RHODE ISLAND CENTER FOR FREEDOM & PROSPERITY

TAX PLAN ANALYSIS

February 2012

Tax Increases Will Cost Jobs and Return Far Less than expected

Governor's proposed Tax Hikes will Harm already Fragile Economy

In late January 2012, Rhode Island's Governor proposed a new budget that included a number of tax and fee increases, with the goal of balancing the state's chronic budget deficits. In order to properly assess the impact of such hikes on the state's economy, the RI Center for Freedom & Prosperity conducted a detailed, economic analysis, utilizing the Center's dynamic tax modeling tool, RI-STAMP.

The Governor's plan attempts to address the perpetual budget deficit by ***cutting some spending and raising some taxes***. As demonstrated by RI-STAMP, this path will produce negative consequences.

Analysis: to best simulate the Governor's tax proposal, the following revenue targets were entered into RI-STAMP.

- $69.7 million increase in Sales Tax revenues via expansion of the base, with tax increases in some sectors
- * $13.6 million increase in motor vehicle registration fees was input as a Fuel Tax increase
- $7 million increase in revenues from smoking products and other items entered as a Cigarette Tax
- $3.8 million in other misc. taxes & fees were not included in the projection

After running these inputs through the RI-STAMP algorithm, the negative economic consequences of the proposed tax and fee increases become clear. Full details can be found in the table on the following page, but in summary:

- The expected total revenue increases of **$95 million** are not attained, as tax increases depress overall economic activity … the state will see **only a $35 million** increase in revenues.
- Over **1400** private sector jobs will be lost
- Municipalities will **lose $9.75 million** in revenues due to lower commercial property taxes, as a consequence of lower overall economic activity
- The State will **lose almost 1%** in overall Gross State Product
- Investment in the State will **drop by $27 Million**

Because a sales tax increase would make Rhode Island even less competitive with its regional neighbors, and nationally overall, consumer and entrepreneurial behavior would be significantly altered, resulting in lower economic activity and actually worsening the state's economic plight. Municipalities, all too often overlooked, will also suffer a loss in revenues from this unintended consequence.

Balancing the budget is the wrong goal; and tax increases are precisely the wrong solution!

Recommendation:

Conversely, if the Ocean State was to cut its sales tax to 5%, a very different scenario is projected to occur, because our state would suddenly become a more attractive place to purchase goods and services, meaning economic activity would increase. *(See the Policy Brief, Dynamic Effects of Tax Policy)*

If instead, Rhode Island wants to address the larger economic picture, by looking to produce more jobs and a brighter economic future for our citizens …

… cutting taxes and cutting spending will produce a more vigorous economy!

Dynamic Tax Modeling:
Unintended Consequences of the Governor's Tax Hike Plan

Measurement	Governor's Proposed Tax Increases: target of $95 Million
Jobs	**LOSS of 1436 Private Sector jobs** **GAIN of 445 Gov't Jobs**
Gross State Product (GSP)	**LOSS of $391 Million** (or 0.87%)
Investment $$ in RI	**LOSS of $27 Million**
Net State Revenues	**GAIN of $35 Million**
Sales Tax Receipts	*Gain of $49 Million*
Personal Income Tax Receipts	*Loss of $16.5 Million*
State Fees	*Loss of $8.75 Million*
*Auto Registration Fees**	*GAIN of $13 Million*
Cigarette Tax Receipts	*GAIN of $3.25 Million*
Corporate Tax Receipts	*Loss of $2.5 million*
Other State Taxes	*Loss of $2.5 million*
Municipal Revenues	**LOSS of $9.75 Million**
Local Business Property Taxes	*Loss of $6.75 Million*
Local Fees	*Loss of $2.25 Million*
Local Residential Property Taxes	*n/a*
Other Local Taxes	*Loss of $0.5 Million*
Net State and Local Tax Revenues	***GAIN of $25.5 Million***

** Most figures rounded to nearest $0.25 million*

Explanation: There is a common and fundamental miscalculation when it comes to projecting the effects of tax policy on tax receipts. Too often, the more short-sighted and simplistic static calculation is utilized, when in reality the more complex dynamic impact should be evaluated. The downstream effects of tax policy on various aspects of the economy are rarely discussed or attempted to be quantified, either at the state or municipal level.

Reality Supports the RI-STAMP Projections

Some may argue that an economic modeling program is just theory and that the actual world may present a very different reality. However, right here in our own New England back-yard, there is specific empirical evidence that fully supports the core premise of the RI-STAMP projections regarding the effects of sales tax policy.

It is well-known that cross-border shopping exists to the great benefit of the ***zero sales tax*** state of New Hampshire, with many Rhode Islanders frequently putting in 'orders' with family members and friends crossing through the Granite State to pick up liquor and other items for them … duty free!

In Vermont, a recent study showed that its border counties are losing up to **$540 Million** in retail sales per year to New Hampshire[1]. In Maine, a similar study showed that its border counties are likewise losing **$2.2 Billion**, in addition to thousands of retail jobs[2].

If Rhode Island moves ahead with raising or adding new taxes to specific industry sectors, those sectors will most certainly lose cross-border shoppers, customers, and jobs to our neighboring states.

However, with the close proximity of Rhode Island to many Massachusetts and Connecticut residents, it is clear that Rhode Island can win the southern New England sales tax competition; that our economy can benefit from cross-border shopping and see a pronounced increase in economic activity and jobs for our state and our cities & towns … if we can find the wisdom to cut the sales tax and let consumers do the rest.

WHAT IS RI-STAMP?

Developed by the Beacon Hill Institute at Suffolk University, RI-STAMP is a customized, comprehensive model of the RI state economy, designed to capture the principal effects of city tax changes on that economy. In general STAMP is a five-year dynamic computable general equilibrium (CGE) tax model. As such, it provides a mathematical description of the economic relationships among producers, households, government and the rest of the world. It is general in the sense that it takes all the important markets and flows into account. It is an equilibrium model because it assumes that demand equals supply in every market (goods and services, labor and capital); this is achieved by allowing prices to adjust within the model (i.e., prices are endogenous). The model is computable because it can be used to generate numeric solutions to concrete policy and tax changes, with the help of a computer. And it is a tax model because it pays particular attention to identifying the role played by different taxes.[3]

End Notes:

1 The Unintended Consequences of Public Policy Choices, p3: http://www.vermonttiger.com/files/unintended-consequences-2-1.pdf

2 Path To Prosperity, p1: http://www.mainepolicy.org/wp-content/uploads/VER-2-Path-to-Prosperity-The-Great-Tax-Divide-041311.pdf

3 The Beacon Hill Institute, What Is STAMP?; http://www.beaconhill.org/STAMP-Method/STAMP.pdf