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**Testimony on Tax Policy  
Senate Ways & Means Committee  
February 8, 2012**

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Senator McGinn and members of the committee, thank you for the opportunity to appear before you today.

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. We support pro-growth policies for communities and the state.

Respected empirical studies show there are five areas of state government that can have an influence on economic growth. These are the five that economists generally agree upon.

The **investment rate** in plant and equipment, including efficient physical and communications infrastructure, has a strong positive impact on growth. The higher an economy's capital intensity (machines, buildings, roads, bridges, etc.), the more prosperous the economy.

**Human capital** and the efficiency of labor have also been shown to be significant to growth. Measures of human capital include the literacy rate, school enrollment ratios, and labor demographics.

Linked to investment and human capital, there is substantial support for the contribution of **continuing technological innovation and improvement** in sustaining economic growth. This suggests that support for research and development and education is important.

**Reliable legal systems** are a significant basis for economic growth. These systems provide dependable enforcement of private contracts, protection of private property rights, effective law enforcement, and an absence of corruption.

Public policy which supports **economic freedom** through open economies supports higher growth rates. We would include tax structure and business regulation in this category.

This is the area, of course that has received much attention over the past year. With last year's passage by the House of Substitute for Senate Bill 1, and with the Governor's proposal to lower and eventually eliminate the individual income tax, the Kansas Economic Progress Council decided we wanted a closer look at the impact of income tax cuts on the economy.

We believe that lowering taxes can be a contributing factor to economic growth, but we also know that taxes fund state programs that can be equally important.

We began looking for someone who could provide us dependable research on the economic impact of income tax cuts, someone who was familiar with the Kansas economy and our tax structure. Whenever I asked for advice on who might do such a study, the answer was usually Dr. John Wong, who had one research project for us before.

Dr. Wong is the Associate Dean of the Division of Urban and Professional Studies at the University of North Texas at Dallas.

He is well known for his previous work as the Interim Director and a Professor in the Hugo Wall School of Urban and Public Affairs at Wichita State University. While in Kansas, Dr. Wong was the principal author of the annual *Governor's Economic and Demographic Report*. He was also a consulting economist for the Kansas Consensus Revenue Estimating Group, the Kansas Department of Revenue, and the Kansas Department of Labor.

We contacted him and he was willing to undertake the research. Dr. Wong was unable to be here today to talk about his study, so I will attempt to explain what he did, although I'm not an economist. I'm a lobbyist. If there are questions I can't answer, I will be glad to forward them and try to get you a response.

The study is based on Substitute for Senate Bill 1, but the conclusions apply to any income tax cut reduction.

Dr. Wong looked at the legislation and the Supplemental note on the bill. Using the consensus estimates for FY 2012, he estimated the bill's impact on FY 2012 receipts and FY 2013 receipts.

That's exhibit 5 and 6 in the report. It shows that in FY 2013, individual income tax revenues would be reduced by \$541 million and corporation income tax would be reduced by \$61 million for a total of \$603.5 million.

Dr. Wong wanted to measure the direct effects of the income tax cut, the indirect effects, and what's called the induced effects. Induced effects occur when additional income has a resulting impact on sales, income, and jobs.

He used professional social accounting and impact analysis software known as IMPLAN 3. I have noticed that this is the same analysis software that Arthur Laffer has used in association with the Governor's income tax proposal. It is basically used to measure the ripple effects on the economy when people and businesses have more money to spend. It can also measure the ripple effects on the economy when government has less money to spend.

IMPLAN is a very thorough program.

IMPLAN and the associated database contain a set of social/economic accounts that describe the structure of the U.S. economy in terms of transactions between households, governments, and 440 standardized industry sectors classified on the basis of the primary commodity or service produced.

The database also describes the local and regional economy in terms of industry output, value added, employment, imports, and exports. A wide variety of sources are used to construct the databases, including the annual economic census conducted by the U.S. Commerce Department and the U.S. Bureau of Labor Statistics.

The IMPLAN model provides estimates of leakages (how much supporting economic activity will originate from outside the model's study area).

Multipliers are estimated within the IMPLAN model and are based on the actual industry where the spending initially occurs and the structure of the study area's economy. IMPLAN also estimates induced activity based on data collected on household consumption patterns.

Exhibit 12 in the study shows the impact of the individual income tax reduction and it is positive. Dr. Wong readily admits that when you lower income taxes, there is a positive affect. In this case, it's a gain of 4,903 in jobs, over \$185 million in labor income and total value added of \$339 million. The output, or the quantity of goods or services produced, s \$589 million. The output is important because that's how we measure economic growth. It's essentially what is measured in gross domestic product or gross state product.

Exhibit 13 is a list of the industries most affected by the individual income tax reduction.

