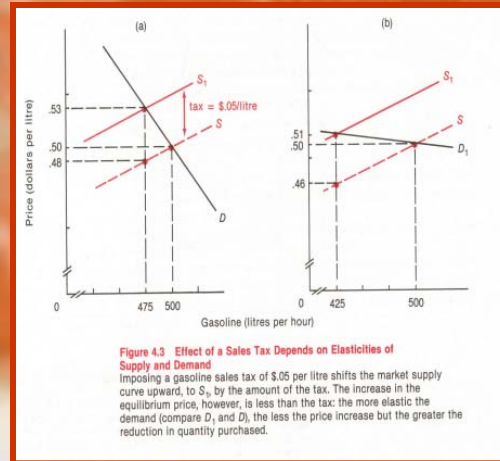


Balancing Taxes, Education Funding and Long-Term Economic



2009 Colorado Education Association
Denver, Colorado
Richard G. Sims, Ph.D., Chief Economist
National Education Association

February, 2009



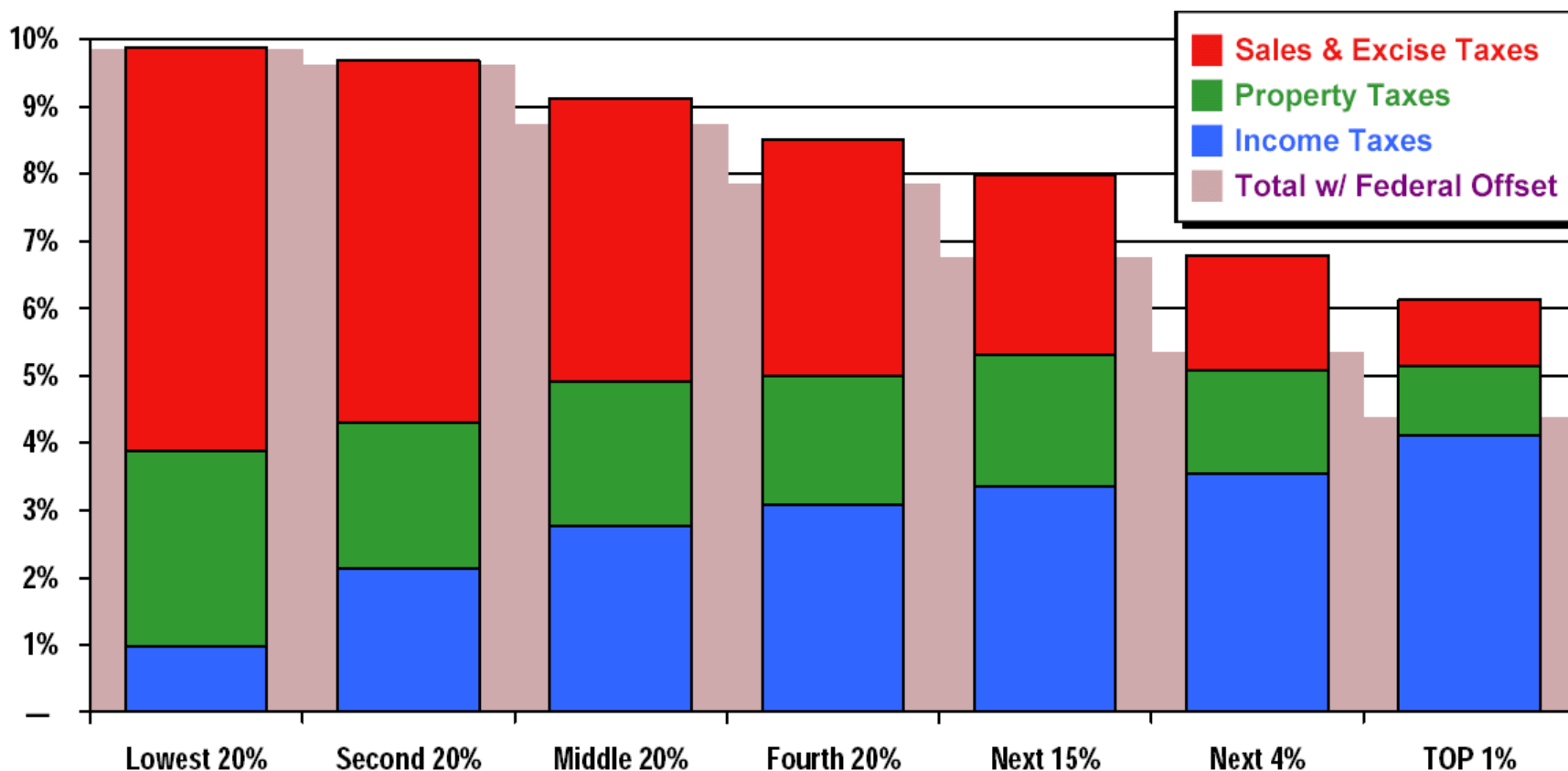
The First Principle of Public Finance

Your tax system should look like you did it on purpose.

