VIEWPOINT
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Tax Hikes Kill Jobs and Tax Cuts Create Them

By Michael LaFaive

Summary

New economic projections suggest Gov. Jennifer Granholm's proposed tax increases will destroy thousands of jobs and billions of dollars in wages.

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More than 13 percent of Michigan's labor force is unemployed, and thousands of workers are underemployed or fear for their jobs. Yet a tax hike proposal by Gov. Jennifer Granholm would cause the loss of nearly 30,000 Michigan jobs in fiscal year 2011 alone, according to a new Mackinac Center estimate. The Legislature should repudiate this plan and immediately cut state spending and taxes.

The governor's tax increase, proposed in February, would extend the state sales tax to a wide variety of services, while lowering the sales tax rate from 6 percent to 5.5 percent beginning Dec. 1, 2010. This would generate a net tax increase of $554 million in fiscal 2011. Gradually offsetting that hike would be a phased-in elimination of the hated Michigan business tax surcharge over two years (beginning Jan. 1, 2011) and a gross receipts tax rate reduction from 0.8 percent to 0.6 percent, also phased in over two years starting on Jan. 1, 2012. Nevertheless, the entire plan would raise more than $940 million in new state tax revenues through 2014, according to the Michigan House Fiscal Agency.

To gauge the economic impact of these changes, Mackinac Center analysts worked with the tax experts at the nonprofit Beacon Hill Institute in Boston to build a Michigan-specific economic model using the State Tax Analysis Modeling Program. Our model indicates that in fiscal 2011, Michigan would lose 29,900 jobs; wages would drop by more than $1,400 per person; real disposable income would fall by $1.9 billion statewide; and total investments in the state would decline by $264 million.

The subsequent business tax cuts would reverse only part of the damage. After the cuts were fully phased-in beginning in 2014, investment in the state could be expected to increase to a total of $951 million and total real disposable income would rise by $409 million. Despite those improvements, however, the net job loss would still be 13,500 and the net impact on per-capita wages would still be negative through 2014, declining by $1,085 from fiscal 2011.

We recognize that models are simplifications of reality and that they become less accurate the further into the future you try to predict. Still, they can provide useful insights, and in this case, the modeling projections are consistent with the historical record. After all, since 2001, Michigan has

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Estimated Revenue Generated by Category of Service Tax Expansion

(Millions of Dollars)

SECTOR	FY 2010-11
Utilities (water and sewer)	$45.2
Construction (repair and maintenance)	47.9
Transportation and Warehousing	35.0
Information (movies, cable, satellite)	150.3
Accommodation & Food Service (parks & camping)	13.5
Administrative Support & Waste Management (travel agencies, security systems, landscaping, waste)	165.9
Arts, Entertainment & Recreation (spectator sports, fitness centers, golf, skiing, bowling)	170.9
Educational Services (private, for profit services)	23.4
Health Care & Social Assistance (child care)	57.3
Real Estate (realtor classes, market studies)	54.2
Other Services (personal care, death care, dry cleaning)	324.0
Professional, Scientific & Technical (legal, accounting, consulting, architecture)	174.2
TOTAL	**$1,261.8**

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury

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foregone scheduled tax cuts, raised other taxes and hiked myriad "fees" that really function as taxes. In 2007, Gov. Granholm led a successful effort to increase personal and business taxes by $1.4 billion.

Yet in the decade from 1999 to 2008, ours has been the only state to suffer a contraction in state gross domestic product — negative 2.1 percent. During that period, Michigan's per-capita personal income fell to 13.1 percent below the national average, and from April 2006 through April 2010, the state experienced the nation's highest unemployment rate for 49 consecutive months.

It is good to see that the governor's plan acknowledges that at least some tax cuts are necessary.

The grim reality is that a tax hike at this time could contribute to an economic "death spiral," in which extracting more revenue from businesses and families leads to reduced economic activity, leading in turn to calls from the political establishment for even more tax increases.

In fairness, it is good to see that the governor's plan acknowledges that at least some tax cuts are necessary. Still, we question the need to phase them in only after a tax hike. It is not hard to imagine politicians later amending the law to thwart the promised tax cuts once the new tax revenue has begun rolling in.

The governor's proposal is the wrong tack to take with a state that has experienced a lost decade of economic growth. Research and experience have shown that, on balance, taxation is a jobs and opportunity killer. Gov. Granholm's tax proposal should be rejected before it kills more jobs and denies more wealth to Michigan residents.

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