

Taxes and State Economic Performance

Presentation to the New Mexico
Legislative Revenue Stabilization
and Tax Policy Committee

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New Mexico Was Kansas before Kansas

Top rate of New Mexico's personal income tax cut more deeply than that of any other state except Ohio

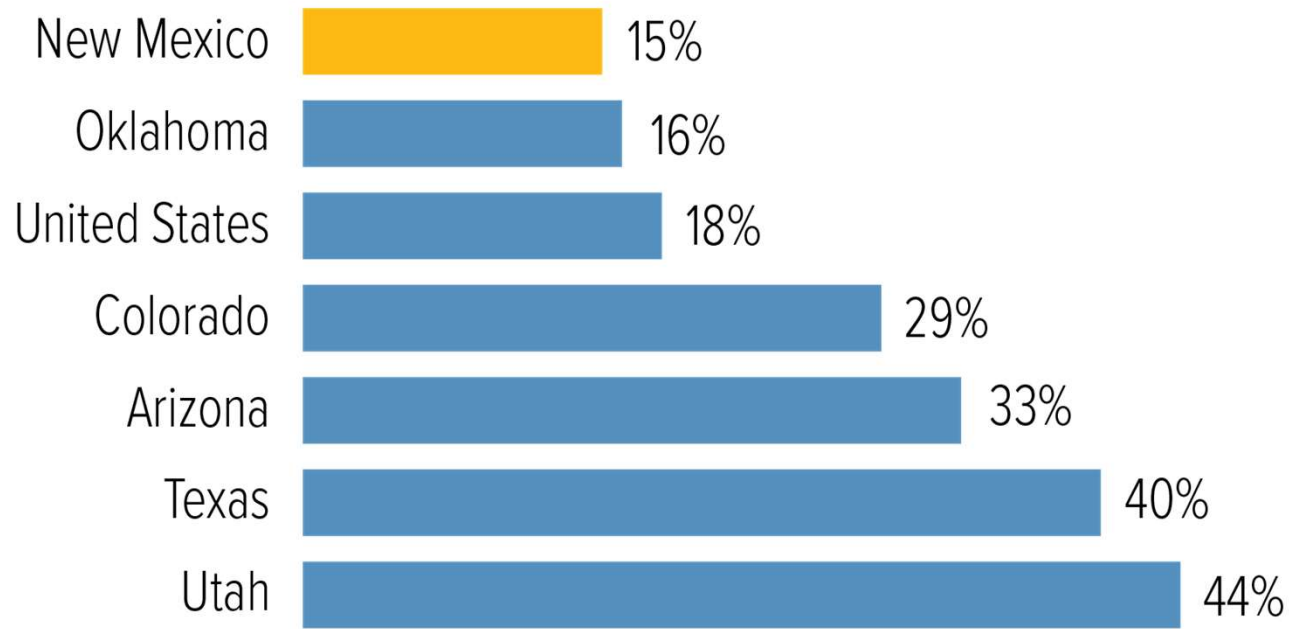
| | Rate cuts enacted | Top rate cut from/to | Percent cut in top rate | Percentage point cut in top rate |
|----------------|--------------------------|----------------------|-------------------------|----------------------------------|
| New Mexico | 2003 | 8.2% to 4.9% | 40% | 3.3 |
| Ohio | 2005, '13, '15, '19, '21 | 7.5% to 3.99% | 47% | 3.51 |
| Kansas | 2012 | 6.45% to 4.6% | 29% | 1.85 |
| North Carolina | 2013, '15, '17 | 7.75% to 4.99% | 36% | 2.76 |

Other Components of New Mexico's Supply-Side Tax Cut Experiment

- 2003 tax cut package included 50% exclusion for long-term capital gains; reduced to 40% in 2019 (1 of only 9 states with any capital gains break)
- 2013 HB 641: top corporate top rate cut from 7.6% to 5.9%; elective single sales factor apportionment for manufacturers

