



Price Theory for Legislators in One Lesson

By Michael LaFaive

(Editor's note: This commentary is a follow-up to LaFaive's December Viewpoint, titled "Dear Tax Raisers: Please Tell Us Where to Cut," which can be found at www.mackinac.org/11439.)

Summary

The economic law of demand should be an easy concept to grasp, even for Michigan's legislators. Let's hope they apply it soon.

Main Text Word Count: 556

Unfairly labeled "the dismal science," economics is actually exciting in the ways it helps us understand how the world works. One example is "price theory," which studies how prices influence buyers' and sellers' decisions. Legislators are among those who could benefit from some basic lessons, especially in the area of economic development, because they often decry the lack of jobs in Michigan even as they raise the price of creating them.

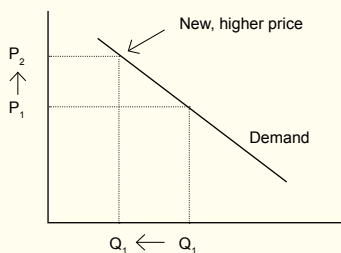
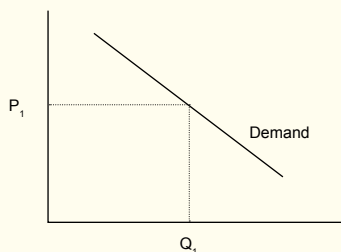
Begin with an economic axiom that amounts to common sense: For almost every product, there's an inverse relationship between price and the quantity demanded. Translation: If you raise the price of wheat (for example), wheat sales decline. If you lower the price, sales rise. Most people recognize this as the law of demand.

Now consider how the Michigan Legislature has routinely raised the price of living, working or creating jobs in the state: In the past few years, it has, among other things, passed a \$600 million business tax hike, new and higher state business licensing fees and a "re-monopolization" of the electric utilities. These price hikes cannot escape the law of demand. As with expensive wheat, the opportunity to live, work or create jobs in Michigan will now attract fewer buyers.

We can see the results all around us, and they appear in state economic output rankings, where Michigan has fallen from 16th to 41st place in just nine years. We see it also in an outbound migration rate that's hit a record high, according to an annual United Van Lines report last June: 70 percent of client traffic in Michigan is in the outbound direction. Census data confirms this trend.

Contrast all this with Texas, which has a nearly 60 percent inbound migration rate and whose net migration showed growth of 584,000 people between 2002 and 2007, according to the U.S. Census Bureau. Among other cost-lowering measures, six years ago Texas decreased the cost of doing business by adopting a major tort-reform package. The Texas Alliance for Patient Access has tracked the increase in various medical personnel in the state since that reform took place. They report that in the last three years, the number of primary care physicians alone has expanded 33 percent

Wheat, or Employed Michiganders



These graphs show how price hikes lower quantity demanded. The idea applies universally — even in the Michigan Legislature. When politicians raise the cost of living, working or creating jobs in Michigan, we get less economic activity.

faster than the population as a whole. Maybe that's just coincidence, but price theory suggests otherwise.

So, are lawmakers just confused about this aspect of economics? Probably not. Why else would they have spent the last 14 years handing targeted tax breaks and subsidies to a handful of select corporations on the theory that lowering the cost of doing business for these "winners" will spur job creation? These targeted programs haven't helped the economy, partly because they've been overwhelmed by the measures the Legislature has adopted that raise costs for everyone else.

The special interests that benefit from the spending supported by tax hikes contend that the alternative is underfunding things like education or road construction, but that's a false dilemma: Mackinac Center scholars and others have offered many reform ideas to save money without impacting the amount or quality of core state services.

For Michigan to once again be a prosperous state full of opportunity, lawmakers must make it an attractive place in which to work, live, invest and create and raise families. Lowering the relative price of those things is the first and best place to start.

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