Kansas Economic Progress Council
Suite 200
212 West 8th
Topeka, Kansas 66603

Testimony on House Bill 2650
House Taxation Committee
February 9, 2012

Mr. Chairman and members of the committee, thank you for the opportunity to testify on this important topic. I'm Bernie Koch with the Kansas Economic Progress Council, a statewide not for profit organization of businesses, trade associations, chambers of commerce, and individuals.

Lowering taxes can be an important part of those policies. It comes under the heading of economic freedom.

However, other factors that can be encouraged by government have been shown by respected empirical studies to be as important, if not more important, including investment in infrastructure and equipment; human capital and labor efficiency; continuing technological innovation; and reliable legal systems.

States without income taxes

With the attempts to phase out the individual income tax last legislative session, we began to look at the states without an individual income tax and found other factors at work that significantly affect their economies.

States without an income tax usually have abundant natural resources or heavy tourism that results in significant state revenue. States without an income tax depend more on sales and property taxes to fund government services. And states without an income tax often have many kinds of other taxes and fees that we don't have in Kansas.

The studies used to argue that income taxes should be eliminated all use Gross State Product as an element. Gross State Product is the market value of all final goods and services produced in a state, usually in one year.

Gross state product and gross domestic product are the way we measure the economy and economic growth. For example, a recession is defined as two consecutive quarters of negative economic growth as measured by a country's gross domestic product.

U.S. Department of Commerce Bureau of Economic Analysis keeps the information on what makes up Gross State Product.

For example, Alaska does not have an individual income tax. Alaska's Gross State Product is made up of 25% mining (which includes their abundant oil and gas production) and 18.7% government. So 43.7% of Alaska's economy comes from activities that have absolutely nothing to do with whether or not the state has an income tax. And yet, that 43.7 percent is included in the calculations in these studies that conclude no income tax produces economic growth. That should be disaggregated. It's not a fair comparison. It's comparing apples and oranges.

Likewise Wyoming. Wyoming's Gross State Product is 31.3% mining because that state produces 40% of all U.S. coal production. 13.4% of Wyoming's GSP is government. So 44.7% of Wyoming's economy also has nothing to do with whether or not there's an income tax in that state, but once again, that is not taken into account in the conclusions of many of the tax studies you have been hearing about.

Those are two of the most extreme examples, but we really don't get a fair shake in these studies. Our mining is only 1.4% of the Kansas Gross State Product. In 2010, Texas mining was 9.4% of its Gross State Product. We suspect that will much higher in 2011 because of the heavy fracking activity.

Government is 11.8% of Texas Gross State Product. You add their mining and their government as measured in Gross State Product and it's over one/fifth of the Texas economy. That 21% is included in the studies that conclude that no income tax means a better economy. But those sectors of the economy don't have much to do with an income tax.

The Wall Street Journal said on July 27th that the fastest-growing employment sector in Texas over the past decade has been oil and gas, up 63% in the past decade, to 243,000 jobs. That same story said one of the biggest increases in jobs over the past decade in Texas was in government, up 19%, or 301,000.

That's not to say there's no merit in looking at individual income tax reductions, especially for businesses that pay at the individual rate. I'm saying the evidence is not as strong as it's being portrayed.

Corporate taxes

It would also be beneficial to look at corporate taxes. There is a really valuable new study that was released by the Arkansas State Chamber of Commerce recently that included information about Kansas corporate tax structure that is very significant. The study was done by Ernst & Young.

The report looks at the total effective tax rate after statutory tax credits on different kinds of businesses in eight states in the region, including Kansas. The eight states are: Arkansas, Kansas, Louisiana, Mississippi, Missouri, Oklahoma, Tennessee, and Texas.

The types of companies considered are corporate headquarters, research and development, durable goods manufacturing, food product manufacturing, renewable energy equipment manufacturing, motor vehicle parts manufacturing, and business support services.

Some of the findings:

- Missouri out-competes all of the other states studied in five of the seven categories: research and development, durable goods manufacturing, food product manufacturing, renewable energy equipment manufacturing, and motor vehicle parts manufacturing.
- Texas is most competitive in the region for company headquarters and business support services, but scores poorly on tax burden for renewable energy equipment manufacturing.

- Effective tax rates vary widely in Kansas by business. For example, Kansas business support services have an effective tax rate of 19.7% while durable goods manufacturing has an effective tax rate of 8.1%. Kansas has the highest tax burden in the region for services, but among the lowest for manufacturing.
- Missouri's tax credits average 27%, the highest of the states studied, and have a significant impact on that state's business tax rankings.
- Kansas effective tax rate on corporate headquarters is 11 and a half times as great as Texas in this category.

I have included the most important chart in the study in my testimony at the end of my testimony.

I suggest the legislature needs to look at our competitiveness in this area as well. Our Effective Tax Rate on business services is the highest of any Effective Tax Rate in any state on any kind of business. That really sticks out.

Tax study

We recently released a study by economist Dr. John Wong, formerly with the Hugo Wall School of Urban and Public Affairs at Wichita State University.

Dr. Wong was a member of the Kansas Consensus Revenue Estimating Committee for many years and was the principal author of the annual Governor's Economic and Demographic Report.

His study concluded that for every job created by a reduction in Kansas income tax rates, 1.63 jobs would be lost by an equal reduction in state spending. Similarly, for every dollar of labor income generated by a reduction in income tax rates, $1.78 would be lost by an equal reduction in state spending.