Little Evidence that New Mexico's Tax Cuts Spurred Job Creation

Change in private sector job growth, Feb. 2003 – Feb. 2019



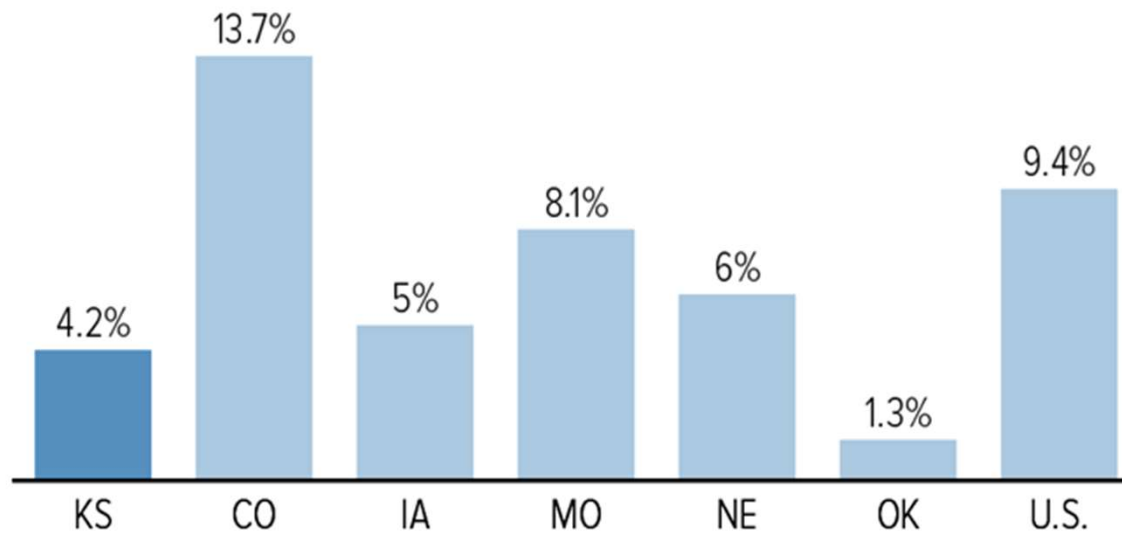
Source: CBPP analysis of BLS data, August 2022

The Kansas Supply Side Economics “Experiment” 2012-2017

- In 2012 and 2013, KS lawmakers compressed tax brackets and cut top PIT rate from 6.45% to 4.9%
- Eliminated all PIT on income from “passthrough” businesses – partnerships, S-corps, LLCs
- Top rate was scheduled to drop to 3.9% in 2018, with further triggered tax cuts based on revenue growth with eventual “march to zero”
- Faced with massive budget crisis and bond rating downgrades, lawmakers froze 4.6% rate in 2014
- In 2017, lawmakers overrode Brownback veto to restore tax on passthroughs, increase top rate to 5.7%, and eliminate march to zero

The Kansas “Experiment” Failed (1)

Private-Sector Job Growth: Kansas Lagged Most Neighbors and U.S. After Cutting Taxes



Note: Data cover December 2012 (the month before the tax cuts took effect) to May 2017 (the month before they were scaled back).

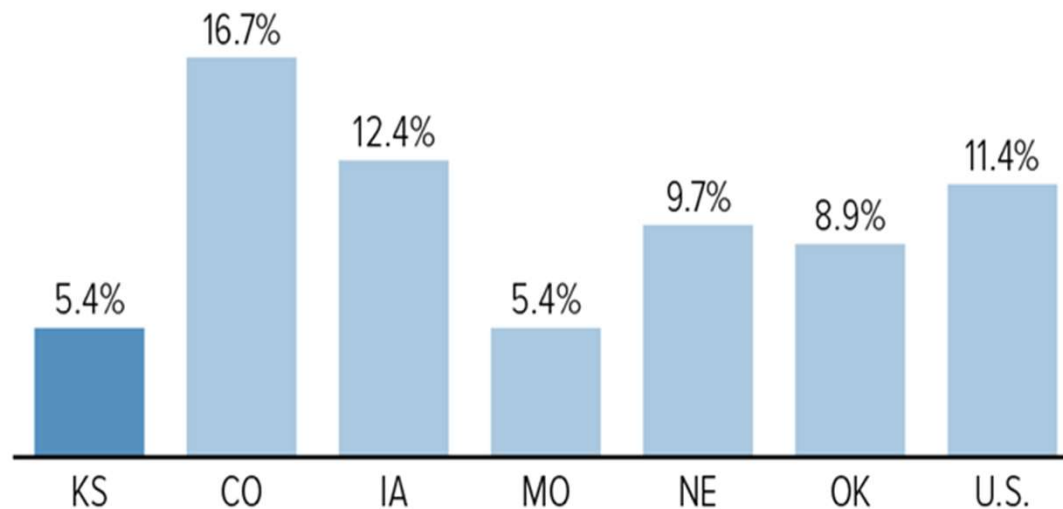
Source: Bureau of Labor Statistics, 2017