Colorado

State & Local Taxes in 2002

Shares of family income for non-elderly taxpayers



Source: [Who Pays?: A Distributional Analysis of the Tax Systems of All 50 States, Second Edition](#), Institute on Taxation and Economic Policy, 2003.

Different taxes grow at different rates

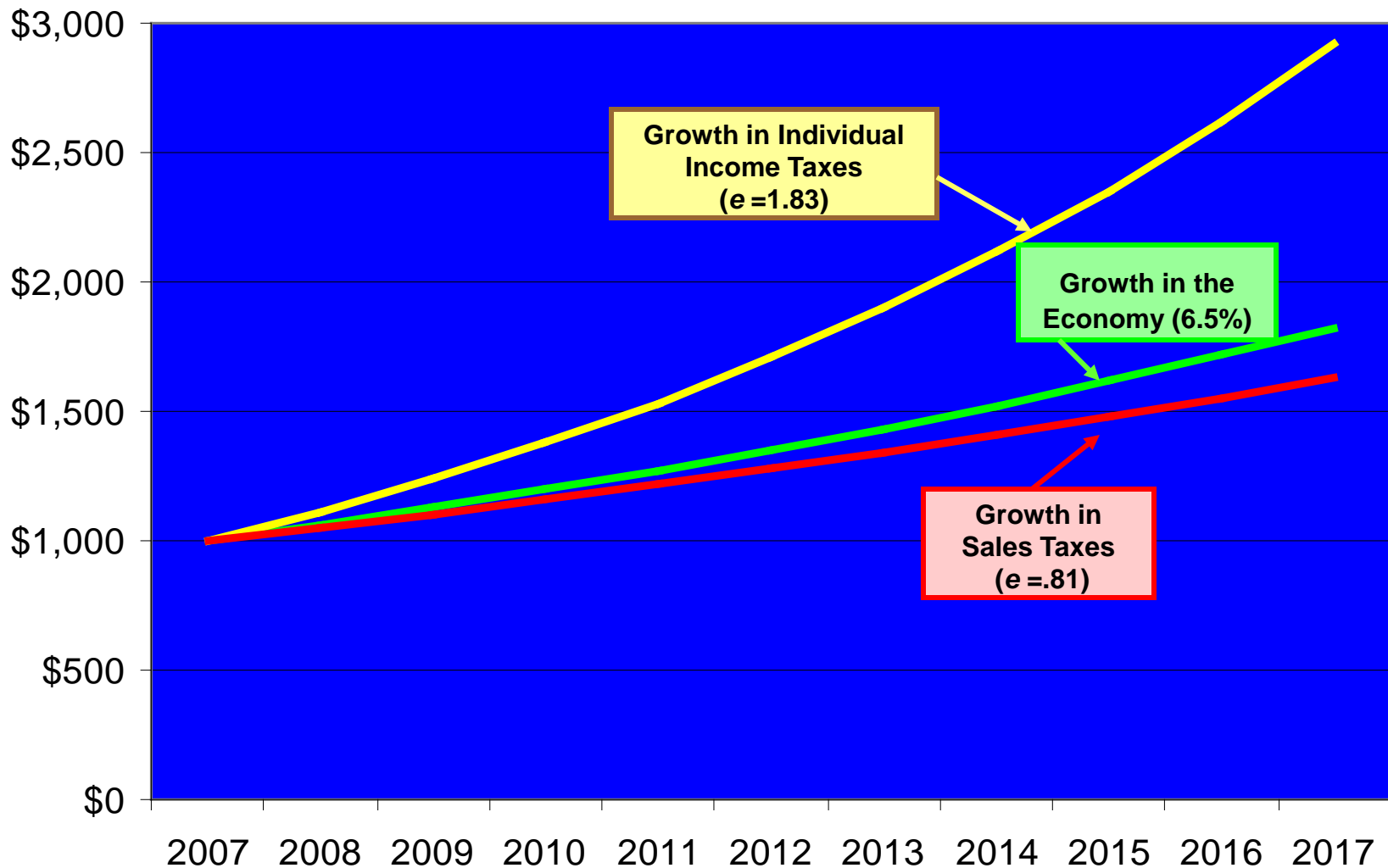
Some Typical State Tax Elasticities

<i>STATE</i>	elasticity
Individual income tax	1.83
Sales tax	0.81
Corporate income tax	0.78
Alcoholic beverage tax	0.39
Beer and wine tax	0.53
Cigarette/tobacco	0.43
Motor fuel tax	0.43
Property tax	0.76
Most fees, license and use taxes	0.5 to 0.7