Exhibit 14 is the economic impact of the corporation income tax reduction.

Exhibit 15 is a list of the industries most affected by the corporate tax reduction.

Now we get to the point where Dr. Wong's study differs from many of the studies you have heard about the benefits of income tax reductions.

He has also estimated the impact of an equal amount of state spending reductions of \$603.5 million. That is Exhibit 16 and 17.

Employment loss is 8,927, and you can also see the loss of labor income, value added, and output.

There is also a list of industries most affected.

Then there is Exhibit 18 that puts it all together. The combined impact of tax and resulting spending reductions is a loss of 3,441 jobs, \$166 million in labor income, \$130 million in total value added, and \$58 million in output).

Based on all of this, here are Dr. Wong's conclusions:

- For every job created by a reduction in 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.

- Likewise, for every dollar of value added generated by a reduction in income tax rates, \$1.34 would be lost by an equal reduction in state spending.
- Finally, for every dollar of total output generated by a reduction in income taxes, \$1.09 would be lost by an equal reduction in state spending.

Why does this happen?

There are at least two reasons why a reduction in state spending would have a greater negative impact than an equal reduction in state taxes.

- 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, particularly since so few manufactured goods are built within the state.
- Second, a tax reduction disperses the benefits throughout the state, both geographically and across residents. The effect on any individual and on any business is minor. 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.

That's the economic analysis. Dr. Wong also did a tax incidence study as part of this report.

Tax incidence is the study of who ultimately bears the economic burden of a tax. Broadly speaking tax incidence analysis examines the impact of taxes on the distribution of income within a society.

We've been hearing a lot about this issue at the national level lately. I can honestly say we asked Dr. Wong for this information long before Occupy Wall Street started up, at least three months beforehand.

The underlying structure of the model developed for this study is based upon a methodology established for a study for the *Report of the Governor's Tax Equity Task Force* in 1995.

The taxes included in the Kansas tax incidence model are the state individual income tax, state and local residential property taxes, and state and local retail sales taxes.

This study divides Kansas taxpayers into ten income groups, and estimates combined taxes in each income group before and after the income tax reduction. The results are in Exhibit 23, which shows the current distribution of taxes across Kansas households, and Exhibit 34, which shows distribution of taxes across Kansas households if Substitute for Senate Bill 1 had been passed.

This does not include any proposal to eliminate the earned income tax credit, so it is truly a tax cut for all levels of income.

The conclusion of this part of the study is that the proposed changes make taxes more regressive because progressive income tax receipts balance the regressive residential property and retail sales taxes. So, when you lower income taxes, the total tax burden becomes more regressive.

Thank you for the opportunity to present this information today.

# Estimated Impact of SB 1

Exhibit 5: Proposed Income Tax Rates For TY2012 and TY2013

	TY 2012	TY 2013
Individual	3.058 %	2.610 %
Individual	5.461	4.650
Individual	5.635	4.800
Corporation	3.500 %	3.500 %
Corporation	6.116	5.210

Source: Supplemental Note on House Substitute for Senate Bill No. 1, As Amended by House Committee of the Whole, 2011

Exhibit 6: Impact on FY2013 Receipts

(in thousands)	
Individual	\$ (541,900)
Corporation	(61,600)
<b>Total</b>	<b>\$ (603,500)</b>

Source: Supplemental Note on House Substitute for Senate Bill No. 1, As Amended by House Committee of the Whole, 2011

# Income Tax Reduction

## Exhibit 12: Economic Impact of Individual Income Tax Reduction

Impact Type	Employment	Labor Income	Total Value Added	Output
<b>Direct Effect</b>	3,235	\$114,727,680	\$216,330,752	\$369,161,280
<b>Indirect Effect</b>	770	\$36,716,848	\$60,801,280	\$112,852,552
<b>Induced Effect</b>	899	\$33,752,044	\$62,258,176	\$107,976,560
<b>Total Effect</b>	4,903	\$185,196,576	\$339,390,464	\$589,990,400

## Exhibit 13: Industries Most Affected by Individual Income Tax Reduction

Description	Total Employment	Total Labor Income	Total Value Added	Total Output
Food services and drinking places	545	\$9,922,394	\$14,888,088	\$32,789,562
Private hospitals	270	\$15,627,437	\$16,411,171	\$33,188,218
Offices of physicians, dentists, and other health practitioners	264	\$21,119,186	\$24,495,570	\$37,226,272
Real estate establishments	227	\$4,757,982	\$22,367,202	\$30,524,510
Nursing and residential care facilities	218	\$6,388,454	\$6,621,364	\$10,147,554
Retail Stores - Food and beverage	180	\$4,971,335	\$7,555,343	\$12,046,058
Retail Stores - General merchandise	162	\$4,361,666	\$6,486,309	\$10,189,123
Wholesale trade businesses	143	\$1,093,399	\$3,696,870	\$5,313,541
Private household operations	136	\$10,235,323	\$17,599,678	\$25,093,800
	131	\$866,300	\$992,820	\$1,024,878