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The Kansas “Experiment” Failed (2)

Economic Growth: Kansas Lagged All Its Neighbors and U.S. After Cutting Taxes

Growth in inflation-adjusted private-sector gross domestic product



Note: Data cover fourth quarter 2012 (the quarter before the Kansas tax cuts took effect) to second quarter 2017 (the quarter in which the tax cuts were scaled back).

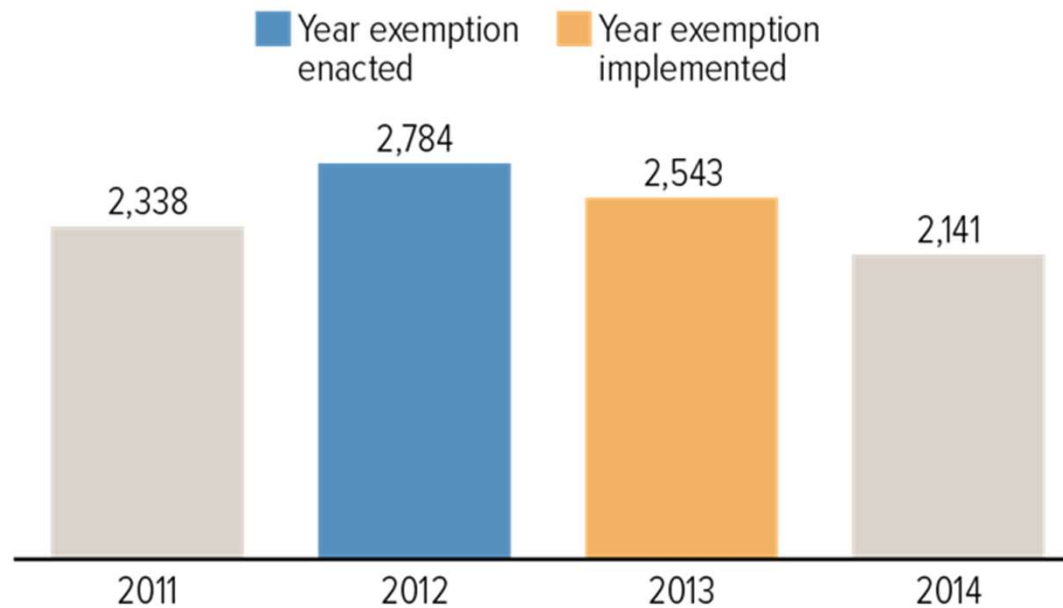
Source: Bureau of Economic Analysis, 2017

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The Kansas “Experiment” Failed (3)

Number of Kansas Pass-Throughs Rose Only Temporarily After Tax Exemption Enacted

Number of new Kansas pass-through businesses created



Note: Excludes sole proprietorships.