Only elasticity > 1.0

Sources: *Southern Economic Journal*, 2006, Bruce, Fox & Tuttle; *North Carolina Tax Guide 2002*; various state studies.

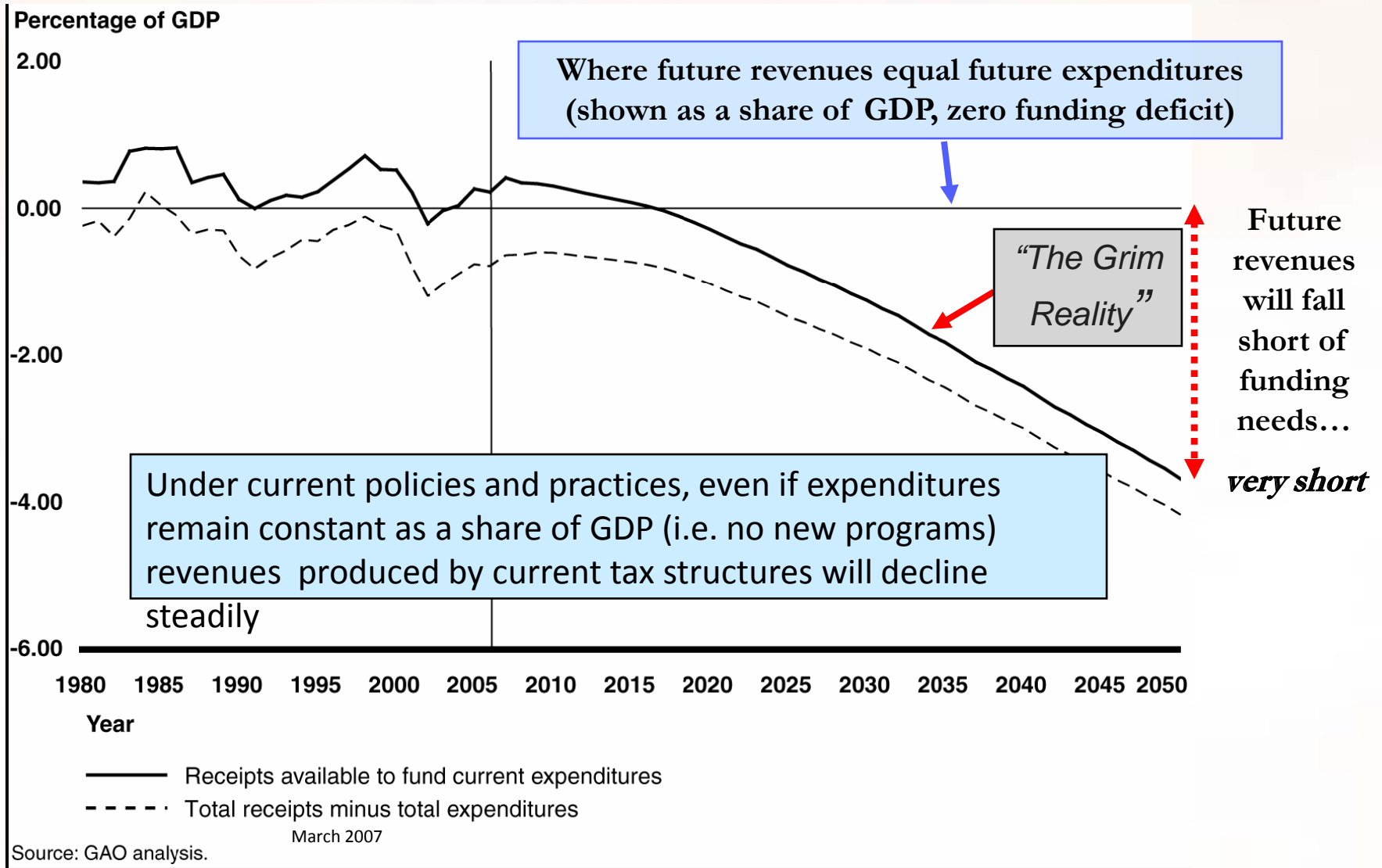
Elasticities: Income Tax, Sales Tax and Economic Growth



Average growth rate for the U.S. economy, 1981-2006 = 6.2% (U.S. BEA). Average long-term PIT elasticity, $e = 1.8$; average long-term sales tax elasticity, $e = 0.83$ (Bruce, Fox & Tuttle, 2006.)

