October 7, 2009

Dear Oregonians:

The 2009 legislature raised taxes on corporations and high-income Oregonians to help address Oregon’s revenue shortfall due to the recession. These targeted revenue measures were part of a fiscal plan that also included cutting public services and maximizing the receipt of federal recovery funds to meet Oregon’s $4 billion revenue shortfall.

We are a group of Oregon economists who have considered what the legislature did and have concluded that there is a valid economic case for the actions the legislature took.

Unlike the federal government, our state government must maintain a balanced budget. Because Oregon cannot engage in deficit spending, in a fiscal crisis the state must balance its budget by cutting services, raising taxes or both.

There are, as a result, no easy options for states in this kind of recession. That said, the worst thing the state can do during a recession is further reduce aggregate demand — the total spending by households, businesses and government. Without the revenue measures enacted by the legislature, aggregate demand in Oregon will further fall and the economy will further contract.

The bulk of the money that the state spends on public services — more than 90 percent of which goes to education, health and human services and public safety — is spent right here in Oregon.

Cutting state spending reduces in-state aggregate demand, virtually dollar-for-dollar. Some forms of state spending, particularly in the area of health care, bring matching federal dollars into the state’s economy. So cuts to certain public services result in even bigger reductions in aggregate demand because they prevent federal dollars from coming into Oregon’s economy.

Tax increases targeted at high-income households and corporations also reduce demand, but not as much as cutting state services. High-income people typically don't spend all their money, and some of the money that they do spend is likely to be spent outside Oregon. In addition, the deductibility of state income taxes from federal taxable income means that a fraction of state tax liabilities are, in effect, shifted to the federal government. Therefore, a tax increase on high-income Oregonians does not reduce aggregate demand in Oregon dollar for dollar. And since a significant fraction of Oregon’s corporate taxes are paid by out-of-state, multi-state corporations, the corporate tax measure also does not reduce demand dollar for dollar in Oregon.

Eminent economists, such as President Barack Obama's budget director Peter Orszag, and Nobel Prize winner Joseph Stiglitz, agree that in a recession, it is preferable for states to enact targeted tax increases than to cut services.

In sum, our economic analysis leads to the conclusion that the Oregon legislature's decision to balance budget cuts with tax increases targeted on corporations and high-income Oregonians while maximizing receipt of federal dollars to fill a $4 billion shortfall was, from an economic perspective, a prudent course of action.

Signed: [1]

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