Maine Office of Policy and Management
181 State House Station
Augusta, Maine 04333

<u>Director</u>
Jonathan P. LaBonté

The Potential Economic Impacts from the Three Percent Surtax on Incomes over $200,000

March 20, 2017

When tax rates increase, individuals make choices that result in less reportable income, less work and/or moving their residence to lower tax rate regions. Wealthiest individuals, in particular, have considerable discretion in making these choices—they can shelter income by adjusting the timing of capital gains, they have greater financial flexibility and can opt to work less, and, in cases where two homes are owned, they can shift their legal residence to the lower tax rate jurisdiction. If tax rates increase enough, some may even choose to sell their home or business and leave a state completely. Behavioral responses such as these are widely recognized in economics. With respect to Maine's new surtax policy, the question isn't *if* these types of responses occur, but by *how much* and *when*.

One straightforward way to estimate these sensitivities is to use economic modeling software. The Regional Economic Models, Inc. (REMI) economic forecasting tool used by OPM utilizes local and regional economic data to forecast changes in the Maine economy given a particular input.

According to this forecasting tool, the estimated tax increase from the new surtax policy results in a net out-migration of residents. The loss of income associated with this outward migration is around 0.5 to 1.0 percent of total personal income to the state. This loss of income, combined with the other effects of the surtax, are enough to overwhelm any positive impacts created by the spending of the tax revenues. Indeed, OPM staff estimate that private sector employment, disposable incomes (statewide) and overall economic activity will be negatively affected by the policy (these results and further details on the methodology are available in the full report).

The extent to which the negative impacts associated with higher tax rates are offset by increased spending depends on the assumptions for how the tax revenues will be spent. OPM reviewed scenarios ranging from 100 percent of the funds going to property tax reduction to 100 percent going to local education spending or local government spending. The analysis shows that the net impact of the policy change is least negative when all of the revenues are used toward spending. In other words, if the policy is enacted and less than 100 percent goes to education or local government spending, the overall negative economic impact increases.

It's important to note that the economic impacts generated by REMI are relative to a baseline forecast. While the policy is expected to negatively impact the economy, economic growth may still be positive—just less than it would have been if the policy was not in place. For instance, if the policy is implemented, employment is still expected to grow in 2017 in the low outmigration scenario, but not as much as it would have otherwise.

Does a policy that encourages outward migration make sense, given Maine's demographic situation?
It is broadly recognized that this state needs more people, not fewer. Last year, Maine was one of only two states in the nation with a declining natural population, and the working age population is projected to decline precipitously over the next 20 years. Given this state's demographic context and the need to attract more people, does a policy that encourages outward migration make sense? Can Maine afford to lose any of its high net worth population? Maine needs policies that encourage growth, business investment and the formation of capital—not policies that hurt the economy and create disincentives for residents to remain here.