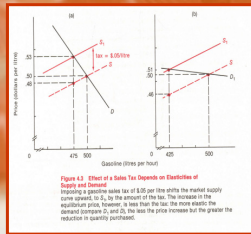


Balancing Taxes, Education Funding and Long-Term Economic Development



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



The First Principle of Public Finance

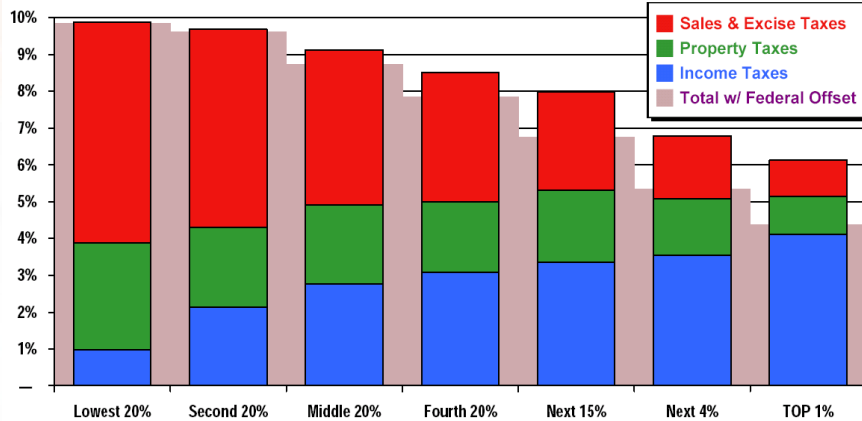
Your tax system should look like you did it on purpose.

Richard G. Sims

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

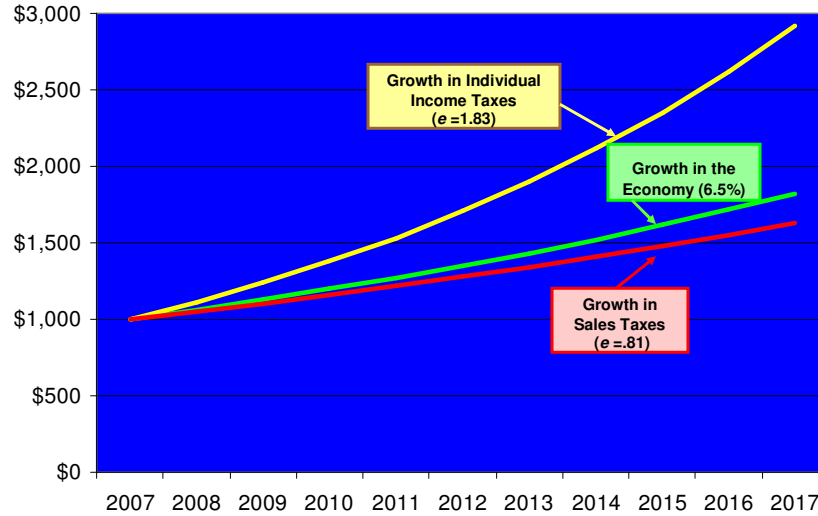
Some Typical State Tax Elasticities

STATE	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.

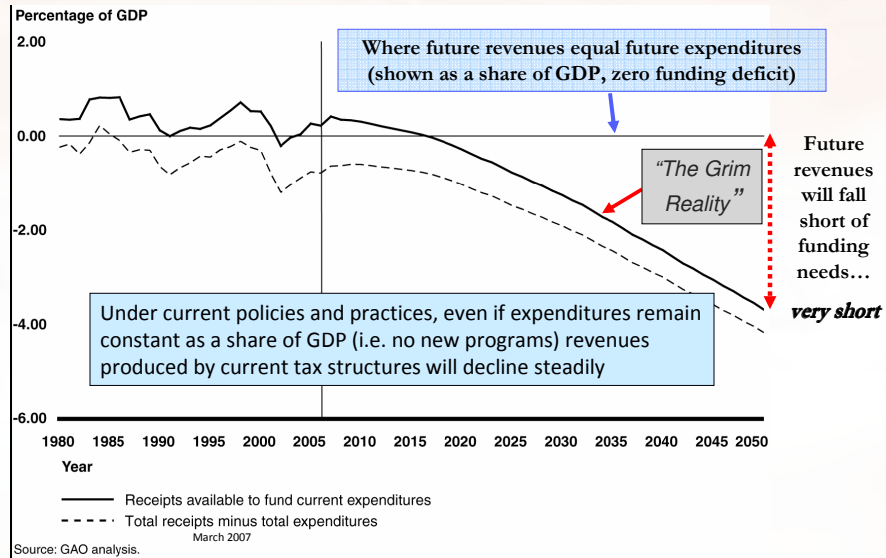
Elasticities: Income Tax, Sales Tax and Economic Growth



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



The Economics of the Stimulus

IMPACT ON COLORADO 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?

