Oregon Center For Public Policy

Executive Summary

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December 21, 2003

Preventing Self-Inflicted Wounds:
Voting Yes on Measure 30 is Critical for Oregon's Economy

By Jeff Thompson

In February, Oregon voters will decide the fate of a $1.1 billion revenue package adopted by the 2003 legislature. Voting "yes" on Measure 30 will shore up state programs and services that have been undermined by a weak economy. The failure of Measure 30 would drain $1.9 billion from the economy at a time when Oregon is attempting to sustain a fragile economic recovery.

Opponents of Measure 30 argue that increased taxes in the legislative revenue package would interfere with Oregon's economic recovery. Analysis of legislative revenue package, however, shows that its failure would be worse for the economy:

- Failure of Measure 30 will drain over $1.9 billion from Oregon's economy compared to only $347 million if it succeeds.
- Budget cuts that will be implemented if Measure 30 fails will drain $282 million in federal matching funds from Oregon's economy over the next three years.
- If Measure 30 succeeds, $120 million in reduced federal income taxes, due to the deductibility of state income taxes on federal income taxes, would be available for Oregon's economy.

If Measure 30 fails, decreased spending by state government will trigger public and private sector job losses. In the 2003-05 budget, education spending would be cut by $428 million, public safety by $83 million, and human services programs by $269 million.

Voters will still be paying lower taxes even if they approve Measure 30, due to a series a large federal tax cuts. Middle-income Oregonians will pay $81 under Measure 30 in 2003, but also receive an $844 federal tax cut. The richest one percent of Oregonians will pay $4,084 under Measure 30, and benefit from a $36,500 federal tax cut.

Measure 30 will have little impact on Oregon's business climate. Oregon already has among the lowest business tax burdens in the country, and ranks favorably for overall business costs. Education and public safety, two state services that are more important for business location decisions, face millions of dollars in additional cuts if Measure 30 fails.

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In February, Oregon voters will decide the fate of a $1.1 billion revenue package adopted by the 2003 Legislature. Measure 30 will shore up state programs and services that have been undermined by a weak economy. Its defeat would drain $1.9 billion from the state's economy at a time when the state is attempting to sustain a fragile economic recovery.

The Legislature's revenue package was designed to balance the state's budget while avoiding further cuts to education, public safety and human services programs. The primary source of revenue is a temporary income tax surcharge. Several smaller permanent and temporary changes to the tax code comprise the remaining revenue sources.

The tax increases in the revenue package are overwhelmingly based on the ability to pay. The typical household would pay just $81 in 2003, with the lion's share of individuals' tax dollars coming from the top fifth of Oregon households. Despite a state tax increase, Oregonians will be left with lower overall taxes due to large federal tax cuts.

Opponents of the revenue package argue that raising taxes will slow Oregon's economic recovery. The truth is, though, that if voters overturn this revenue package, the state's economy will be much worse off than if it is approved. Raising taxes does take a bite out of consumer spending, but there are obvious benefits to the state's economy that would flow directly from the tax increase. If voters kill the measure, $1.9 billion will be sucked from Oregon's economy with no replacement dollars in sight.

Enactment of Measure 30 will have little impact on Oregon's business climate or the state's ability to attract and retain businesses in the future. Oregon's business taxes are low compared to other states, and taxes are not an important factor in business location decisions. On the other hand, the revenue package's defeat will lead to further deterioration of the state's educational institutions and other public infrastructure, truly damaging the state's business competitiveness and economic development capacity.

Primer on the revenue package: budget and tax implications

The Legislature's revenue package would raise $792 million for the 2003-05 budget cycle (biennium) and $311 million for the 2005-07 budget cycle. A temporary income tax surcharge accounts for the bulk of the tax increase. The revenue package also calls for raising the corporate minimum tax and reducing some existing tax deductions and exemptions.[1]

The progressive personal income tax surcharge expires after 2005.[2] This graduated surcharge would raise 64 percent of the package's $1.1 billion; rates range from zero to nine percent of tax liability, depending on the taxpayer's income. The typical Oregon household would pay $71 under the surcharge in 2003, while the most affluent one percent of households would pay $4,483 (See Appendix A). Household heads and couples filing jointly with income below $20,000 pay nothing under the surcharge.

