



# W.E. UPJOHN INSTITUTE

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FOR EMPLOYMENT RESEARCH

300 South Westnedge Ave. □ Kalamazoo, MI 49007

**PRESS RELEASE: FOR IMMEDIATE RELEASE** □ Contact: Timothy Bartik or Richard Wyrwa  
Ph. 269-343-5541 □ Fax 269-343-7310 □ [wyrwa@upjohninstitute.org](mailto:wyrwa@upjohninstitute.org)

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A just-completed study by Tim Bartik and George Erickcek, researchers at the Upjohn Institute, presents evidence that balancing the state of Michigan's budget by spending reductions, rather than tax increases, would affect Michigan's economy negatively in the short-run.

Michigan policymakers are currently attempting to deal with a projected \$925 million deficit in the state budget, which under state law must be eliminated. Using a regional econometric model, Bartik and Erickcek find that closing this gap by tax increases, rather than spending cuts, would add over 7,000 in jobs and \$300 million in income to the state economy.

Bartik and Erickcek's findings can be explained by the relative effects of state taxes and spending on demand for Michigan's goods or services. Increases in state taxes reduce demand for Michigan's goods and services, but by less than a dollar for each dollar in increased taxes, because Michigan consumers and businesses spend much of their income on goods and services produced at least in part outside of Michigan. In contrast, the immediate effect of state spending cuts is to directly reduce, dollar for dollar, the goods and services produced by government employees.

Similar patterns of effects occur for smaller increases in taxes that are substituted for spending cuts. For example, Bartik and Erickcek estimate that freezing the state's income tax rate at 4%, rather than lowering it as scheduled to 3.9% in January 2004, and using the extra revenue generated to avoid some spending cuts, would add over 700 jobs and \$30 million in income to the state economy.

Bartik and Erickcek's study only looks at the short-run effects, in 2004, of different state spending and tax policies. They note that long-run effects of different mixes of taxes and public services on business and household location are important to consider, but lie outside the scope of their study.

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The Upjohn Institute for Employment Research is an independent, non-profit and non-partisan research organization in Kalamazoo. The findings of Bartik and Erickcek's study are those of the authors and should not be construed as official views of the Upjohn Institute. To read Bartik and Erickcek's study visit [http://www.upjohninstitute.org/Michigan\\_budget\\_study.html](http://www.upjohninstitute.org/Michigan_budget_study.html).

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