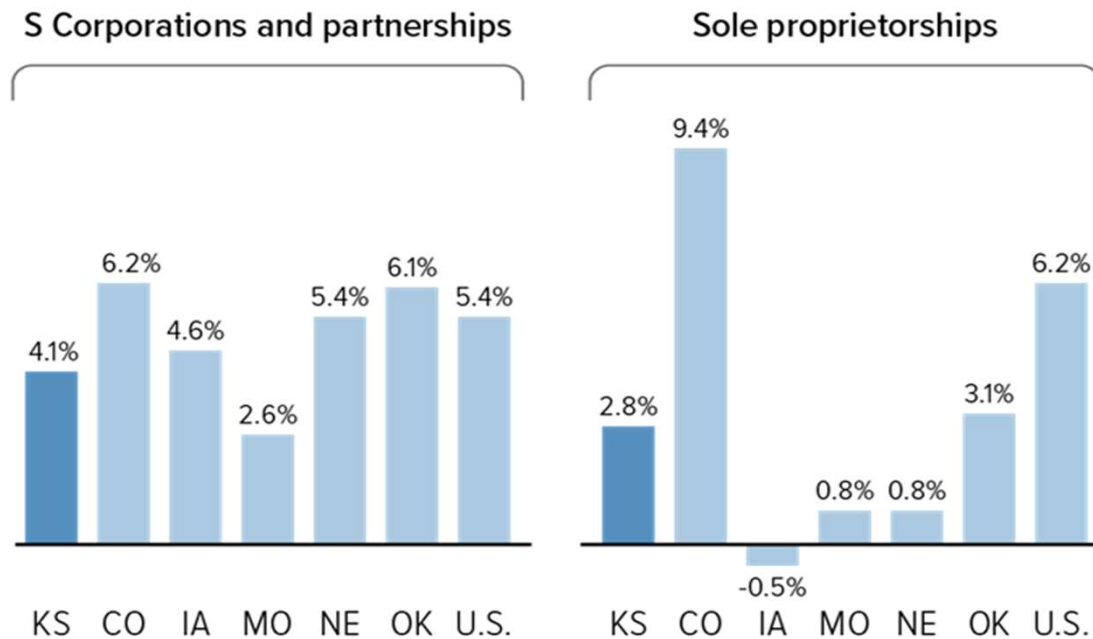
Source: Kansas Department of Revenue, “Governor’s Consensus Revenue Estimating Working Group Final Recommendations,” October 4, 2016

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The Kansas “Experiment” Failed (4)

Growth in New Business Owners: Kansas Lagged Most Neighbors and U.S. After Cutting Taxes

Growth in number of federal tax returns reporting income from pass-throughs, 2012-2015



Note: Pass-through businesses are firms whose owners report their profits on their individual income tax returns. Includes limited liability companies (LLCs).

Source: Internal Revenue Service, Statistics of Income

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NM Already Has a Reasonably “Competitive” Business Tax Structure -- Notwithstanding GRT Pyramiding (1)

- Tax Foundation does periodic “Location Matters” study that evaluates combined state/local taxes on new in-state investment for 8 types of “representative” corporate facilities
- Although it’s possible to quibble with the details in the TF study, this simulation strategy is the only theoretically legitimate approach to measuring the relative tax liabilities imposed by the totality of a state’s business tax structure
- Still gives no answer to the questions of how significant any interstate differences are in actually driving business location decisions relative to other costs and govt services

NM Already Has a Reasonably “Competitive” Business Tax Structure -- Notwithstanding GRT Pyramiding (2)