The measure also makes permanent changes to the income tax code. These permanent changes account for just 7 percent of the total General Fund revenue produced under the measure. One of these permanent changes phases out the special state deduction for elderly medical expenses as incomes increase.[3] Most seniors would not be affected; only 31 percent of seniors would see any increase from this change.[4]

Increased corporate income taxes account for 24 percent of the General Fund revenue raised. Measure 30 increases the minimum corporate income tax from $10 to a range of $250 to $500 for "S" corporations and $250 to $5,000 for "C" corporations, based on the amount of sales in Oregon. The measure would also temporarily reduce corporate tax credits, change the treatment of "extraterritorial" income, lower the depreciation for SUVs purchased for certain business use, and lower the subtraction for corporate dividends.[5]

The package would also:

- extend a 10 cent per pack cigarette tax first enacted in 1993 that will otherwise expire, raising $22 million in 2003-05.[6]
- reduce the discount for early payment of property taxes, raising $43 million in 2003-05.[7]

Budget impacts of failure

The revenue package was integral to the Legislature's efforts to balance the state budget. If Measure 30 fails at the polls, state programs will face deep cuts. House Bill 5077 includes $546 million in automatic cuts to the 2003-05 budget if the revenue package is not approved by voters.

Reductions under HB 5077 include:

- $290 million in education funds siphoned primarily from K-12, community college and higher education budgets.
- $188 million in human services program cuts targeting services to the disabled and the elderly, health care for low-income families, and job training.
- $58 million in public safety program spending affecting mainly state police and corrections budgets.

Since HB 5077's automatic reductions don't balance out the potential lost revenue, a "no" vote on the revenue package will lead to an imbalance in the state's general fund, forcing the Legislature to meet in a special session to fix the imbalance.[8] At that point legislators could come up with another way to raise the necessary funds. Or they could slash another $248 million in from the 2003-05 budget, pushing total cuts in this budget cycle beyond $790 million.[9]

Another $311 million will have to be sliced in the 2005-07 budget cycle if the package is defeated.

Distribution of taxes in the revenue package

The centerpiece of the revenue package is a temporary, graduated personal income tax surcharge. Overall, the package is progressive; is means that those with the highest incomes would pay the bulk of the increase. The typical Oregonian would pay $81 more per year in taxes under the revenue package, or less than $7 per month, during each year through 2005. The top 20 percent of Oregonians, those with incomes above $71,000, would pay 71 percent of the revenue package. The richest 1 percent of Oregonians would pay an average of $4,084 more per year and the lowest-income 20 percent will pay $14 more. (See Appendix A for distribution table).

Because state income taxes are deductible on federal income taxes, the revenue package would offset to some extent federal income taxes paid by Oregonians. The richest one percent would pay $4,730 more in Oregon taxes, but $646 less in federal taxes. Decreased federal taxes offset 15 percent of the total state tax increase.[10]

The economic impacts of Measure 30 and its failure

Some Oregonians fear that raising taxes will further weaken the state's economy. They argue that, by increasing taxes now, voters will hurt consumer spending and threaten the weak recovery that has begun in Oregon.

This fear is misplaced. While implementation of Measure 30 may dampen consumer spending somewhat, on balance, far more damage will be done to the state's economy if voters reject the revenue package.

If the revenue package fails, Oregon's economy will lose $1.3 billion in 2003-05 and $549 million in the next two-year budget cycle (Table 1 and Figure 1) - a combined $1.9 billion. If voters approve the revenue package, the economy will decline by only $245 million in 2003-05 and $102 million in the 2005-07 biennium--$347 million.

The budget cuts triggered by the measure's failure will deprive the state of millions of dollars in lost federal matching funds. State budget cuts will lead to decreased spending among those who receive income from the state. Meanwhile, any spending reductions caused by the new tax would be minimized because much of the increase is levied on upper-income families, who are more likely to dip into savings to pay the tax before they will rein in their spending.

A "no" vote would likely further undermine the state's reputation as a place to create or expand a business. Studies have shown that business location decisions are more closely tied to the quality of education, infrastructure, and public safety services than to taxes. Already, Oregon ranks low among the 50 states for business costs and business tax burden.[11] Yet, Oregon's difficulties in funding its schools, as publicized in Doonesbury, have generated far more national publicity than the low cost of doing business here. Failure of the revenue package will force $428 million in additional budget cuts for education in 2003-05, while its passage will have minimal impact on already low business taxes.

