

Tax Increases versus Spending Cuts

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Wisconsin, like most other states, is facing a very large budget gap with revenue from existing taxes and fees expected to be over \$6 billion **less** than the amount of money needed to continue providing the existing level of public service over the next biennium. As the legislature is required to enact a balanced budget, for the most part the budget gap must be filled by increasing taxes and fees or by reducing state spending, or a combination of these two policies.

Both increasing revenues from taxes and fees and cutting spending are bad for the economy—they are anti-stimulus in the sense that they result in increased unemployment and slower economic growth. The macroeconomic argument about the negative impact of taxes is oft-repeated and well known. What is often missed in public debates is the fact that cutting state spending has equally negative impacts on the economy. Government spending is used to buy goods and services from the private sector and to pay government employees. When spending is cut, fewer goods and services are purchased and some state and local employees lose their jobs and others are paid less, which in turns usually implies that these individuals purchase fewer goods and services. Lower levels of consumption and employment obviously are not good for the Wisconsin economy.

A number of economists have argued that cutting state spending will do **more** harm to the economy than an equal dollar increase in taxes. The argument is that if additional taxes are levied on those with relatively high incomes, these high-income households will pay all or a portion of their additional tax liabilities by reducing their savings rather than cutting consumption. Their behavior would cause no short-run negative impact on the economy, while most spending cuts will translate directly into fewer purchases of goods and services, and consequently be more detrimental to the state's economy.

Reductions in spending and increases in revenues almost always affect different people. Cuts in spending have the largest impact on recipients of state and local government services. Thus cuts in state aid to school districts are likely to negatively impact Wisconsin's public school students. Eliminating the capital gains exclusion would raise taxes for a relatively small number of mainly high income state residents.

In general, increases in broad based taxes, such as the individual income tax would mean that the cost of closing the state budget gap would be borne by a large number of Wisconsin residents. Relying heavily on spending cuts means that the heaviest burdens of filling the budget gap are borne disproportionately by a relatively small number of the state's residents, those who rely heavily on state services and state and local government employees.