Why is a low elasticity something to be concerned about?

Outlook for Net State and Local Receipts and Expenditures



Source: GAO analysis.

The Economics of the Stimulus

**IMPACT ON COLORADA OF A \$100 B. FEDERAL STIMULUS GOING TO
THE 50 STATES' EDUCATIONAL OPERATION BUDGETS**

(Colorado's assumed share: \$1,161 million)

<i>Employment Change Total (all jobs in thousands)</i>	78.9
Government	0.9
Private Non-Farm	78.1
 <i>Breakdown of Private Non-Farm</i>	
Manufacturing	1.0
Non-Manufacturing	48.7
 <i>Breakdown of Non-Manufacturing</i>	
Mining	0.0
Construction	4.7
Trans&Public Utilities	1.2
Fin&Ins&Real Estate	2.8
Retail Trade	7.4
Wholesale Trade	1.1
Agri&Forest&Fish Services	0.6
Services	58.1
 <i>Breakdown of Services</i>	
Hotels	0.2
Pers Serv & Repair	1.0
Private Household	0.2
Auto Rep&Serv	0.5
Misc. Bus Serv	4.8
Amusem & Recreation	1.0
Motion Pictures	0.1
Medical	0.7
Misc. Prof Serv	2.4
Non-Profit Org	1.5
Education	45.9
 <i>Breakdown of Education</i>	
Education Professionals (generally, degree requiring positions)	22.2
Other Occupations within education	23.7

The federal stimulus directed toward education is assumed to be distributed to states based on their share of U.S. population. The states are assumed to spend the stimulus money in a manner similar to their recent budgetary patterns of school funding. The employment figures represent jobs created by both the direct spending through the school budgets and the indirect and induced jobs that are created or supported by that initial expansion of school funding. Given the current recessionary conditions involving comparatively high unemployment and the high potential for budget cuts, many of these jobs will be jobs saved rather than jobs that are new to the economy.

**Do low business taxes lead
to economic growth?**

Tax Foundation's Top 10 and Bottom 10 Business Tax Climates States

Tax Rank	TOP 10 STATES	Avg. Growth	Growth Rank
1	Wyoming	5.3%	1
2	South Dakota	4.5%	9
3	Nevada	4.3%	17
4	Alaska	3.5%	49
5	Florida	4.2%	31
6	Montana	4.4%	15
7	New Hampshire	4.3%	21
8	Texas	4.6%	8
9	Delaware	3.9%	46
10	Oregon	4.0%	43