There are two reasons for this.

- First, a high percentage of government expenditures initially stay within the state's economy, going either to employees in the form of salaries or to local businesses for the purchase of goods and services. In contrast, though most spending by Kansas residents takes place within Kansas, much of those monies quickly leave the state's economy.
- In contrast, the spending reduction scenario severely affects a small number of state residents and businesses—state employees and those private-sector businesses that serve state employees and state government directly. The likelihood of a business failing under this scenario is much greater than in the tax increase scenario. A business failure will have a ripple effect across the economy.

2% limitation

Kansas Economic Progress Council opposes the 2 percent mechanism in this bill that, in effect, acts as a spending lid. In 26 of the past 30 years, the inflation rate in the United States has been above 2%, according to the Bureau of Labor Statistics. Last year, it was 3.2%. I can remember it being over 13% in 1980.

A 2% limitation puts the state in a squeeze when inflation is above 2%.
I believe this 2% limitation would inevitably lead to another raid on the transportation program. Even without a spending lid, we have taken over a billion dollars from those revenues over the past 22 years.

We believe there's merit in looking at carefully targeted income tax reductions, but completely eliminating a source that provides almost 45% of our general fund revenue doesn't seem justified.

Thank you for the opportunity to appear today.

Arkansas Chamber of Commerce Tax Study
December 2011

Table 6
State and Local Effective Tax Rates Net of Statutory Credits, by Industry and State

State	Headquarters		Research & Development		Durable Goods Manufacturing		Business Support Services		Food Product Manufacturing		Renewable Energy Equipment Manufacturing		Motor Vehicle Parts Manufacturing	
	ETR	Rank	ETR	Rank	ETR	ETR	ETR	Rank	ETR	Rank	ETR	Rank	ETR	Rank
Arkansas	4.7%	2	9.9%	5	9.2%	4	16.2%	4	8.2%	3	12.5%	4	10.6%	4
Kansas	4.6%	3	12.0%	2	8.1%	6	19.7%	1	7.9%	4	8.0%	7	7.2%	7
Louisiana	6.2%	1	12.7%	1	6.9%	7	14.3%	7	8.9%	2	13.5%	2	12.4%	2
Mississippi	1.5%	7	9.5%	6	10.3%	1	15.0%	6	9.2%	1	14.4%	1	12.0%	3
Missouri	4.1%	6	7.7%	8	5.0%	8	15.0%	5	6.5%	8	6.7%	8	5.9%	8
Oklahoma	4.4%	5	11.4%	3	9.2%	2	18.0%	2	7.2%	6	10.8%	5	8.7%	6
Tennessee	4.6%	4	11.1%	4	9.2%	3	16.8%	3	7.3%	5	9.9%	6	9.2%	5
Texas	0.4%	8	8.4%	7	8.7%	5	13.7%	8	6.5%	7	12.6%	3	13.6%	1
Other States' Avg.	*3.7%*		*10.4%*		*8.2%*		*16.1%*		*7.7%*		*10.8%*		*9.9%*	

Unemployment Rates for States

Unemployment Rates for States Monthly Rankings Seasonally Adjusted Dec. 2011[p]		
Rank	**State**	**Rate**
1	NORTH DAKOTA	3.3
2	NEBRASKA	4.1
3	**SOUTH DAKOTA**	**4.2**
4	**NEW HAMPSHIRE**	**5.1**
4	VERMONT	5.1
6	IOWA	5.6
7	MINNESOTA	5.7
8	**WYOMING**	**5.8**
9	UTAH	6.0
10	OKLAHOMA	6.1
11	VIRGINIA	6.2
12	**KANSAS**	**6.3**
13	HAWAII	6.6
13	NEW MEXICO	6.6
15	MARYLAND	6.7
16	LOUISIANA	6.8
16	MASSACHUSETTS	6.8
16	MONTANA	6.8
19	MAINE	7.0
20	WISCONSIN	7.1
21	**ALASKA**	**7.3**
22	DELAWARE	7.4
23	PENNSYLVANIA	7.6
24	ARKANSAS	7.7
25	**TEXAS**	**7.8**
26	COLORADO	7.9
26	WEST VIRGINIA	7.9
28	MISSOURI	8.0
28	NEW YORK	8.0

30	ALABAMA	8.1
30	OHIO	8.1
32	CONNECTICUT	8.2
33	IDAHO	8.4
34	**WASHINGTON**	**8.5**
35	ARIZONA	8.7
35	**TENNESSEE**	**8.7**
37	OREGON	8.9
38	INDIANA	9.0
38	NEW JERSEY	9.0
40	KENTUCKY	9.1
41	MICHIGAN	9.3
42	SOUTH CAROLINA	9.5
43	GEORGIA	9.7
44	ILLINOIS	9.8
45	**FLORIDA**	**9.9**
45	NORTH CAROLINA	9.9
47	DISTRICT OF COLUMBIA	10.4
47	MISSISSIPPI	10.4
49	RHODE ISLAND	10.8
50	CALIFORNIA	11.1
51	**NEVADA**	**12.6**

[p] = preliminary.
NOTE: Rates shown are a percentage of the labor force. Data refer to place of residence. Estimates for the current month are subject to revision the following month.
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