Which is worse? Tax increases or reduced spending?

In principle, neither tax increases nor reductions in state spending are good for a slowly growing state economy. Higher taxes can lead to reduced consumer spending, depending in large part upon who is required to pay the increased taxes. On the other hand, reduced state spending can damage the economy, as well. As a major employer and purchaser of goods and services in Oregon, state spending infuses the economies of rural and urban communities alike. State dollars also attract federal tax dollars for matching-fund projects, which sustain and create jobs and produce wealth locally.[12]

It's better for a state's economy to maintain spending through higher taxes than to try to save money by cutting taxes. Economists Joseph Stiglitz, a winner of the 2001 Nobel Prize in Economics, and Peter Orszag of the Brookings Institute have noted that during a downturn "the adverse impact of a tax increase on the economy may, if anything, be smaller than the adverse impact of a spending reduction, because some of the tax increase would result in reduced saving rather than reduced consumption."[13]

High-income families can afford to finance tax increases by reducing their savings rather than cutting back on spending. Unlike most low- and middle-income families, high-income households typically make more money than they need to meet their living expenses. In 2002, the highest-income fifth of American households had an average *after-tax* income of $113,000, but only $79,000 in living expenses, or 70 percent of their after-tax income.[14] Those with very high incomes need even less of their income to meet their living expenses. The richest five percent of Americans spend 63 percent of their income on living expenses and the richest one percent spend only half of their income on living expenses.[15]

Stiglitz and Orzag recommend that states target the wealthy for tax increases. That way, the degree to which the money comes from savings is maximized, while the effect on spending is minimized. Measure 30 follows the Stiglitz and Orzag recommendation.

The Legislature's progressive tax package calls for 43 percent of the new money to come from the most affluent five percent of Oregonians, with incomes over $129,000. Thus, a considerable share of the tax increase would likely be paid through reduced saving rather than curtailed spending. Fully 71 percent would be paid by the top fifth of households.

Estimating reduced consumer spending

Economists disagree on the degree to which a temporary tax hike depresses consumer spending. One prominent economic theory, the "permanent income" theory of consumption, predicts that consumers will not modify spending at all in the face of a temporary tax-induced decline in income. Research has found that the theory, and its related assumptions, does not strictly hold.[16] However, while we may assume that the temporary tax increase will somewhat dampen consumer spending, we also know the decline will be much smaller than the full amount of the tax.[17] This is especially true of a temporary tax increase paid chiefly by the affluent. The research supports that temporary increases have considerably smaller impacts on consumer spending than do permanent ones.[18]

Several studies of a *temporary* income tax increase at the federal level have found a drop in consumer spending of roughly 35 cents for each dollar of revenue the government gained.[19] Another recent study found that a temporary proportional increase in federal taxes would reduce consumption by 29 cents for each dollar of increased taxes.[20] Much of the research literature also finds even smaller responses to federal income tax changes.[21] The decline in consumer spending is greatly influenced by which taxpayers are actually paying most of the freight of a new tax.

This OCPP analysis conservatively assumes that consumer spending would decline by 35 percent of the tax increase.[22] Since the increase in Oregon taxes is offset by a decrease in federal taxes, consumer spending declines as a share of the net tax increase. This estimate suggests that consumer spending would decline by $245 million in the 2003-05 budget cycle, and $102 million in next budget cycle (2005-07) if voters approve the legislative revenue package (Table 1). Combined, consumer spending would decline by $347 million.

Table 1. Economic impacts of success and failure of revenue package

	Failure of revenue package			Revenue package success		
	2003-05	2005-07	Combined	2003-05	2005-07	Combined
State spending (including lost matching funds)	-$988 million	-$407 million	-$1.4 billion	$0	$0	$0
Consumer spending	-$346 million	-$142 million	-$488 million	-$245 million	-$102 million	-$347 million
TOTAL	-$1.3 billion	-$549 million	-$1.9 billion	-$245 million	-$102 million	-$347 million
Addendum:						
Change in disposable income	-$988 million	-$407 million	-$1.4 billion	-$701 million	-$292 million	-$993 million
Federal income tax offset				$89 million	$31 million	$120 million
Federal matching funds	-$198 million	-$84 million	-$282 million			

Notes: State spending is change from baseline, adjusted for change in federal matching dollars. Disposable income is the change in state spending (in the case of failure) or the tax increase minus the federal income tax offset (in the case of success). Changes in consumer spending are calculated as 35 percent of the change in disposable income.