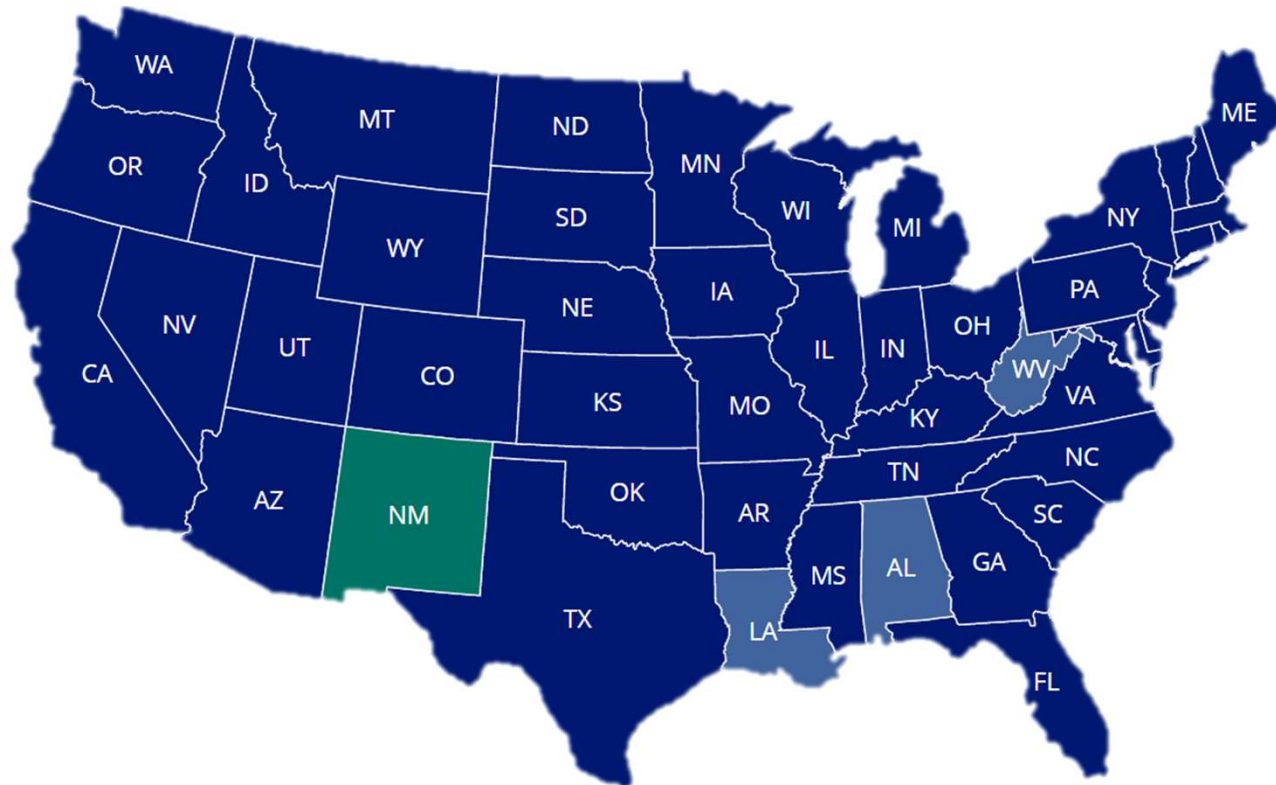
- “Location Matters” finds that NM largely in “middle of the pack” of states nationally in S/L taxes on new business facilities and often imposes lower taxes than its neighbors. E.g.:
- NM imposes lower taxes than TX on 7 of 8 business types
- NM imposes lower taxes than all neighbors on new computer programming/data processing businesses, and lower taxes than all except OK on new corporate HQs and R&D facilities
- NM imposes lower taxes than 3 of its 5 neighbors on back-office support facilities, distribution centers, and labor-intensive manufacturing plants

Investing in human capital will help address New Mexico's fundamental "competitiveness" problem.

