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Comments before the Joint Tax Study Committee Hearing
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Thank you Senator Harkins and members of the committee for the opportunity to address this hearing today. I will discuss economists' views of state fiscal policy, specifically tax policy, the role the University Research Center (URC) can play in the analysis of current and proposed tax policy in Mississippi, and I will conclude with an overview of the state's economy.

Like much of economic policy, what constitutes "good" tax policy often is in the eye of the beholder. Views on fiscal and tax policy vary from person to person, and my role as state economist is not to advocate a particular stance. Nonetheless, through decades of research and analysis economists as a profession have developed a set of concepts they generally consider the basis for sound tax policy at the state level. Author David Brunori has condensed these ideas for state tax policy into five basic principles: (1) raising adequate revenue, (2) neutrality, (3) fairness, (4) ease of administration and compliance, and (5) accountability. I will briefly discuss each of them.

Obviously raising adequate revenue is the most central function of any tax system. However, what characterizes revenue as "adequate?" The short answer is enough to meet the public services demanded by the citizens of the state. The longer answer to this question is more complicated and nontrivial as Mississippi has a lot of needs, which the elected representatives of the state must prioritize. Underlying the principle of raising adequate revenue are the characteristics of sufficiency, stability, and certainty. Sufficiency and stability mean the tax system is adaptable to changing economic conditions and consistently collects desired revenues. Certainty means changes to the tax system are infrequent and do not unsettle economic decisions.

The neutrality of a tax means the degree to which the tax disrupts the free market. All taxes cause distortions and the goal of sound policy is to minimize these distortions. For many years the consensus among policymakers has been the best way to achieve neutrality in taxation is a broad base and low rates, which also means limited exemptions, deductions, and credits.

While fairness in taxation may sound like a loaded term, it essentially consists of two concepts. One, fairness in taxation means taxpayers who are in similar situations are treated the same, and two, that taxpayers are taxed to some degree according to their ability to pay. Levying the same taxes on individuals and businesses with similar incomes and assets is important to maintaining public confidence in the tax system. Achieving this type of equity is also related to neutrality by keeping a broad tax base and limiting exemptions. More difficult to attain is the equity associated with taxpayers' ability to pay. One reason is this sense of equity likely reflects an individual's ideological viewpoint. One person might view a progressive tax, in which the rate of taxation increases as an individual's income increases, as preferable to a proportional tax that levies the same rate on all taxpayers regardless of income; another person might hold the opposite view. However, most policymakers and analysts oppose regressive taxes in which the rate of taxation decreases as an individual's income increases. Unfortunately, most state tax systems are characterized as regressive because consumption taxes such as sales, use, and excise taxes–all of which are regressive–are central components. According to Brunori, about half of the tax revenue states collect originates from regressive taxes. Because of their importance as a source of revenue to most states, consumption taxes are unlikely to change. However, the individual income tax in most states is at least slightly progressive, which reduces some of the regressivity of the overall state tax system.

The fourth principle is ease of administration and compliance, which is essential to a sound state tax system. The more complex a tax system is the larger the burden placed on taxpayers and the government to ensure compliance. If taxpayers spend more time and effort trying to figure out how to meet tax requirements, they become less likely to pay the taxes they owe, and governments will spend more time and effort in attempts to collect these taxes. Most state tax systems perform well in terms of administration and compliance as the collection of state sales taxes and personal income taxes occurs close to the source. Nevertheless, some taxes such as business taxes and estate taxes often have more elaborate requirements.

Finally, accountability means a state must not only be able to enforce its existing tax code, but also create new tax legislation in a visible, public manner. Actions contrary to this manner can lead to specific exemptions for preferred individuals or groups and compromise other principles like neutrality and fairness. Public review and evaluation of tax policy can promote accountability as well.

I also would like to briefly discuss the body of research produced by economists on the relationship between state fiscal policy and state economies and the research specific to Mississippi conducted by URC. The findings of studies that evaluate the effects of various state taxes on economic growth and development have produced a variety of results and these results are often found to be inconsistent over different time periods. In my view, this lack of consensus among researchers on the effects of state tax systems on regional economies points to the limits of fiscal policy at a state level. It is also in line with the findings of research by URC, which is that changes to state taxes in Mississippi are likely to have marginal effects on economic growth, employment, and population. While the structure of the changes also will determine the welfare effects of tax reforms on any particular income group, the overall effects on the state economy nevertheless likely will be very modest.

Economists have reached broad determinations about what affects state economies. A 2014 study by Soledad Artiz Prillaman and Kenneth Meier concludes the national economy is the single most important influence on the economic environment of a state. I believe this conclusion is particularly true for a state like Mississippi with a relatively small economy. Prillaman and Meier note intrinsic factors that significantly affect the economy of a state include the education level of the population, the price of land, and the price of energy–and that state policy makers can do little to directly influence these factors. Their study as well as others suggest state spending on elementary education, secondary education, and higher education as well as infrastructure can promote economic growth over the long term.

In terms of analysis, URC stands ready to evaluate the fiscal and economic impacts of proposals or bills introduced to the legislature that affect Mississippi's tax code. In most cases, URC can provide an assessment with a relatively brief turnaround time. The analysis can include the effects on revenues and the economic effects, including changes to the state's real GDP, employment, income, and population. To assess the effects of changes to the state tax structure, URC utilizes a dynamic fiscal and economic impact model known as Tax-PI produced by Regional Economic Models, Inc. (2021). URC has used this model for several years to evaluate the effects of changes to the tax code, at least as far back as the Taxpayer Pay Raise Act of 2016. Essentially, the Tax-PI model uses the current path of economic growth for the state, provides a shock to the economy due to some event such as a change in tax policy, and compares the differences in the economy under the shock with the status quo to determine the impacts of the event.

I will conclude my comments with a short discussion of the current status of Mississippi's economy. Like the rest of the country the state continues to recover from the relatively brief but steep recession experienced in 2020. The state's economy is expected to experience some of the strongest growth in over a decade in 2021. The Bureau of Economic Analysis reported real GDP for Mississippi increased 6.2 percent at annualized rate in the first quarter, which gives support to robust growth this year. According to the Bureau of Labor Statistics as of July of this year Mississippi has recovered over 82 percent of the jobs lost in March and April of 2020, a larger share compared to the nation as a whole. Nevertheless, the surge in COVID-19 cases due to the delta variant already has lowered the short-term economic outlook for the nation and the state. The primary reason is the threat to continued growth in consumer spending due to reductions in "socially dense" activities and low inventories because of supply bottlenecks. These supply chain issues also range beyond the U.S. as other countries impose restrictions to deal with COVID-19 outbreaks. Inflation has become a concern in recent months as the Consumer Price Index increased more than 4 percent year-over-year in both April and May and more than 5 percent year-over-year in June and July. Several factors have contributed to the increase in prices, including transfers from the federal government, the full reopening of the U.S. economy and pent-up demand, and the previously mentioned supply chain issues. Many economists including the chair of the Federal Reserve believe these factors are largely temporary and that around the end of 2021 the price level will decline, settling near but likely slightly above its pre-recession levels. In sum, the Mississippi economy is expected to rebound strongly in 2021, but the surge in COVID-19 cases may stanch this recovery. Growth in 2022 and beyond currently is expected to return to near or slightly above pre-pandemic levels.

I will close my comments by again thanking the committee for the opportunity to address this hearing today, and I will gladly take any questions from the members.

References

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