Richard G. Sims

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

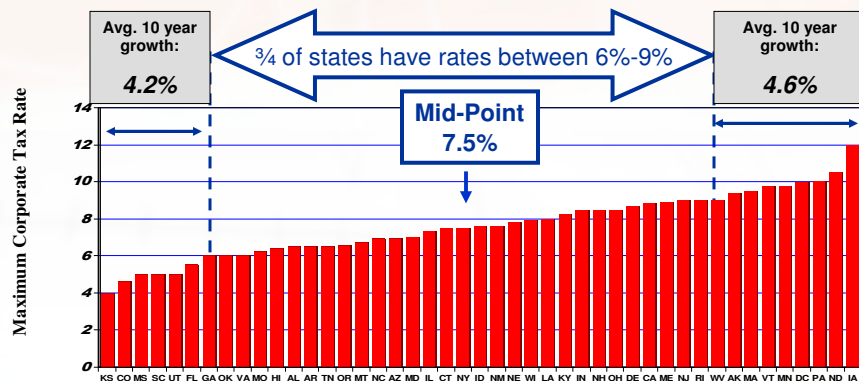
Average growth: 4.3%

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
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

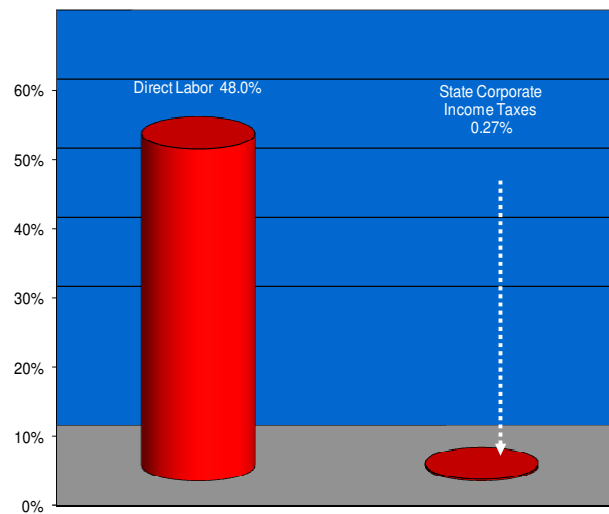
Business Climate Rankings

According to the November 2008 issue of *Site Selection* magazine

- ▶ 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



Source: U.S. Department of Commerce, National Income and Product Accounts, 2003.

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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

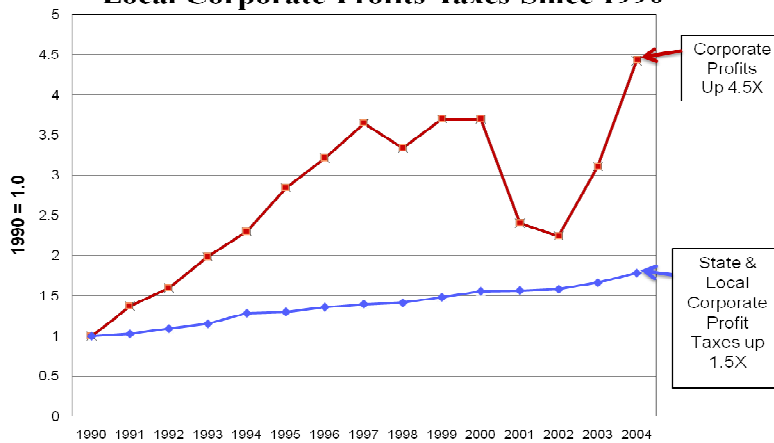
Cost Factor	Manufacturing (%)	Office (%)
Labor	36	72
Transportation	35	0
Utilities	17	8
Occupancy	8	15
Taxes	4	5
Total	100	100

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.

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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