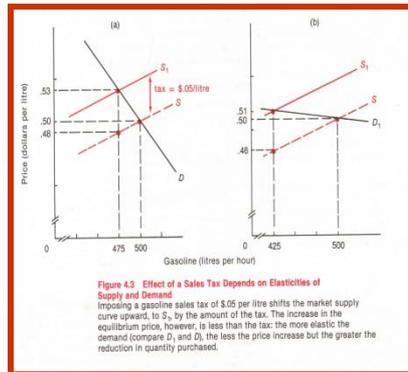


Balancing Taxes, Funding, and Economic Growth



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National Education Association
Davis, California
April, 2009**



The First Principle of Public Finance

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



The Second Principle of Public Finance

Your tax system will probably do what it is designed to do.

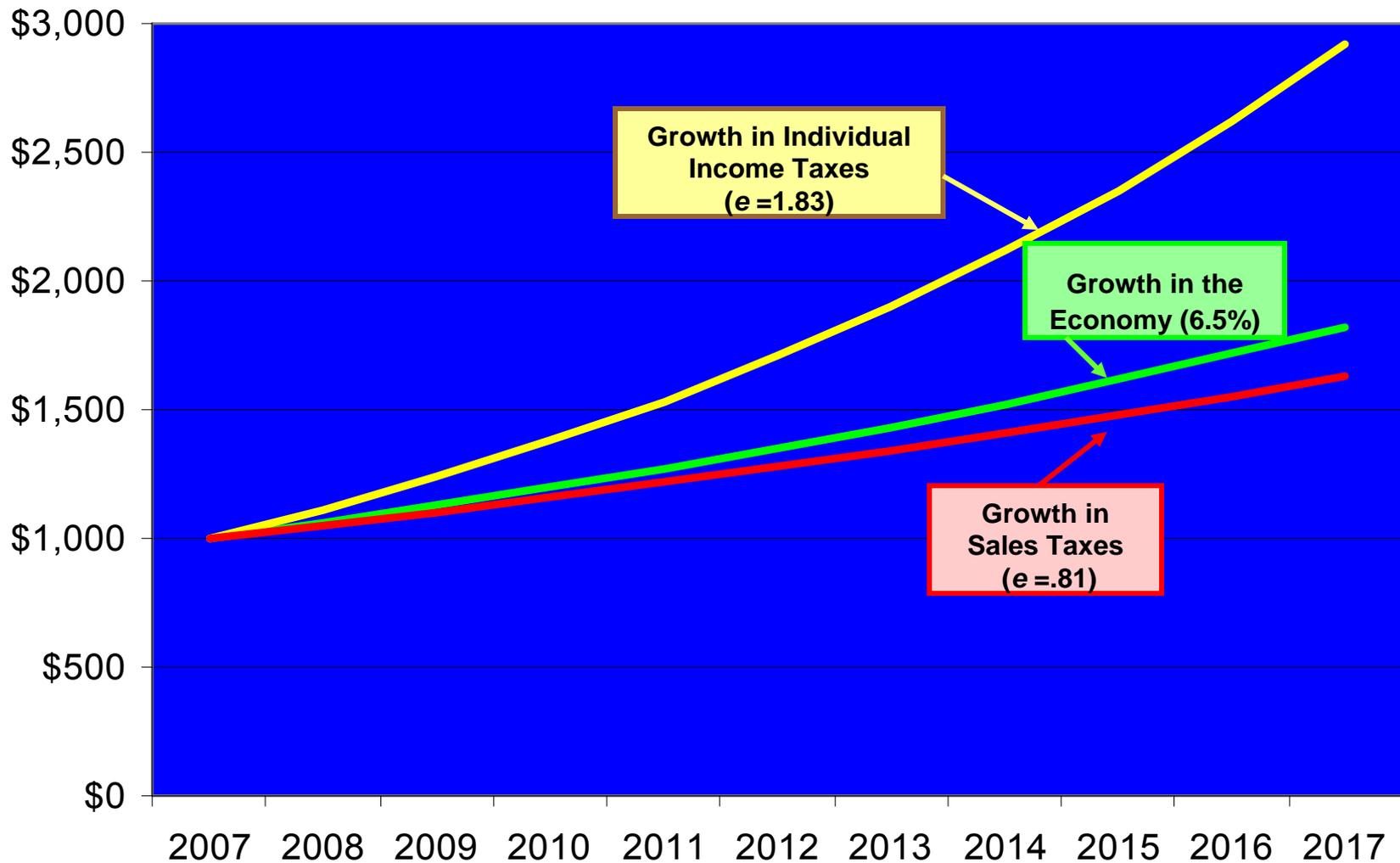
Different taxes grow at different rates

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

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.)