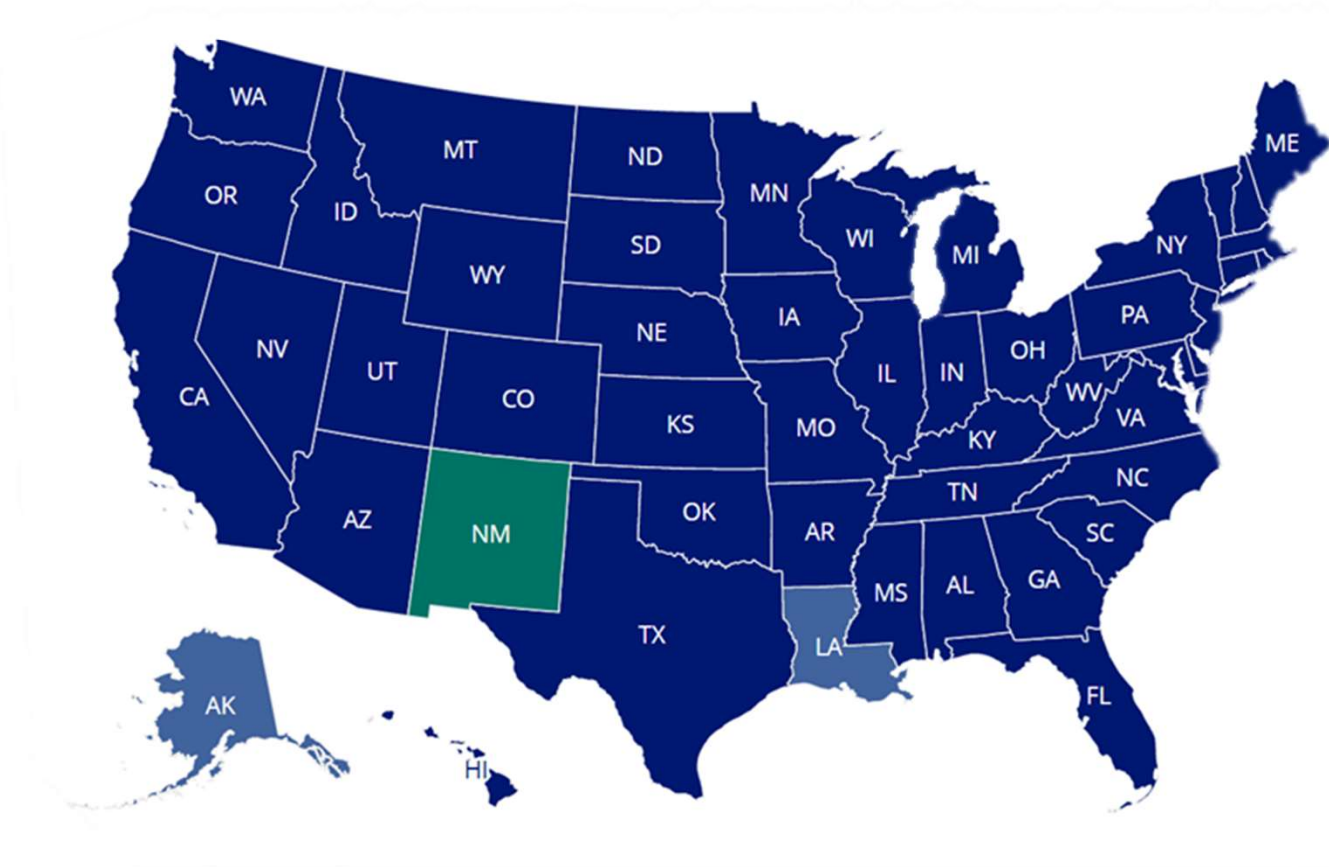
Educational Attainment of NM Workforce

- NM ranks 47th in share of adults with high school diploma
- NM ranks 40th in share of adults with B.A. or more, at 28%
 - Below all bordering states except OK
 - 6 states at 40% or above, including CO
 - MA is at 45%
- Little progress among current students