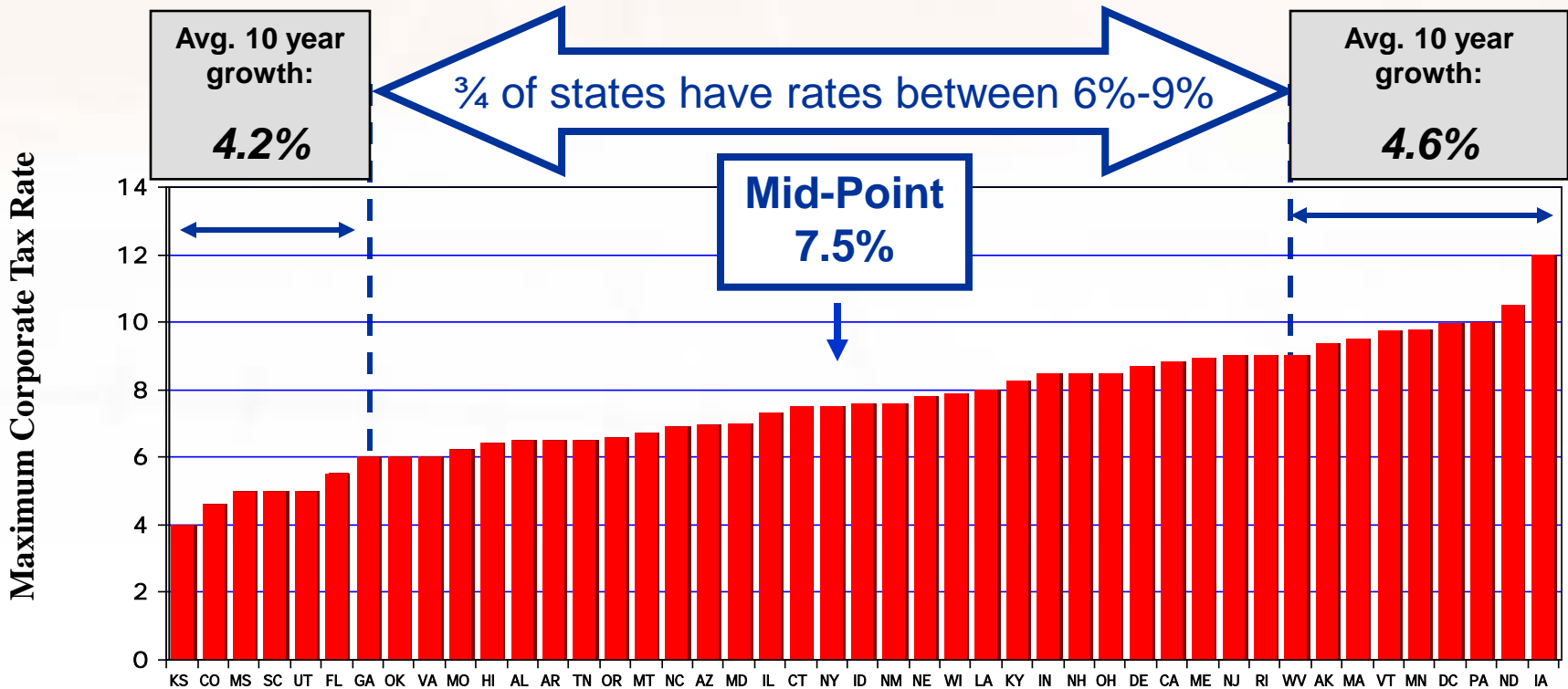
Average growth: 4.3%

Tax Rank	BOTTOM 10 STATES	Avg. Growth	Growth Rank
41	Maine	4.1%	38
42	Minnesota	4.4%	13
43	Nebraska	4.2%	30
44	Vermont	4.5%	10
45	Iowa	4.2%	27
46	Ohio	3.8%	48
47	California	4.1%	39
48	New York	4.2%	35
49	New Jersey	4.3%	23
50	Rhode Island	4.2%	29

Average growth: 4.2%

Sources: Tax Foundation, 2007 State Business Tax Climate Index; Income data from U.S. Department of Commerce, Bureau of Economic Analysis

State Corporate Income Tax Rates



The 45 States with a Corporate Income Tax

**Just how valuable is a good
business climate in
encouraging growth?**

**"Best Business
Climate"
Rank**

**Avg.
Growth
2003-07**

Business Climate Rankings

According to the November 2008 issue of
Site Selection magazine

1	North Carolina	36
2	Tennessee	39
T3	Alabama	18
T3	Texas	14
5	Indiana	49
6	Florida	12
7	Ohio	48
8	Virginia	25
9	Illinois	29
10	Georgia	50
11	New York	9
T12	Kentucky	42
T12	Missouri	47
14	South Carolina	35
15	Pennsylvania	28
16	Michigan	51
17	Mississippi	17
18	Iowa	33
T19	Maryland	16
T19	Minnesota	34
21	Kansas	23
22	Louisiana	2
23	Arizona	30
24	Oklahoma	5
25	California	19