If voters reject Measure 30, Oregon's economy will lose $1.3 billion in 2003-05 and $549 million in the next budget cycle, totaling $1.9 billion.

If voters approve the revenue package, the economy will decline by only $245 million in 2003-05 and $102 million in the 2005-07 biennium, totaling $347 million.

The estimated decreases in consumer spending if Measure 30 succeeds at the polls would be smaller than the decline in government spending if the revenue package fails. If it fails, spending by the state of Oregon, not including additional lost matching funds, will decline by $790 million in the 2003-05 budget cycle and $323 million in 2005-07, totaling $1.1 billion. Including lost matching funds, state spending will decline by $988 million in 2003-05 and $407 million over the following two years.[23]

Consumer spending will take a hit if Measure 30 is approved by the voters, but it will take a *far harder* hit if it fails. People will lose their jobs and contractors will lose contracts due to reduced state spending. Because it is graduated, the revenue package is focused on those least likely to cut their spending in the face of a new tax. The alternative—further state budget cuts—will be focused largely on people who belong to middle-income and lower-income households. Consumer spending will decline by $488 million if the revenue package fails, with $346 million of the decline coming in 2003-05.[24]

Loss of federal matching funds exacerbates state spending cuts

Spending on many state programs is "matched" by, or otherwise tied to, federal dollars. If state spending is cut, fewer federal dollars flow into Oregon, exacerbating the impact of the cuts. Spending on matched programs is considerable, and the resulting loss of federal dollars if the revenue package fails will be significant.

Human services programs bring in the most federal matching dollars. Federal Medicaid funds are the largest source of federal human services funds and are spent in Oregon on a wide range of services. Medicaid funds spent on the Oregon Health Plan go to hospitals and doctors and their employees and suppliers. Long-term care expenditures keep nursing homes, assisted living facilities and adult foster homes in business.[25] A "no" vote on the revenue package in February will lead to $269 million in cuts to state human services programs in 2003-05 under House Bill 5077.

OCPP analysis indicates that the following losses will be triggered if the revenue package fails:

- A $197 million reduction in federal matching funds for human services and healthcare programs in 2003-05.
- $83 million in lost human services and healthcare matching funds in the 2005-07 budget cycle.[26] (This is an estimate, since the next Legislature will make the final decision.)
- A combined loss of $465 million in 2003-05 for providers of and recipients of health care and social services.
- Job losses in hospitals, nursing homes, and other providers of health care and social services.

Each $1 million reduction in state general funding of long-term health care providers results in approximately 47 jobs lost, according to an ECONorthwest analysis of reduced spending for long-term care providers.[27] Long-term care spending accounts for nearly one-third of Oregon's $2.4 billion general fund Human Services budget.[28] Since services to seniors and the disabled will face $18 million in cuts in 2003-05, the ECONorthwest analysis suggests the job losses associated with the failure of the legislative revenue package could be significant. These job losses will result in further decreased consumer spending at other Oregon businesses and reductions in state and local tax receipts. Other health care and social service sectors would suffer similar impacts.

All state programs combined will lose $198 million in federal matching funds in 2003-05 and an estimated additional $84 million in the 2005-07 budget cycle. Combined, Oregon will lose $282 million in federal matching funds over the next three years if the revenue package fails.

Reducing federal taxes

Itemizers can fully deduct state income taxes when calculating federal income taxes. Thus, increasing Oregon's state income tax will trigger a partially offsetting decrease in federal income taxes paid by Oregonians. The degree of the state tax offset of federal taxes is largely based on the degree to which the state tax increase targets higher income households. Such households tend to itemize more than lower-income households. They also tend to have higher federal tax rates. The revenue package would raise $591 million in state personal income taxes in 2003-05, but would lower the amount of federal income taxes paid by

