



Bruce Hanna

State Representative, District 7
House Republican Leader

April 9, 2009

Chairman Phil Barnhart
House Committee on Revenue
900 Court Street NE, H-383
Salem, OR 97301

Chairman Barnhart:

I am writing to request a hearing and work session on HB 3469, which establishes a \$500 child tax credit and doubles the personal income tax brackets. According to LRO, the child tax credit would create 10,000 jobs and doubling the tax brackets would create 19,000 jobs. Additionally, changing the brackets would result in a 22% tax reduction for taxpayers earning less than \$30,000, while taxpayers with income over \$100,000 would receive an average tax reduction of just under 3%. I am so encouraged by the number of jobs created by these proposed tax changes that I have used one of my priority bills as the vehicle to allow the consideration of this bill.

Like you, I am committed to finding ways to stimulate Oregon's economy and I hope that HB 3469 is given consideration in the Revenue Committee.

Sincerely,

Representative Bruce Hanna

Cc: Speaker Hunt
Rep. Bentz
Rep. Bailey



STATE OF OREGON
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Legislative Revenue Officer
Paul Warner

TO: Representative Mary Nolan
FROM: Paul Warner
DATE: April 6, 2009
RE: Uses and Limitations of the Oregon Tax Incidence Model

You asked for an analysis of using Oregon Tax Incidence Model (OTIM) job impact estimates to evaluate state tax policy decisions in the current recessionary environment.

OTIM is a computable general equilibrium model designed to show how tax changes affect wages and prices and how these changes ultimately affect the overall level of economic activity as measured by total personal income and employment. OTIM compares a baseline projection with how it will look after wages and prices and income have fully adjusted to a tax change. This is assumed to reflect a 5-year adjustment period. After accounting for these changes OTIM produces new estimates for the distribution of income and state revenue.

OTIM is a long-term regional model. It shows how changes in state tax policy could affect the regional flow of capital and labor into and out of Oregon over time, everything else the same. OTIM's most useful purpose is providing a framework for analyzing how major tax changes affect the economy and distribution of the tax burden over the long-term. It provides a systematic way to assess the long-term trade-offs associated with changes in the major tax bases such as income, sales and property.

OTIM is not a short-term forecasting model. The model starts with the basic assumption that the economy is in a long-run equilibrium position and compares that with a new long-run equilibrium following a change in tax policy. The long-run equilibrium situation is one characterized by no cyclical unemployment—meaning the economy is not in recession. Job gains in the OTIM simulations occur due to increases in participation rates of the current labor force and in-migration from other states. The model is not designed to address the current problem of very high cyclical unemployment caused by insufficient demand in the U.S. and world economy.



OTIM requires a balanced state budget, meaning that a tax reduction must be accompanied by spending decreases. Over the long-term this can result in offsetting private sector job creation but in a short-term recessionary environment tax reductions increase the size of the state's budget gap putting further downward pressure on state services. In the short-term this can exacerbate the problem of insufficient demand in the state economy.

Finally, although OTIM requires a balanced budget, it does not account for the long-term productivity affects government spending may have on the state economy. For example, spending on education should lead to a more productive labor force over time, making the state economy more competitive. OTIM does not capture these longer-term relationships for two reasons. First, it has a 5-year time horizon. Many spending programs are likely to have affects well beyond this horizon. Secondly, there is only limited empirical research on how state expenditures and productivity are linked making it very difficult to quantitatively specify these relationships in a model. This means that the long-term impact of state expenditures on the economy is likely to be understated in the OTIM simulations.