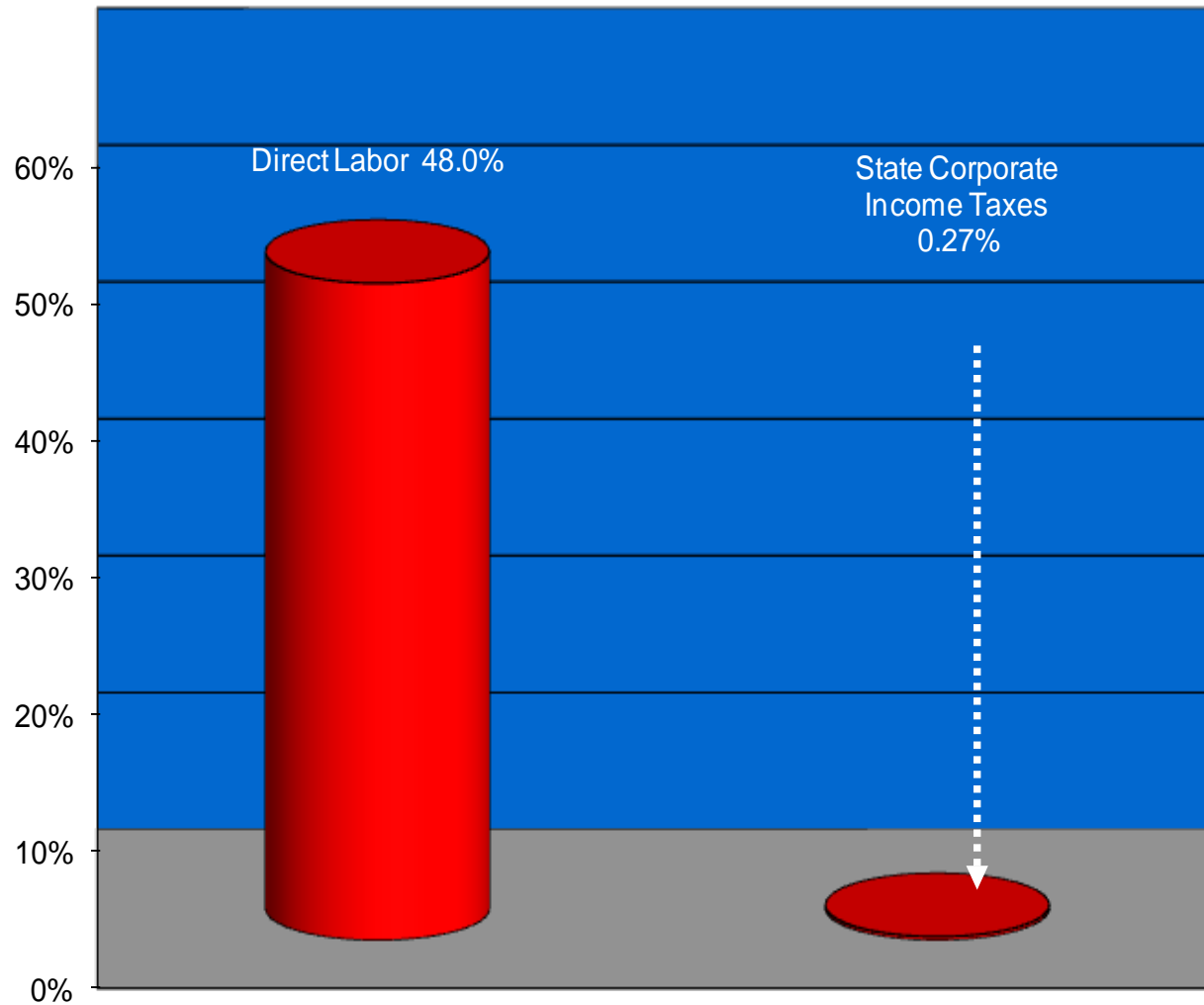
► Of the top 10 ranked states,
none were among the 10 fastest growing
states—
but three were among the slowest 10.

► Of the top 25 “*Best Business Climate*”
states, only 10 grew as fast as the average
of the 50 states.

► Of the top 25 “*Best Business Climate*”
states, 3 were in the top ten fastest growth
states—but 6 were among the 10 slowest
performing states.

Why don't taxes matter more?

Shares of Total Business Costs



From the previous article by the *Federal Reserve Bank of Boston:*

“In summary, site selection data do not suggest any correlation between low taxes and positive economic growth, or between high taxes and slow growth. The location requirements are too many, the process too complicated, and other factors too important to justify a strong relationship.”

“The single most important factor in site selection today is the quality of the available work force. Companies locate and expand in communities that can demonstrate that the indigenous work force has the necessary skills required by the company or that have the training facilities to develop those skills for the company.”

