Iowa Fiscal Partnership

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CONTACT: Mike Owen or Peter Fisher, (319) 338-0773, mikeowen@iowapolicyproject.org.

Kansas' failed tax-cut experiment holds warnings for Iowa

New report exposes the danger of supply-side tax-cutting by states

IOWA CITY, Iowa (Jan. 24, 2018) — A new report shows Iowa lawmakers should pay attention to the failed experiment in Kansas and focus any tax changes on fairness and stabilizing revenues for education and other critical services.

"Kansas tried cutting taxes to promote economic growth in 2012 and instead wound up lagging its neighbors — including Iowa — and the nation, forcing cuts in school funding and other needs," said Peter Fisher, research director of the nonpartisan Iowa Policy Project (IPP).

The new report from the Center on Budget and Policy Priorities is the latest illustration of why Kansas shows how not to proceed. And now that this is clear, tax-cut proponents have backed off their earlier celebration of Kansas.

"It's a bad risk for our state," Fisher said. "It is being driven by outside forces and ideology, and we already know it does not work."

In 2012, tax-cut supporters said Kansas would boost its economic competitiveness by sharply curtailing taxes on high-income people and businesses. While Kansas Governor Sam Brownback had called the cuts a "shot of adrenaline into the heart of the Kansas economy," the result left tax-cut supporters scrambling for excuses, saying that the Brownback experiment was tainted.

CBPP, however, found the Kansas tax cuts to be a valid test of supply-side economics. That they failed the test is not a surprise. The CBPP report as well as previous IPP research by Fisher, available at www.gradingstates.org, shows that the preponderance of academic research has found that personal income tax cuts typically produce little if any economic growth.

From December 2012 (just before the tax cuts took effect) to May 2017 (just before they were repealed) jobs in Kansas grew only 4.2 percent, below all of its neighbors except Oklahoma and less than half of the 9.4 percent job growth in the United States.

Yet in Iowa, promises of tax changes are coming with a heavy dose of the failed supply-side, trickle-down approach. And work on the changes is — so far — behind closed doors.

"Iowa's tax discussion from start to finish belongs out in the open. The impacts will be felt by all Iowans, and all Iowans should be at the table — with legitimate analysis like that from CBPP, IPP's Peter Fisher and other respected Iowa economists, to be front and center," said Mike Owen, executive director of IPP.

The Iowa Fiscal Partnership has identified keys to responsible tax reform, which includes eliminating federal deductibility as Governor Reynolds has proposed to reduce tax rates that appear higher than they are — but only if that change comes without a reduction in revenue, and does not increase the overall inequity in Iowa taxes that favors the wealthy.

"At a time of budget shortfalls, we cannot afford to lose more resources for schools and vulnerable families, and in any case we need to introduce more fairness in taxes to reflect Iowans' ability to pay," Owen said. "Currently, the bottom 80 percent of Iowa working-age households pay — on average — 10 percent of their income in state and local taxes, and the wealthier pay steadily less. New income-tax cuts at the top would make this worse."

CBPP's research found that Kansas's tax cut experiment was a valid — and failed — real-world test of supply-side economics for the following reasons:

- **Kansas sharply curtailed spending after enacting the tax cuts.** Some argue that the tax cuts didn't produce economic growth because lawmakers didn't follow it with spending cuts, but this does not match reality. State spending was tightly restricted in the aftermath of the tax cuts. Between fiscal years 2012 and 2016, Kansas's General Fund spending rose only 0.3 percent without adjusting for inflation and fell 5.5 percent after adjusting for inflation and population growth. If Kansas had cut spending more, its economic and job growth would have been even more lackluster as teachers, nursing home aides paid with Medicaid funds, private road maintenance contractors compensated with Highway Fund dollars, and others employed by the state would have had less money to spend locally.
- **Downturns in agriculture, energy, and airplane manufacturing don't explain the tax cuts' ineffectiveness.** Some have cited the decline of oil, gas, and commodity prices, as well as a decline in Kansas's energy sector to help explain the state's poor economic performance. But the aircraft manufacturing and energy sectors are too small a part of the Kansas economy for their downturns to appreciably affect the state's job creation record. The two sectors lost 2,500 and 3,100 jobs, respectively, between 2012 and mid-2017 — well under 1 percent of the state's total employment. And, while combined earnings of farmers fell significantly in Kansas in the years following the tax cuts, all of the state's neighbors except Nebraska had even bigger declines, as did the country overall. Despite this, Kansas' job growth still lagged behind all but one of its neighbors.
- **Kansas's exemption of "pass-through" income from the income tax led to only modest tax avoidance.** The exemption for pass through income — that is, income from businesses such as partnerships, S corporations, and sole proprietorships that filers report on individual tax returns — did create an incentive for various kinds of tax avoidance strategies. But the Kansas Department of Revenue's own data shows that there was, at most, only a small and temporary uptick in the number of pass-through business formations that might have been due to tax avoidance.

"Some will continue to argue that Kansas's fiscal and economic struggles after its tax cuts aren't relevant to other states, but plenty of evidence says that they are. Other states should be very cautious in pursuing tax cuts in the name of supply-side economics because time and time again we have seen this approach fail," said Michael Mazerov, author of the report.

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