

The Lessons of Kansas

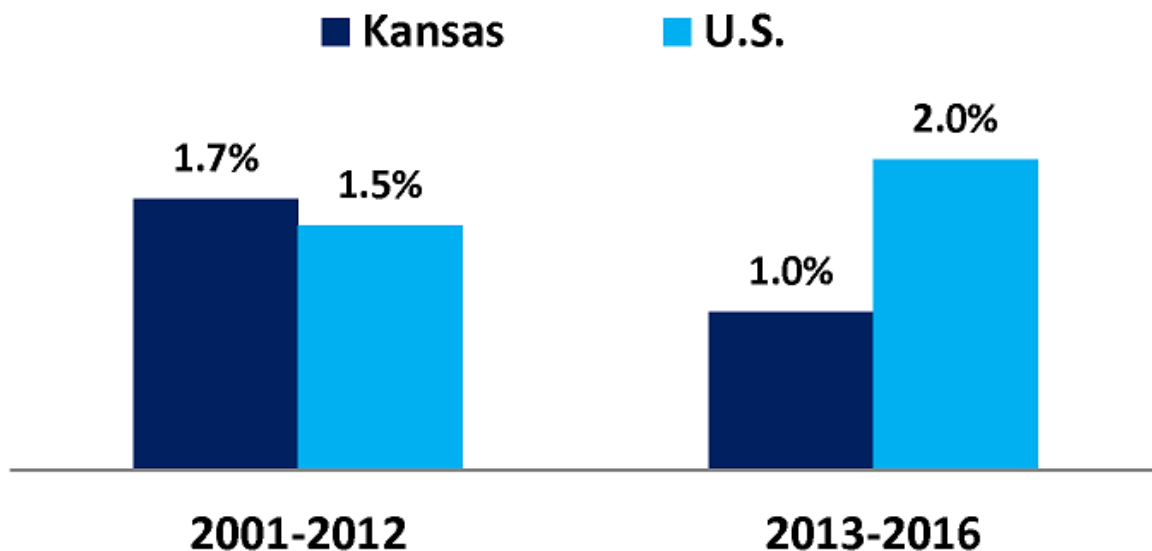
For advocates of income tax cutting, Kansas was to be the poster child. Governor Sam Brownback signed legislation in 2012 slashing income taxes and cutting the state budget by over 13 percent. Drastic income tax cuts had been pushed by Stephen Moore and by Arthur Laffer, author of ALEC's *Rich States, Poor States*, who argued they would provide an "immediate and lasting boost" to the economy.¹ The Governor claimed they would "create tens of thousands of jobs and will make our state the best place in America to start and grow a small business." It would be like "a shot of adrenaline into the heart of the Kansas economy."² Laffer and Moore finally had the case study they had been pushing for to demonstrate the efficacy of drastic cuts in state income taxes, leading, they hoped, to ultimate elimination of the tax.

In June of 2017, this drastic social experiment came to an end. The Kansas legislature overrode the Governor's veto and enacted a bill to roll back most of the tax cuts. For the bottom two income tax brackets, rates were raised nearly to the level that existed prior to 2012, and the third (top) bracket that had been eliminated was brought back.³ The elimination of all income taxes on so-called "pass-through" business income, which turned out to be a very expensive yet ineffective measure, was repealed.

The experiment failed in part because the tax cuts did not produce the promised boost to the state's economy. To see how far they fell short, consider that the state of Kansas had not been a laggard before the cuts. From 2001 through 2012, the state had actually grown faster than the U.S. as a whole. But for the four years since the tax cuts took effect, the Kansas economy has grown at just half the rate of the U.S. economy.

Kansas GDP Growth Lags Behind U.S. after Tax Cuts

Average annual percent change in real GDP



Source: Bureau of Economic Analysis , Real GDP by State (chained 2009 dollars), 2000-2016

In the 8th edition of ALEC's *Rich States, Poor States*, Laffer, Moore and Williams argued that a proper assessment of the impact of the tax cuts on the Kansas economy should consider the state's economic performance relative to the region's or the nation's before the tax cuts, and after.⁴ They also argued that the lackluster performance in 2013 is partly due to problems in the aircraft industry, and that the rest of the state economy actually did well that year.

These points are well taken. So let's look at job growth in Kansas before and after the tax cuts, and let's take into account the ups and downs of the aircraft industry. Aircraft manufacturing is concentrated in Wichita, and is a major driver of the entire Wichita economy. In the table below we look at total nonfarm employment growth in Kansas as a whole, in Kansas minus Wichita, and in the U.S.