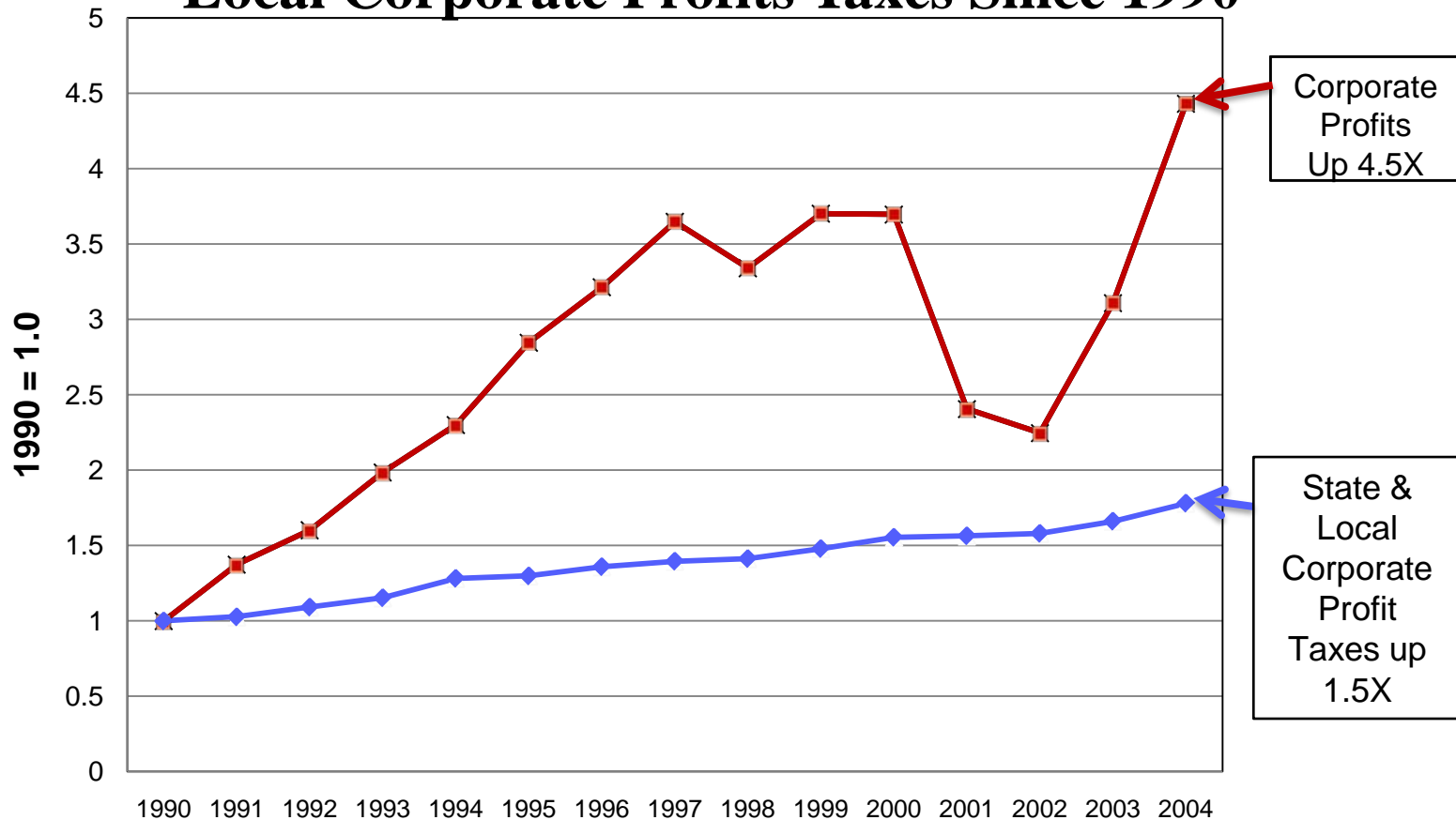
Firms Say Labor Their Major Cost Considerations When Expanding or Relocating a Business

Cost Factor	Manufacturing (%)	Office (%)
Labor	36	72
Transportation	35	0
Utilities	17	8
Occupancy	8	15
Taxes	4	5
Total	100	100

Source: Robert M. Ady, "The Effects of State and Local Public Services on Economic Development," New England Economic Review, Federal Reserve of Boston, March/April, 1997.

Besides, business income taxes have been dropping for years

Growth of Corporate Profits and State and Local Corporate Profits Taxes Since 1990



Source: Data from IRS *Statistics of Income Bulletin*, Spring 2008; chart by Richard Sims.



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Factors Affecting Location Decisions; Business Climates; and State and Local Tax Treatments

Summary

The most important factor in a company's location decision is the availability and skill of the labor force. Other important factors include the cost and availability of land, the local infrastructure, the proximity to natural resources, the quality of life, and the proximity to universities or research institutions. Most studies found that, when deciding where to do business, businesses considered ease of incorporation, regulatory burdens, and tax burdens less important than those factors listed above.