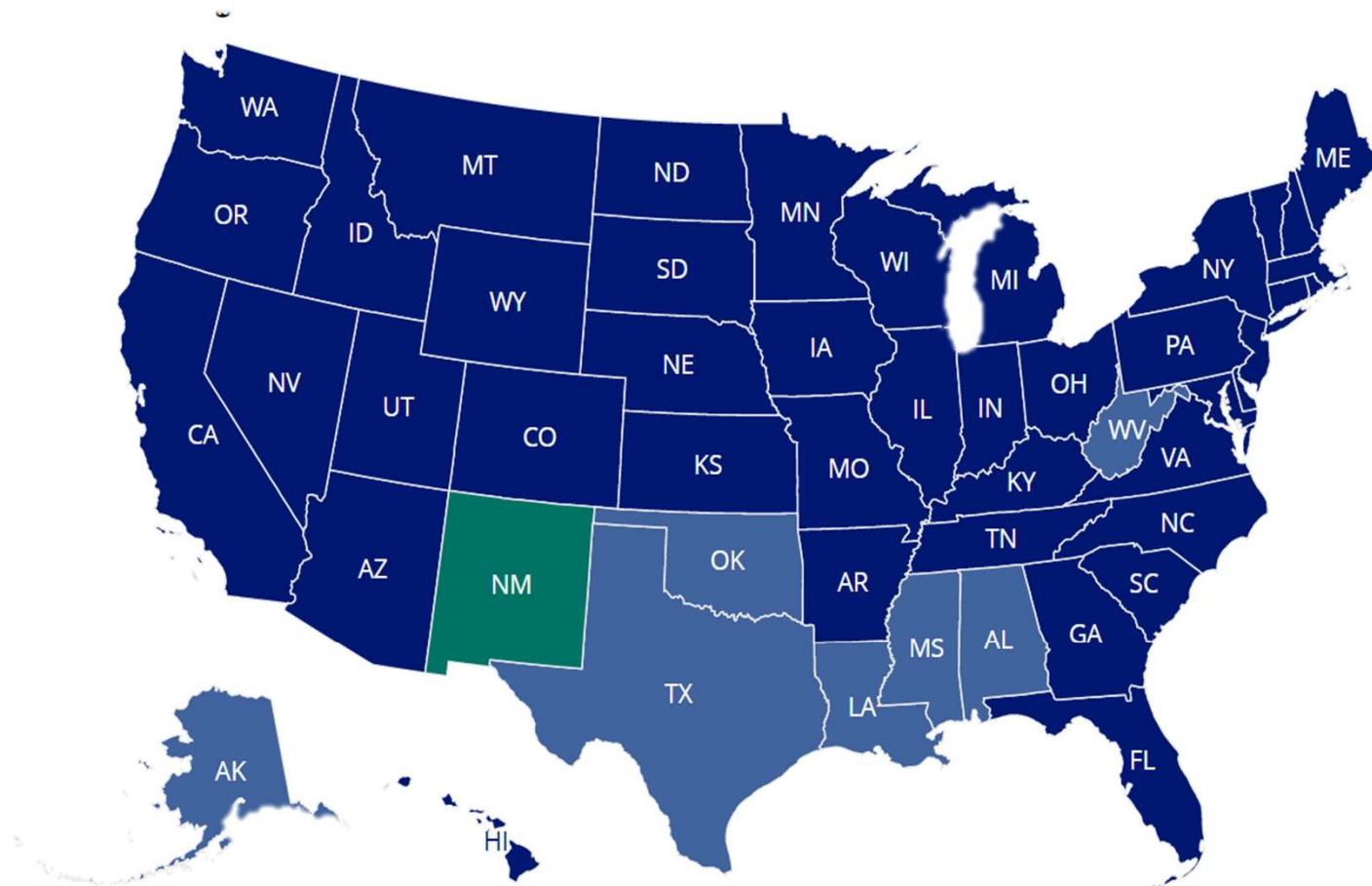
NM Ranked 47th in Share of 4th Graders Scoring Proficient in Math, 2019 NAEP