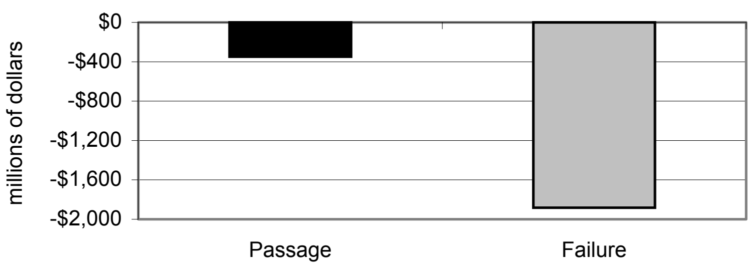
$89 million, offsetting 15 percent of the increase.[29] Federal taxes paid by Oregonians would decline by $31 million in the 2005-07 biennium.

If the revenue package fails, Oregonians will send an "extra" $120 million to the federal government--$120 million that could have stayed in Oregon's economy.

Combined economic Impacts

The state's ongoing fiscal crisis is harmful to Oregon's economy, regardless of the success of the revenue package. Decreased spending, from cuts to state programs or from increased taxes on consumers, will further depress the economy and make the recovery more difficult. The revenue package's success, however, is not as bad for the economy as its failure would be. Failure of the revenue package would cause far greater damage to the economy, in terms of reduced spending, than its approval. The combined impacts of the revenue package's failure will drain $1.9 billion from Oregon's economy (Figure 1). If the revenue package is approved, the loss will be minimized at just $347 million. The combined economic damage caused by the failure of the revenue package is over five times as large as its success.

Figure 1. Impacts of revenue package - passage and failure
(Combined 2003-05 and 2005-07)



Source: OCPP analysis

The combined impacts of the revenue package's failure will drain $1.9 billion from Oregon's economy.

If the revenue package is approved, the loss will be minimized at just $347 million.

"Business climate" and long-term economic prospects

The revenue package's modest corporate tax increase will have little impact on Oregon's "business climate." In fact, it contains much-needed reform. The main provision impacting corporations is the increase in the minimum corporate income tax. Prior to the adoption of the revenue package, two-thirds of Oregon's corporations paid a minimum income tax of $10.[30] Some of these companies were profitable, but used accounting loopholes to avoid paying more in taxes. The package raises the minimum corporate income tax to a range of $250 to $500 for "S" corporations and $250 to $5,000 for "C" corporations, based on the amount of sales in Oregon. The increase in corporate minimum tax will raise $73 million in 2003-05 and $76 million in 2005-07, representing 13 percent of the total revenue package.

The other provisions of the revenue impacting corporations include temporarily reducing or delaying corporate tax credits and the subtraction for dividends, as well changes in the treatment of "extraterritorial" income and expensing and depreciation of SUVs. These five changes will raise $151 million in 2003-05 and $112 million in 2005-07. All of the corporate tax changes combined account for 24 percent of the revenue package.

The modest corporate tax increase in the revenue package is consistent with Oregon's status as a low-tax state for business. A 2001 study by the Utah State Tax Commission showed that Oregon had the lowest state and local business tax burden among Western states.[31] Research on business taxes in all fifty states shows that Oregon consistently has among the lowest state business taxes in the nation.[32] Recent analysis also shows that Oregon ranks low compared to the rest of the nation for overall business costs.[33]

What matters for business location decisions?

Oregon has lower business taxes than most other states, but the research literature indicates that this matters little for business location decisions. One recent analysis found that "tax incentives and tax packages are uniformly viewed as low priorities by location consultants, relatively unimportant to the basic decision."[34]

More important for business location is education and the quality of a region's workforce. The study documents a survey of business leaders where "72 percent cited workforce suitability as the top criterion in the selection of a city. In the past, location decision-makers put more emphasis on land, buildings and transportation networks. Corporate real estate executives' litany has changed from 'location, location, location' to 'education, education, education.'"[35] It takes money to provide education. If the revenue package fails, further cuts will be made at all levels of education in Oregon.

Oregon has a low business tax burden, but has faced education financing problems since Measure 5 was enacted more than a decade ago. Once viewed as a model, in recent years Oregon's education system has been held up for national ridicule and been cited repeatedly as an impediment for firms to attract top-quality job candidates with children.[36] The state's colleges and universities have been forced to scale back curriculum and programs, too. This chronic inability to finance public education presents a serious impediment to Oregon's future economic development. The revenue package does not overturn the millions in cuts that education, public safety, and other public services have absorbed over the past two years. But it would prevent hundreds of millions of dollars in additional cuts that will make the situation even worse.