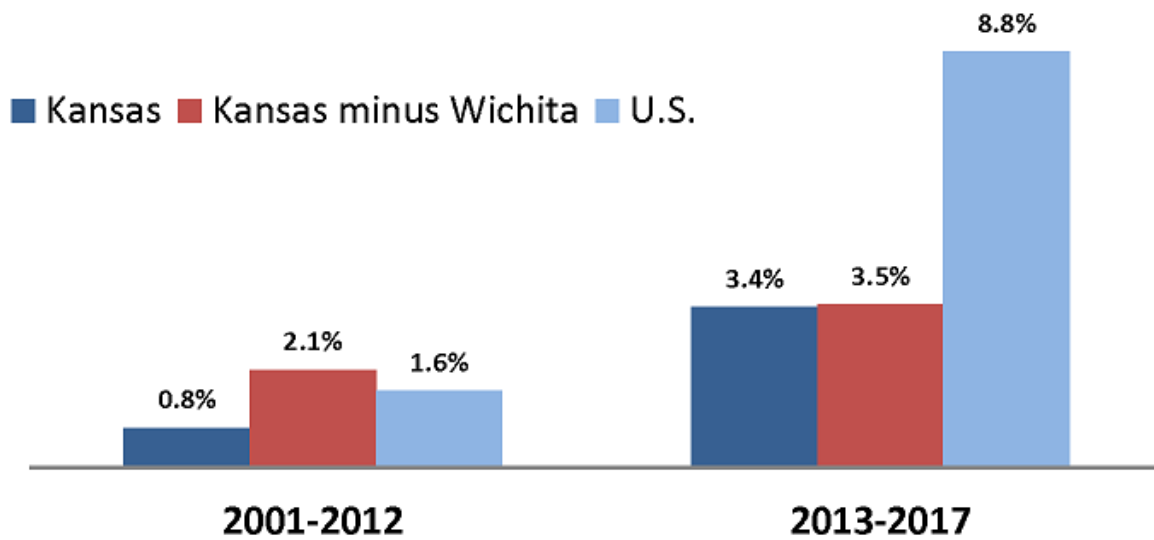
From 2001 to 2012, before the tax cuts, total nonfarm employment in Kansas outside Wichita grew 2.1 percent, outperforming the nation, which grew at 1.6 percent. Wichita declined 3.5 percent during this period, leaving the state as a whole with just 0.8 percent growth, half the U.S. average. Thus the aircraft industry, and the Wichita economy generally, is entirely responsible for the state's overall poor performance during the pre-tax-cut period.

After the tax change, that is from 2013 through May of 2017, Wichita grew 3.2 percent, the rest of Kansas 3.5 percent, while the U.S. economy grew 8.8 percent. The bottom line

is that, if one wants to treat the aircraft-based Wichita economy as a special case and focus on the rest of the state to determine the effects of tax cutting, for the 12 years before the tax cuts Kansas beat the national growth rate by 30 percent, while for the four years since the tax cuts Kansas growth has lagged the nation's, coming in at only two-fifths of the national rate. And no matter how you look at it, the Kansas economy since the tax cuts has performed well below the national economy.

Kansas Job Growth Lags U.S. After Tax Cuts

Percent change in non-farm jobs



Source: U.S. Bureau of Labor Statistics, Current Employment Statistics, average annual non-farm employment 2000 through May, 2017.

Laffer and Moore have also defended the complete exemption of income from pass-through entities (such as partnerships and S-corporations) in the Kansas tax cut law of 2012, a provision that was eliminated in the June 2017 legislation. Their support for this exemption consisted of a statistic on new business filings, which set a Kansas record in 2012 of 15,000, then reached 15,780 in 2014.⁵ But if the law is really stimulating job growth through new business formation, this should be reflected in the number of workers employed in new establishments. Again, we should compare the performance of Kansas relative to the nation.

What we find is that from 2000 through 2012, Kansas accounted for, on average, .99 percent of the U.S. jobs created in opening establishments. But since then (2013 through the third quarter of 2016), only .92 percent of such jobs have been in Kansas.⁶ The exemption of pass-through income was supposed to make Kansas more “competitive” for new business, but the state’s share of employment in newly opened establishments, instead of increasing, has declined since the tax cuts. The exemption of pass-through income may have fueled a surge in businesses reconstituting themselves as pass-through entities to avoid taxation, because the revenue losses were much larger than predicted, but it does not appear to have produced any actual growth.