# Corporation Income Tax Reduction

## Exhibit 14: Economic Impact of Corporation Income Tax Reduction

Impact Type	Employment	Labor Income	Total Value Added	Output
Direct Effect	347	\$16,756,934	\$28,078,738	\$60,526,945
Indirect Effect	105	\$5,367,917	\$9,500,342	\$17,913,013
Induced Effect	131	\$4,910,877	\$8,715,769	\$14,908,635
<b>Total Effect</b>	<b>582</b>	<b>\$27,035,727</b>	<b>\$46,294,849</b>	<b>\$93,348,593</b>

## Exhibit 15: Industries Most Affected by Corporation Income Tax Reduction

Description	Total Employment	Total Labor Income	Total Value Added	Total Output
44-45 Retail trade	192	\$5,074,001	\$8,096,886	\$12,118,831
42 Wholesale Trade	49	\$3,498,865	\$6,016,313	\$8,869,705
31-33 Manufacturing	37	\$2,868,116	\$4,375,562	\$22,286,226
48-49 Transportation & Warehousing	34	\$1,804,887	\$2,792,315	\$4,911,209
81 Other services	32	\$831,498	\$1,061,458	\$2,072,989
52 Finance & insurance	32	\$1,873,892	\$3,255,125	\$6,376,445
62 Health & social services	31	\$1,365,600	\$1,593,908	\$2,660,500
54 Professional- scientific & tech svcs	27	\$1,760,437	\$2,022,155	\$3,684,460
56 Administrative & waste services	21	\$723,061	\$919,379	\$1,496,155
72 Accommodation & food services	20	\$362,745	\$554,332	\$1,173,980

# State Spending Reduction

**Exhibit 16: Economic Impact of State Spending Reduction**

Impact Type	Employment	Labor Income	Total Value Added	Output
Direct Effect	-6,578	(\$288,973,312)	(\$355,521,536)	(\$456,851,168)
Indirect Effect	-440	(\$20,702,318)	(\$33,888,256)	(\$64,778,268)
Induced Effect	-1,909	(\$68,683,016)	(\$126,576,384)	(\$219,833,184)
<b>Total Effect</b>	<b>-8,927</b>	<b>(\$378,358,656)</b>	<b>(\$515,986,432)</b>	<b>(\$741,462,592)</b>

**Exhibit 17: Industries Most Affected by State Spending Reduction**

Description	Total Employment	Total Labor Income	Total Value Added	Total Output
* Employment and payroll only (state & local govt, non-education)	-4,805	(\$212,760,240)	(\$240,979,824)	(\$240,979,840)
Food services and drinking places	-478	(\$8,322,664)	(\$12,487,768)	(\$26,988,442)
Employment services	-310	(\$8,780,215)	(\$9,475,155)	(\$12,986,845)
Real estate establishments	-187	(\$3,742,514)	(\$17,593,502)	(\$23,359,324)
Maintenance and repair construction of nonresidential structures	-180	(\$10,260,589)	(\$10,734,187)	(\$20,332,102)
Wholesale trade businesses	-139	(\$10,015,381)	(\$17,221,488)	(\$25,389,220)
Offices of physicians, dentists, and other health practitioners	-106	(\$8,076,694)	(\$9,367,937)	(\$14,029,389)
Private hospitals	-103	(\$5,677,064)	(\$5,961,774)	(\$11,977,762)
Nursing and residential care facilities	-94	(\$2,631,255)	(\$2,727,185)	(\$4,023,325)
Services to buildings and dwellings	-88	(\$2,274,134)	(\$2,788,197)	(\$5,325,746)

