

APPENDIX 3

David Cay Johnston: State's job growth defies predictions after tax increases

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Dire predictions about jobs being destroyed spread across California in 2012 as voters debated whether to enact the sales and, for those near the top of the income ladder, stiff income tax increases in Proposition 30. Million-dollar-plus earners face a 3 percentage-point increase on each additional dollar.

"It hurts small business and kills jobs," warned the Sacramento Taxpayers Association, the National Federation of Independent Business/California, and Joel Fox, president of the Small Business Action Committee.

So what happened after voters approved the tax increases, which took effect at the start of 2013?

Last year California added 410,418 jobs, an increase of 2.8 percent over 2012, significantly better than the 1.8 percent national increase in jobs.

California is home to 12 percent of Americans, but last year it accounted for 17.5 percent of new jobs, Bureau of Labor Statistics data shows.

America has more than 3,100 counties and what demographers call county equivalents. Eleven California counties, including Sacramento, accounted for almost 1 in every 7 new jobs in the U.S. last year.

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The Central Valley is home to nine of the nation's 335 largest counties. The data show that all nine counties enjoyed better job growth overall than the rest of America. Sacramento County experienced a 2.7 percent increase, 50 percent better than the national average, as 15,425 jobs were added last year.

Only three California counties lost jobs, a total of 126 fewer positions in sparsely populated Amador, Mariposa and Trinity counties.

These results may surprise those who have heard that tax increases are job killers. Taxes can do that – if what is being taxed directly applies to job creation. For example, a 10 percent increase in payroll taxes (Social Security, Medicare and state disability) would probably hamper job growth, said David Neumark, chancellor's professor of economics and director of the Center for Economics & Public Policy at the University of California, Irvine.

Neumark said he asks his students, "Does raising income tax rates reduce hiring?"

"The answer is no. What firms care about when deciding how many workers to hire is the marginal product of workers and the marginal cost of those workers. So if you are an employer and your personal income tax rate is increased, that does not raise the marginal cost of your workers, but it may encourage you to work a little less hard," Neumark noted, applying standard economic theory.

Some research into tax rates indicates that high rates have the opposite effect: People may work harder, trying to make more money to achieve a desired after-tax income and may slough off if tax rates are lowered. This is known to be the case for people who have a savings target for money to leave their children and are subject to estate taxes – they save more to leave the after-tax sum they prefer, but save less when the tax is lowered or no longer applies to them.

The empirical evidence also shows that the best-paying jobs tend to be clustered in states (and countries) with high taxes. The same tends to be true of wealth creators, including the most money-motivated among scientists, and existing wealth holders not actively engaged in business.

Manhattan, home to the highest taxes in America, is also home to many centimillionaires and billionaires drawn by the proximity of other dealmakers, as well as taxpayer-supported amenities such as museums and performing arts halls.

Overall, Manhattan produces far more in taxes than it gets back in federal tax revenues, making it a major profit center from the point of view of Washington and Albany. And its population is at a record high.

Neumark noted that there is one group of million-dollar-plus income Californians who could easily leave – retirees.

"If you have a California business, it's pretty hard to leave or to move the business, and costly, too," Neumark said.

Only one in 500 American taxpayers, about 300,000, reports a total income of more than \$1 million, and 82 percent of them earn a salary, IRS data shows.

Another factor is what economists call aggregate demand: the total capacity to pay for goods and services. When the economy collapsed in 2008, it hit hard at construction as property values

plummeted, but mortgage debt did not, and at retail, where many young people get started working.

How taxes are spent is also crucial to the effect on jobs. Increasing taxes can, in some cases, encourage job growth.

Highly skilled and educated workers tend to place a high value on commonwealth amenities, such as quality public schools and colleges; extensive parks; honest and reliable law enforcement; as well as fast-responding ambulance and fire suppression services.

Daniel Wilson, a Federal Reserve Bank economist in San Francisco, has been studying the job migration patterns of so-called star scientists, especially those who hold many patents.

His preliminary data show a tendency for such star scientists to move to Washington state, which has no income tax, but not to Texas, which also does not tax incomes. That seems to indicate a preference among such high performers for public amenities and, perhaps, the climate and outdoor options of the West Coast.

Wilson noted that New York, New Jersey and Massachusetts, all high-tax states, also attract star scientists, lending more credence to the idea that commonwealth amenities are valuable to such workers.

The economic revival in California also partly reflects a tendency for otherwise sound economies, when they are at peaks or troughs, to move toward the average performance of all states with sound economies. California fell harder than average so it is rebounding more.

California has a more volatile economy than most of the country. Aerospace, for example, took a big hit after the Berlin Wall came down, and the state has repeatedly experienced other ups and downs larger than the changes in the national economy.

But as long as the California economy remains vibrant – as long as it does not fall into a pattern of fundamental decline the way Michigan has, for example – the temporary tax increases voters approved in 2012 are unlikely to damage economic growth even if they are made permanent.

Spending more money on university-based research and making it easier for star students to get college and graduate degrees by lowering or eliminating tuition could spur the California economy by attracting and retaining more smart and ambitious young people whose success is likely to generate future growth. Creating barriers for them, such as tuition hikes, would create a long-term drag on the economy.

So next time someone tries to tell you that raising income taxes will destroy jobs, tell them the evidence just does not support that claim.

David Cay Johnston, a California native who won a 2001 Pulitzer Prize for his coverage of tax policy, teaches the tax, property and regulatory law of the ancient world at Syracuse University College of Law. He recently completed two years as president of the 5,000-member Investigative Reporters and Editors association.

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