impact of the tax cuts on the household sector. The final section of this paper will explain why this occurs.

Table III calculates the job losses in state government and job gains in the household sector by multiplying the fiscal impact of the income tax cuts taken from Table I line 3 by the number of jobs lost per $ 1 million taken from Table II. Table III also breaks out state spending on education and 'health and other' projects for their approximate share of state general fund expenditures: 60 % for education expenditures and 40 % for 'health and other' expenditures.

Table III - Employment Impact of the 2003 Personal Income and Capital Gains Tax Cuts

Total Impact Taken from Table II, Column 4	Fiscal year 2004 $21.8 M. Impact	Fiscal year 2005 $83.0 M. Impact	Fiscal Year 2006 $167.2 M. Impact	Fiscal year 2007 $275.2 M. Impact	Fiscal year 2008 $360.3 M. Impact
State Government – Education 60 % @(29.2)	-380 Jobs	-1,450 Jobs	-2,930 Jobs	-4,820 Jobs	-6,310 Jobs
State Government – 'Health and Other' 40%@(21.5)	-190	-710	-1,440	-2,370	-3,100
State Government Total Loss (Line 1 + Line 3)	-570	-2,160	-4,370	-7,200	-9,410
Average Household Impact @(+11.7)	+260	+970	+1,960	+3,220	+4,220
Net Impact	-310 Jobs	-1,190 Jobs	-2,410 Jobs	-3,980 Jobs	-5,190 Jobs

Source: Minnesota IMPLAN - Analysis performed by NM Voices for Children

Table III shows the estimated impact of freezing the Personal Income Tax rates at the 2005 level. The table shows the job loss from the PIT tax cuts rising to about -5,194 in the last year of the simulation horizon. This is a relatively slight job loss in an economy with employment of about 800,000. However, job growth was about 16,300 in December 2004, so the drag on the economy was roughly a third of the modest net job growth figure in FY 2006.

The analysis of the PIT tax cuts in terms of their effect on the output of the New Mexico economy helps to answer the question that immediately arises: why are the impact multipliers for employment are so much larger for state government expenditures than for household expenditures? Basically, this is because of purchases of goods and services produced outside of New Mexico by the household sector. Foreign trade accounts for about $48,000 and domestic trade accounts for some $296,000 of direct impacts with no additional impacts. Owner-occupied dwelling also have minimal additional impacts. Another contributing factor is that the increased income due to the New Mexico PIT tax cuts is fodder for the federal income tax, another leakage from the income stream.

According to the IMPLAN analysis, the leakage for foreign trade from the household sector is about $48,000 per $ 1 million and the leakage for domestic trade is about $296,000 per $1 million. New Mexico manufactures a fairly limited array of manufactured products, and therefore these products must be 'imported' from outside the state of New Mexico or from outside the country. Therefore, for each $1 million in tax cuts to households, more than one third of the expenditures have no employment impact in the state of New Mexico. This helps to account for the very low employment contribution of the tax cuts for each $ 1 million in tax reduction. In addition, the household sector tends to purchase directly from sectors with fairly low indirect and induced multipliers, such as owner occupied dwellings.

Table IV – Employment Impact of Freezing the 2003 Personal Income and Capital Gains Tax Cut at the 2005 Level

General Fund Revenue	Fiscal Year 2004	Fiscal Year 2005	Fiscal Year 2006	Fiscal Year 2007	Fiscal Year 2008
Personal Income Tax Reductions	$21.8 See Table III Line 1	$83 See Table III Line 1	$167.2 See Table III Line 1	$167.2 Freeze Impact @ 2006 level	$167.2 Freeze Impact @ 2006 Level
Loss - State Government-Education 60%@29.2	-380 Jobs	-1,450 Jobs	-2,930 Jobs	- 2,930 Jobs	- 2,930 Jobs
Loss - State Government – 'Health and Other' 40%@21.5	-190 Jobs	-710 Jobs	-1,440 Jobs	- 1,440 Jobs	-1,440 Jobs
State Government Total Loss	-570 Jobs	-2,160 Jobs	-4,370 Jobs	-4,370 Jobs	-4,370 Jobs
Gain - Average Household Impact @11.6	+260 Jobs	+970 Jobs	+1,960 Jobs	+1,960 Jobs	+1,960 Jobs
Net Impact	-310 Jobs	-1,190 Jobs	-2,410 Jobs	-2,410 Jobs	- 2,410 Jobs

Source: Minnesota IMPLAN – Analysis performed by NM Voices for Children staff

Table IV shows the estimated impact of freezing the Personal Income Tax rates at the 2005 level. The legislation introduced by Senator Linda Lopez to accomplish this does not freeze the capital gains cut, but only the personal income tax cut. Table V shows the job loss from the PIT tax cuts stabilizing at about -2,410 over the last three years of the simulation horizon. This is a relatively slight job loss in an economy with total nonfarm employment of about 800,000. However, job growth was about 16,300 in December 2004, so the drag on the economy would be held to roughly an eighth of the modest net job growth.