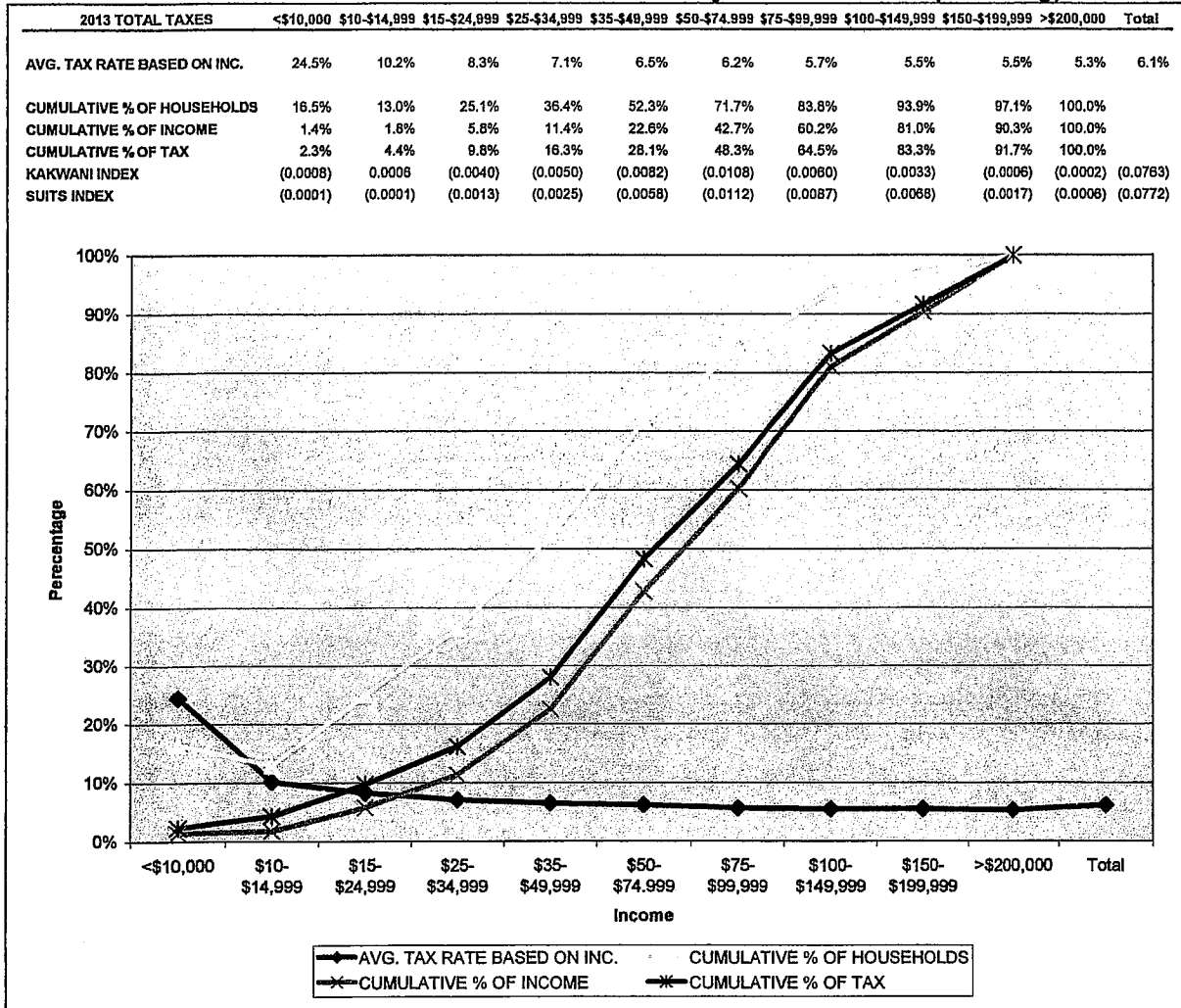


# Combined Impact of Tax and Spending Reductions

## Exhibit 18: Combined Impact of Tax and Spending Reductions

Impact Type	Employment	Labor Income	Total Value Added	Output
Direct Effect	-2,996	(\$157,488,698)	(\$111,112,046)	(\$27,162,943)
Indirect Effect	434	\$21,382,447	\$36,413,366	\$65,987,297
Induced Effect	-879	(\$30,020,095)	(\$55,602,439)	(\$96,947,989)
<b>Total Effect</b>	<b>-3,441</b>	<b>(\$166,126,353)</b>	<b>(\$130,301,119)</b>	<b>(\$58,123,599)</b>

### Exhibit 23: Combined Tax Incidence by Income Class (Existing)



Both the Suits Index (-0.0772) and the Kakwani Index (-0.0763) indicate total Kansas state and local individual income, residential property, and retail sales taxes are slightly regressive. The Minnesota Tax Incidence Study (2005) reported a Suits Index of -0.018 for total state and local taxes while the Wisconsin Tax Incidence Study (2004) reported a Suits Index of 0.006 and a Kakwani Index of 0.013 for total state and local taxes.

Combined individual income, residential property, and retail sales taxes in Kansas are proportional to slightly regressive under income tax rate rollback provisions. Exhibit 34 presents the distribution of combined Kansas individual income, residential property, and retail sales taxes by income grouping. Out of the ten income groupings the highest effective tax rate paid is by households that earn less than \$10,000 (23.8 percent) while the lowest effective rate paid is for households with \$200,000 or more of income (4.8 percent). Again it should be kept in mind that the ETRs are computed as a percentage of Kansas adjusted gross income. The average effective tax rate for the state as a whole is 5.7 percent.