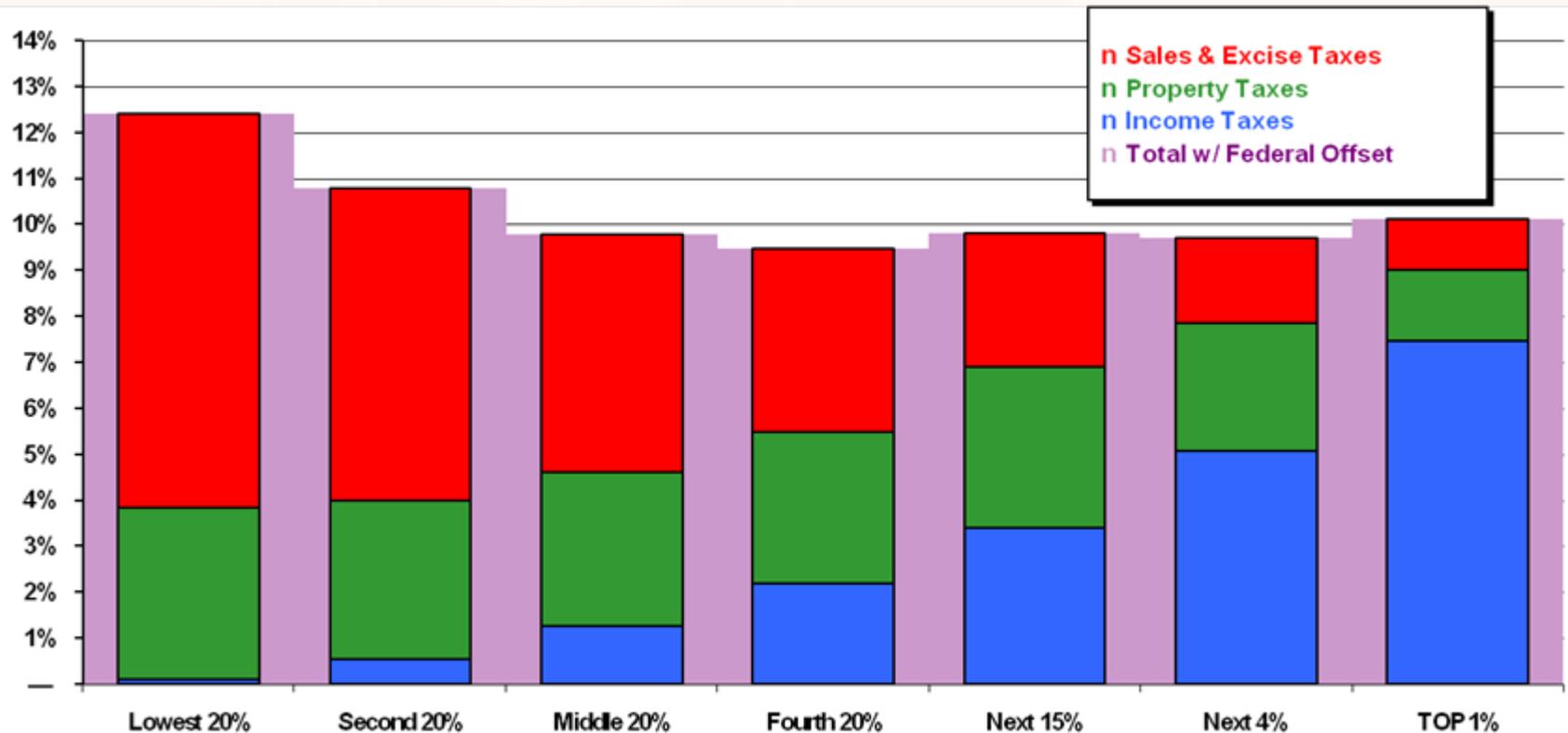
**State & Local Surplus (Gap) After 8 Years
As % of Revenue**

Vermont	3.1	Virginia	(3.0)
North Dakota	2.2	Georgia	(3.2)
Maine	1.3		
New Jersey	0.6	United States	(3.4)
Delaware	0.2		
Wisconsin	0.0	Kentucky	(3.4)
Kansas	(0.3)	Arkansas	(3.5)
Montana	(0.4)	Hawaii	(3.6)
Maryland	(0.5)	New Mexico	(3.6)
New Hampshire	(0.6)	Iowa	(3.7)
Arizona	(0.7)	New York	(3.8)
Massachusetts	(0.8)	Illinois	(4.2)
Utah	(0.8)	Missouri	(4.7)
Oklahoma	(1.3)	Washington	(4.9)
Oregon	(1.3)	Idaho	(5.0)
Nebraska	(1.4)	Indiana	(5.2)
Ohio	(1.4)	North Carolina	(5.6)
South Dakota	(1.7)	Texas	(5.7)
Michigan	(1.7)	Florida	(5.7)
Rhode Island	(1.9)	South Carolina	(6.3)
Minnesota	(1.9)	Wyoming	(7.8)
Colorado	(2.3)	Mississippi	(8.6)
Alaska	(2.4)	Louisiana	(8.8)
California ◀	(2.5)	Alabama	(9.2)
Connecticut	(2.9)	Nevada	(9.2)
West Virginia	(2.9)	Tennessee	(9.7)
Pennsylvania	(2.9)		

Source: State Spending for Higher Education in the Coming Decade National Center for Higher Education Management Systems, Boulder CO, 2003.

