

MiBizwest

Is it smarter to lower Michigan's investment disincentives a lot or a little?

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(Note: On Nov. 13, 2006, Mackinac Center Legislative Analyst Jack McHugh participated in a "Town Hall Meeting" sponsored by The Center for Michigan. Below is the written text of McHugh's speech, in which he explained why it is important to replace the Single Business Tax with government spending reforms, rather than a new tax.)

I'm here to describe how it's very possible to eliminate the SBT and not replace a dime of the revenue. That's what this conference should really be about, by the way.

The government-centric conventional wisdom that prevails near the capitol holds that we must replace the SBT, because it's impossible to cut \$1.8 billion. This is a variant of the "tax cuts must be paid for" concept, which holds that since government is operating as efficiently as humanly possible right now, and since everything it does is equally vital, any revenue lost to a tax cut in one area must be made up with a tax increase somewhere else.

Let me suggest that in a place where the unemployment rate is approaching double the national average and population may be starting to decline, "tax cuts must be paid for" not only is out of touch with the real world, but reveals confusion about whether government exists to serve the people, or vice versa. It also contributes to fuzzy thinking about business taxes.

You often hear the phrase, "Businesses don't pay taxes, they pass them on to customers in higher prices, or to labor in lower wages." Actually, that misrepresents where the burden really falls.

If a firm could raise prices without hurting the bottom line, it wouldn't wait for a new tax to do so. If it's selling to a national or international market, none of the supply-demand equations change because of a new state tax.

The same applies to labor. A firm subject to a new tax can't just take it out of wages. They were already paying as little as possible to get the right mix of skill and dependability. If they could have paid less, they would have done so.

Sometimes you hear that firms



competing in a local market all pay the same tax, so they can all raise prices and no one suffers. Not true. I'll use coffee shops to illustrate. Imagine a tax hike forces all the coffee shops to raise the cappuccino grande price from \$2.50 to three-bucks. It's wrong to assume that all customers will pay more. At \$2.50 I might have bought five cappuccinos a week. At three-bucks I went to Meijer and bought a thermos to bring my own coffee to work.

Add up all the similar consumer responses and the result is a deadweight loss in the earnings of every coffee shop in the state. They gain nothing new from those willing to pay the higher price, and lose the earnings from those who aren't willing.

OK, so in the aggregate the real burden doesn't fall on consumers or labor. There's only one place left to squeeze. Investors. Entrepreneurs. The owners of the company. In my example, a tax hike makes every coffee

shop in the state just a little bit less profitable. The result will be fewer coffee shops and coffee shop workers in the future than would have been the case without the tax hike.

Business taxes are nothing less than a tax on investment. As everyone knows, if you want less of something, you tax it more. If you want more of it, you tax it less.

If you want more investment in Michigan, and more jobs, you lower or eliminate business taxes. If you want less investment and fewer jobs, you spend all your time talking about how to lower business taxes by a lesser amount.

Sometimes we hear, "Shouldn't businesses pay their fair share?" That's really a meaningless question, a silly one even. The right question for this conference is, "Is it smarter to lower the disincentive to invest in Michigan more, or to lower it less?" Unless you're confused about who's the master and who's the servant in the relationship

between government and the people, the answer should be obvious in a state with an economy that's sick in large part because it's not seen as a good place to do business.

Some of those present today have sought to minimize the role of taxes as a factor in Michigan's economic malaise. The Tax Foundation did a comprehensive literature review on this issue, and found that, as they put it, "The economic literature over the past 50 years has slowly cohered around" the hypothesis that businesses are responsive to the lure of low-tax jurisdictions. They concluded that taxes matter a great deal to business, and that, "Every change to a state's system makes it . . . more or less attractive to business."

Alright, now I'll explain how to replace the SBT with nothing... **MIBIZ**

(Note: McHugh then presented a 14-point proposal on how to accomplish that goal).

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