Epilogue: Lower taxes despite the revenue package…

If voters approve the legislative revenue package, Oregonians will be paying more in state taxes, but will still be paying less in taxes overall. This is because the increased taxes in the revenue package are far smaller than federal tax cuts passed in recent years. For example, the typical Oregon household will pay $81 in 2003 due to the revenue package, but receive $763 in overall tax cuts as a result of federal tax cuts implemented since 2000. (See Appendix A for details on the combined tax change.)

Based on the ability to pay, the legislative revenue package boosts state taxes on the most affluent one percent of Oregonians by $4,084 in 2003. Because the federal tax cuts are targeted toward the affluent, these households will get a federal tax cut of $36,500 in 2003 and pay $32,416 less in taxes overall.

The legislative revenue package will allow the state to avoid further cuts to vital state services, and Oregonians will still be paying much less in overall taxes.

Appendix A

Appendix A. Impact of tax changes in Measure 30 - All Oregon taxpayers, 2003

	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $16,000	$16,000 – $27,000	$27,000 – $43,000	$43,000 – $71,000	$71,000 – $129,000	$129,000 – $265,000	$265,000 – Or More
Average Income in Group	$9,600	$21,000	$34,000	$55,600	$91,000	$176,900	$709,800
State Tax Change, All Taxpayers in 2003							
Personal Income Tax	$3	$22	$71	$142	$350	$920	$4,483
Corporate Income Tax	$1	$2	$3	$5	$12	$36	$234
Cigarette Tax	$10	$11	$12	$14	$13	$12	$14
Gross Average State Tax Increase	$ +14	$ +35	$ +85	$ +161	$ +375	$ +969	$ +4,730
as % of income	**+0.1%**	**+0.2%**	**+0.3%**	**+0.3%**	**+0.4%**	**+0.5%**	**+0.7%**
Federal Offset, avg $	$ —	$ –0	$ –4	$ –16	$ –70	$ –134	$ –646
Net state/federal impact of Measure 30	**$ +14**	**$ +34**	**$ +81**	**$ +145**	**$ +305**	**$ +835**	**$ +4,084**
Compare: Federal Tax Cuts in 2003							
Average Cut	$ –106	$ –419	$ –844	$ –1,506	$ –2,963	$ –6,127	$ –36,500
Net State and Federal Changes in 2003							
Average Cut	$ –93	$ –385	$ –763	$ –1,361	$ –2,658	$ –5,292	$ –32,416
Average % of Bush cuts offset by state	13%	8%	10%	11%	13%	16%	13%

SOURCE: Institute on Taxation and Economic Policy, December 2003.

Endnotes:

[1] See "Budget Highlights: 2003-05 Legislatively Adopted Budget," Legislative Fiscal Office, September 2003, and other documents from the Oregon Secretary of State for more details on the legislative revenue package.

[2] The temporary tax increase will be suspended in 2005 if the December 2004 forecast projects an ending balance for the 2003-05 budget cycle that is more than four percent of 2003-05 General Fund appropriations.

[3] The measure also gradually raises the age threshold for seniors to use the special state medical expense deduction. The measure increases the threshold from age 62 by one year each year until 2005, when the threshold will be age 65.

[4] See "No Change for Most Seniors," Leachman, Michael, October 29, 2003, Oregon Center for Public Policy, available at www.ocpp.org.

[5] The revenue package defers 20 percent of corporate tax credits until 2006. Deductions for dividends that corporations receive from subsidiaries are reduced from 70 percent to 35 percent through the end of 2005. Previously "extraterritorial" income was excluded from a corporation's taxable income, but the revenue package requires that it be included.

[6] Two other tax increases were part of the legislative revenue package, but are not part of the general fund budget and are not part of what voters will consider on February 3rd. These are two industry-specific taxes, impacting providers of long-term care facilities and managed care. These levies will bring in $73 million in 2003-05 and $132 million in 2005-07, but are not included in the calculations in this paper.

[7] Currently property tax payments made by November 15th of each year receive a three percent discount, and early payments of two-thirds of the amount owed receive a two percent discount. The legislative revenue package reduces the first discount to two percent, and eliminates the two-thirds discount altogether.