Meanwhile, the budget consequences have been disastrous. Operating reserves have been depleted. State aid for schools remains well below pre-recession levels. Yet in the long run a state's economic health is dependent on a sound education system. States have a crucial role to play preparing the state's workforce for the needs of a 21st century economy. Furthermore, a quality public education system is important for the state to attract investment by businesses providing good-paying jobs who need to attract qualified workers who want good schools for their children.

In defense of the Kansas experiment, Laffer, Moore and Williams argued that the state should have been more patient; it was going to take more time to see results. While the "immediate boost" obviously did not materialize, they continued to defend the tax cuts into 2017, resorting to simplistic comparisons of groups of states to argue that tax cutting does work.⁷ They compare states with no income tax to states with high income tax rates, ignoring the basic principle that correlation does not demonstrate causation. A review of serious research that controls for all the other factors contributing to state economic growth, and that relies on evidence from all 50 states, shows little evidence that cutting personal income taxes will boost a state economy. (Read more about [business taxes and growth](#), [income taxes and small business](#), and [taxes and migration](#).)

Laffer and Moore have also put great stock in migration statistics, arguing that migration flows represent "voting with your feet" in response to high taxes. But the Kansas case does not help their argument. From 2013 to 2015, Kansas experienced a net out-migration of 9,099 people, more than any of their neighbors except Oklahoma, with 9,904 exiting that state.⁸ Missouri, which they are fond of bashing as a high-tax state, did the best, with a net gain of 7,062.

The ALEC defense of the Kansas experiment is largely based on the assertion that the state never actually fully implemented their recommendations, because the legislature refused to enact the budget cuts necessary to offset the drastic tax cuts. While there is truth to this argument in the sense that budget shortfalls are obviously the consequence of revenue cuts exceeding spending cuts, this defense does not address the more fundamental issue: the tax cuts failed to produce the promised results in the form of economic growth. Are Laffer, Moore and Williams prepared to argue that if only education and infrastructure funding had been cut more drastically, the state would have outpaced national growth rates instead of falling well short of them? What new businesses really wanted, in addition to the tax cuts, was more potholes and more poorly educated workers? There is neither logic nor evidence to support such a claim.

¹ Quoted in Michael Leachman, "Debating Kansas' Tax Cuts." Center on Budget and Policy Priorities, Blog, October 30, 2014. <http://www.cbpp.org/blog/debating-kansas-tax-cuts>

² Press release, as quoted in "Kansas Says Goodbye to All That," *State Policy Reports*, Vol. 35, issue 11, June 2017.

³ The bottom bracket rate was 3.5 percent in 2011 and was scheduled to fall to 2.3 percent by 2018 under 2013 amendments to the 2012 tax bill, but instead will rise to 3.1 percent. The second bracket was 6.25 percent in 2011, would have fallen to 3.9

percent by 2018, but instead will rise to 5.25 percent. The top bracket was 6.45 percent in 2011, and would have been effectively 3.9 percent in 2018 (same as the second bracket), but instead will be reinstated at 5.7 percent.

⁴ Arthur Laffer, Stephen Moore, and Jonathan Williams. *Rich States, Poor States*, 8th Edition, Chapter 4. American Legislative Exchange Council, 2015

⁵ Laffer, Moore, and Williams. *Rich States, Poor States*, 8th Edition.

⁶ The source for this data is the U.S. Bureau of Labor Statistics, Business Employment Dynamics, employment in establishments opening during each year, for all private sector businesses, annual figures as of the fourth quarter (third quarter for 2016, the latest quarter available). <http://data.bls.gov/cgi-bin/dsrv?bd>

⁷ Jonathan Williams and Ben Wilterdink. *Lessons from Kansas: A Behind the Scenes Look at America's Most Discussed Tax Reform Effort*. American Legislative Exchange Council, February, 2017. This is largely a reprint of Chapter 4 of *Rich States, Poor States*, published in 2015 and cited earlier.

⁸ Nathan Madden. "Despite Promises, More Kansans Left the State after 2012 Income Tax Plan." Kansas Center for Economic Growth, April 20, 2017. <http://realprosperityks.com/despite-promises-kansans-left-state-2012-income-tax-plan/>