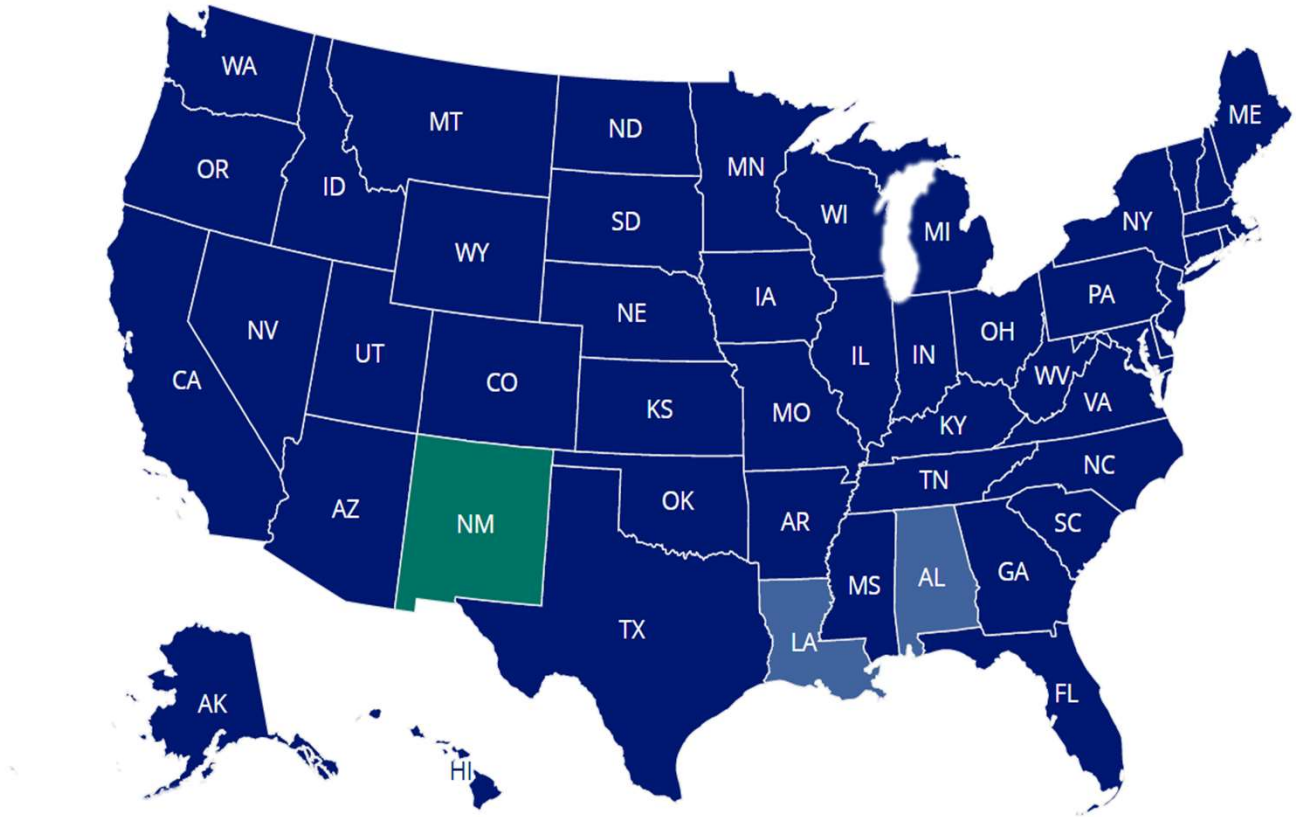
NM Ranked 48th in Share of 4th Graders Scoring Proficient in Reading, 2019 NAEP



NM Ranked 43rd in Share of 8th Graders Scoring Proficient in Reading, 2019 NAEP



NM Ranked 48th in Share of 8th Graders Scoring Proficient in Math, 2019 NAEP



Policy Implications and Recommendations (1)

- “To a hammer, everything looks like a nail.”
- Understandable, therefore, that for a committee charged with tax reform, every problem might appear to have a tax solution
- NM’s tax structure is not a significant contributor to its disappointing and inadequate job creation and income growth
- NM's geographic location, absence of a major "flagship" city, educational attainment levels, and a high dependence on natural resources are more fundamentally problematic

Policy Implications and Recommendations (2)

- NM needs to end its perennial temptation to look for a magic bullet in tinkering with its tax structure.
- It absolutely needs to reject additional across-the-board tax cutting.
- Indeed, it needs to continue the 2019 reforms by eliminating the capital gains tax break entirely and raising taxes on high-income households.
- It can use some of this revenue (as it's done in the past) for targeted GRT pyramiding relief where negative economic development effects can be demonstrated.
- Most of the revenue should be invested in improving education and health care and strategic rural and urban economic development initiatives (e.g., affordable housing).

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