A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas

August, 2008

**Economic Development: Determining the Amounts the
State Has Spent on Economic Development Programs
and the Economic Impacts on Kansas Counties**

“Out of a sample of 115 companies or individuals that received economic development assistance in 1998, only a little more than one-third appear to be operating (in 2008.)”

Top Reasons Businesses Give for Choosing One City Over Another

- 1. Education, Education, Education.**
- 2. Speeding up the Permitting Process and Simplifying the Bureaucracy.**
- 3. The (Un)Importance of Tax Incentives.**

Source: Natalie Cohen, American Capital Access, in “Business Location Decision-Making and the City: Bringing Companies Back,” published by the Brookings Institute, 2000.

Richard G. Sims

The World Bank

A July 2008 study of the causes of growth in the 7 fastest growing countries in the world from 1960 to 2006 concluded there is—

“a robust relationship between public spending and GDP per capita growth.”

Assessing the Impact of Public Spending on Growth: An Empirical Analysis for Seven Fast Growing Countries, the World Bank, July 2008.

“The best approach (to helping workers move up the economic ladder) is to give people access to first-rate education so they can acquire the skills needed to advance.”

Treasury Secretary Henry Paulson

The Wall Street Journal agrees-

**An article rural communities called
local schools --**

“the Best Business in Town”

The Economic Development Administration

“In the New Economy, knowledge, rather than natural resources, is the raw material of business.”

From: *The importance of Quality of Life in the Location Decisions of New Economy Firms*, U.S. Economic Development Administration, 2002.

A study of major nations over the last 200 years

“Contrary to traditional beliefs, the net national costs of government social programs are virtually zero... Contrary to the intuition of many economists and the ideology of many politicians, social spending has contributed to, rather than inhibited, economic growth.”

Peter H. Lindert, Distinguished Professor of Economics, University of California, Davis,
Growing Public: Social Spending and Economic Growth since the Eighteenth Century.

Education as a taxpayer investment

Taxpayer's return on investment in public education exceeds returns generated by the stock market

Long-term return on common stocks:* 6.3%

Public return on investment in education:** 14.3%

**Includes dividends and price changes.*

***Elementary and Secondary, includes additional taxes and reductions in social service outlays.*

Sources: Stockmarket evaluations from a literature survey reported in "Long-term Returns," by Victor Niederhoffer and Alex Castaldo, April 2004; education information from "Returns to Investment in Education: A Further Update," by George Psacharopoulos and Harry Patrinos, World Bank, 2006

**IMPACT ON SOUTH DAKOTA OF A \$100 B. FEDERAL STIMULUS GOING
TO THE 50 STATES' EDUCATIONAL OPERATION BUDGETS**

(South Dakota's assumed share: \$264 million)

<i>Employment Change Total (all jobs in thousands)</i>	10.1
Government	0.1
Private Non-Farm	10.0
 <i>Breakdown of Private Non-Farm</i>	
Manufacturing	0.1
Non-Manufacturing	9.9
 <i>Breakdown of Non-Manufacturing</i>	
Mining	0.0
Construction	0.5
Trans&Public Utilities	0.0
Fin&Ins&Real Estate	0.2
Retail Trade	0.8
Wholesale Trade	0.1
Agri&Forest&Fish Services	0.0
Services	8.3
 <i>Breakdown of Services</i>	
Hotels	0.0
Pers Serv & Repair	0.1
Private Household	0.0
Auto Rep&Serv	0.0
Misc. Bus Serv	0.2
Amusem & Recreation	0.1
Motion Pictures	0.0
Medical	0.1
Misc. Prof Serv	0.1
Non-Profit Org	0.1
Education	7.5
 <i>Breakdown of Education</i>	
Education Professionals (generally, degree requiring positions)	3.6
Other Occupations within education	3.9

The federal stimulus directed toward education is assumed to be distributed to states based on their share of U.S. population. The states are assumed to spend the stimulus money in a manner similar to their recent budgetary patterns of school funding. The employment figures represent jobs created by both the direct spending through the school budgets and the indirect and induced jobs that are created or supported by that initial expansion of school funding. Given the current recessionary conditions involving comparatively high unemployment and the high potential for budget cuts, many of these jobs will be jobs saved rather than jobs that are new to the economy.

Forgone Property Tax Revenue

Historical Growth of Property Taxes v. Actual Growth