[8] Although a special session is likely, it is possible that the Governor could act to implement cuts to balance the budget without legislative action. This approach, however, is uncertain. When similar administrative cuts were proposed in the past, legal questions were raised.

[9] This analysis assumes that the budget gap created if voters reject the revenue package will be closed entirely through budget cuts.

[10] Calculated for OCPP by the Institute for Taxation and Economic Policy (ITEP).

[11] Pennsylvania Economy League, "A Comparative Analysis of Major State Business Taxes in Pennsylvania and Other States," June 2001. Available at http://www.pittsburgh-region.org/public/cfm/library/reports/RptBizTax2000.pdf.

[12] Tax cuts can serve as economic stimulus at the federal level because the federal government can maintain spending and engage in deficit spending. Declining tax revenues in Oregon, however, are clearly a drag on the economy, because the constitutional requirement of a balanced budget forces budget cuts.

[13] Orszag, Peter and Joseph Stiglitz, "Budget cuts Vs. tax increases at the state level: Is one more counter-productive than the other during a recession?" Center on Budget and Policy Priorities, November 6, 2001. Available at http://www.cbpp.org/10-30-01sfp.pdf.

[14] OCPP analysis of 2002 Consumer Expenditure Survey data, available at http://www.bls.gov/cex/2002/Standard/quintile.pdf.

[15] Dynan, Karen, Jonathan Skinner, and Stephen Zeldes, "Do the Rich Save More?" National Bureau of Economic Research working paper, July 2000, page 22.

[16] The economics literature on consumption has consistently found in recent years that consumers behave differently than predicted in the canonical "life-time income, permanent income" theory. Because some households have very low incomes or are otherwise unable to borrow, many households engage in precautionary savings, and some households save in order to leave their heirs an inheritance, the simple theory is inadequate for use in policy discussions.

[17] A consistent body of economic research has found that tax changes do impact consumption. Many studies, like those briefly summarized below, focus on tax changes that are permanent, or that are levied primarily on low and middle-income households, or both. These types of tax changes would be expected to have a larger impact on consumption than would a primarily temporary tax increase that falls more heavily on upper-income households, as the legislative revenue package does. One recent study of permanent payroll tax increases found that consumer spending declined by 50 cents for

each dollar raised. (Parker, Jonathan, "The Reaction of Household Consumption to Predictable Changes in Payroll Tax Rates," *American Economic Review*, September 1999.) One would expect the impact of payroll tax increases to be greater than increases based on income taxes, because payroll taxes place a lower burden on high-income earners. Another study of *temporary* federal *income* tax rebates, which are concentrated disproportionately among lower and middle-income households, found that consumer spending responded by 35 percent to 60 percent of the size of the tax change. (Souleles, Nicholas, "The response of Household Consumption to Income Tax Refunds," *American Economic Review*, September 1999. Souleles studies consumption responses to federal income tax rebates, but the results from this research are typically treated as symmetric and the same reaction, in the other direction, would be expected of a tax increase.) See also Auerbach, Alan and Daniel Feenberg, "The Significance of Federal Taxes as Automatic Stabilizers," NBER working paper, April 2000. Available at http://emlab.berkeley.edu/users/auerbach/ftp/jpe.pdf.

[18] Alan Blinder found that temporary tax increases had one-half of the impact on consumer spending compared to permanent ones. Blinder, Alan, "Temporary Income Taxes and Consumer Spending," *Journal of Political Economy*, 1981, vol. 89, no. 1.

[19] Steindel, Charles, "The Effect of Tax Changes on Consumer Spending," Current Issues in Economics and Finance, Federal Reserve Bank of New York, December 2001. The 1968 federal income tax surcharge was a ten percent increase in its first year, then reduced to 5 percent in 1969 and expired in 1971. The bulk of the legislative revenue package is a three-year temporary income tax surcharge.

[20] Heathcote, Jonathan, "Fiscal Policy with Heterogenous Agents and Incomplete Markets," Duke University working paper #01-03, July 28, 2001.

[21] Economists Joel Slemrod and Matthew Shapiro survey the literature and identify studies showing that consumer spending increased between 16 percent and 24 percent of the size of a temporary federal income tax cut in 1975 (Blinder and Poterba). Shapiro, Matthew and Joel Slemrod, "Consumer Response to Tax Rebates," October 9, 2002, University of Michigan working paper. Research by economist Chrisopher Carroll showed that the marginal propensity to consume out of *permanent* tax cuts might be as low as 30 percent. Carroll, Christopher, "'Risky Habits' and the Marginal Propensity to Consume Out of Permanent Income, or, How Much Would a Permanent Tax Cut Boost Japanese Consumption?" July 21, 2000, National Bureau of Economic Research working paper. Economist James Tobin also finds that temporary income tax increases have small impacts on consumption, "Monetary and Fiscal Effects on Consumption," *Essays in Economics, Volume 2*, MIT Press, 1981.

[22] This estimate is regarded as "conservative" since many analyses of the impact that *permanent* tax changes have on consumption yield results that are only slightly larger or even smaller than 35 percent. Also, most analyses of the impact of tax changes on consumption are at the federal level. What matters for Oregon's economy is the "in-state" propensity to consume. The extent to which households, particularly upper-income households, spend money outside of Oregon, that decrease in spending is not thought to harm Oregon's economy.

[23] Estimates of the lost federal matching funds due to budget cuts are based on projections made by state agency budget staff prior to the vote on Measure 28, and data from the 2003-05 Legislatively Approved Budget on Federal matching funds by program.

[24] This analysis conservatively assumes that the loss in disposable income triggered by state budget cuts and lost federal matching funds would result in a 35 percent reduction in consumption among impacted households. Households losing jobs due to state budget cuts are more likely to reduce spending than are the affluent households that will pay most of the increase in taxes.

[25] Other federal funds, such as food stamp benefits, flow directly into Oregon's economy.

[26] The estimate assumes that the distribution of budget cuts from lost revenue in 2005-07 are identical those cuts outlined for the 2003-05 budget cycle in HB 2512.

[27] ECONorthwest, "The Economic Impacts On the Oregon Economy from the Loss of Federal Matching Funds for Long-Term Care Services for Seniors and Persons With Disabilities," 2002, page 3.

[28] Analysis of the 2003-05 Legislatively Adopted Budget, Legislative Fiscal Office, December 1, 2003, available at http://www.leg.state.or.us/comm/lfo/03_05_leg_adopt_budget/2003-05%20LAB.pdf.

[29] Calculated for OCPP by ITEP.

[30] Sheketoff, Charles, "Corporate Taxes 101," February 2003. Available at www.ocpp.org/2003/cp0302.htm.

[31] "Western States' Tax Burdens, Fiscal Year 1999-2000," Utah State Tax Commission, available at http://txdtm01.tax.ex.state.ut.us/esu/BURDENS/westburd00.html. States studied by the Commission include Arizona, California, Colorado, Idaho, Oregon, Utah, and Washington.

[32] Pennsylvania Economy League, "A Comparative Analysis of Major State Business Taxes in Pennsylvania and Other States," June 2001. Available at http://www.pittsburgh-region.org/public/cfm/library/reports/RptBizTax2000.pdf.

[33] According to the Oregon Progress Board, a recent analysis by the Regional Financial Associates found that Oregon had the tenth lowest "business cost index" in the country. Oregon Progress Board, "Background Data: How is Oregon Doing?" Summer-Fall 2002, page 30.

[34] Cohen, Natalie, "Business Location Decision-making and the Cities: Bringing Companies Back," Brookings Institution Center on Urban and Metropolitan Policy working paper, April 2000.

[35] Ibid.

[36] Recently, Paul Kelly, an executive with Nike shared a story with Oregon Public Broadcasting about Nike losing a job candidate due to concerns over school funding.

The author thanks Dean Baker, executive director of the Center for Economic and Policy Research for his advice in preparing this report and Matt Gardner of the Institute on Taxation and Economic Policy for his work modeling the distributional impacts.

This work is made possible in part by the support of the Ford Foundation, the Governance and Public Policy Program of the Open Society Institute, the Penney Family Fund, the John and Martha Marks Fund of the Oregon Community Foundation, and by the generous support of organizations and individuals. The Oregon Center for Public Policy is a part of the State Fiscal Analysis Initiative (SFAI) and the Economic Analysis and Research Network (EARN).