California

State and Local Taxes 2006



Source: Institute on Taxation and Economic Policy, Who Pays the State and Local Taxes? A Distributional Analysis of the Tax Systems in All 50 States, preliminary data for tax year 2006, provided 2009.

A Growing Concern: *Economic growth does not come free*

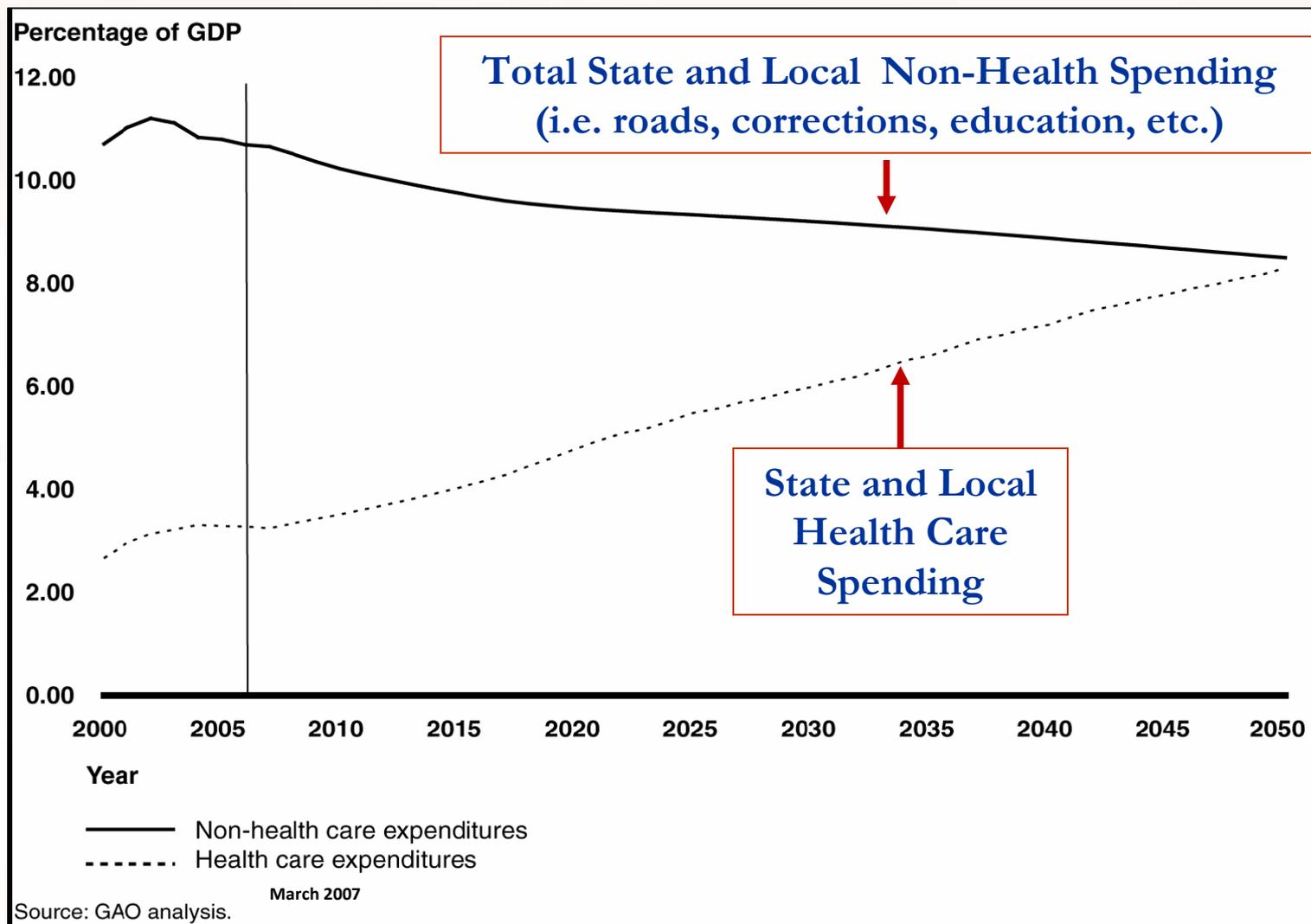
California taxes at various income levels

	\$2,500	\$43,000	\$70,000	\$125,000	\$300,000	\$2,000,000
Taxpayer income	\$2,500	\$43,000	\$70,000	\$125,000	\$300,000	\$2,000,000
CA state & local taxes	\$270	\$4,214	\$6,650	\$12,250	\$29,100	\$202,000
CA per pupil spending	\$8,952	\$8,952	\$8,952	\$8,952	\$8,952	\$8,952

Break-even for a taxpayer with one child: \$92,000

Sources: Institute on Taxation and Economic Policy, Who Pays the State and Local Taxes: A Distributional Analysis of the Tax systems in All 50 States, preliminary data for 2006, downloaded 2009; National Center on Education Statistics, *Revenues and Expenditures for Public Elementary and Secondary Education*, data for school year 2007.

Health care costs will force tax increases, absorb all growth in state and local revenues, and force cuts in non-health care budget sectors



**"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

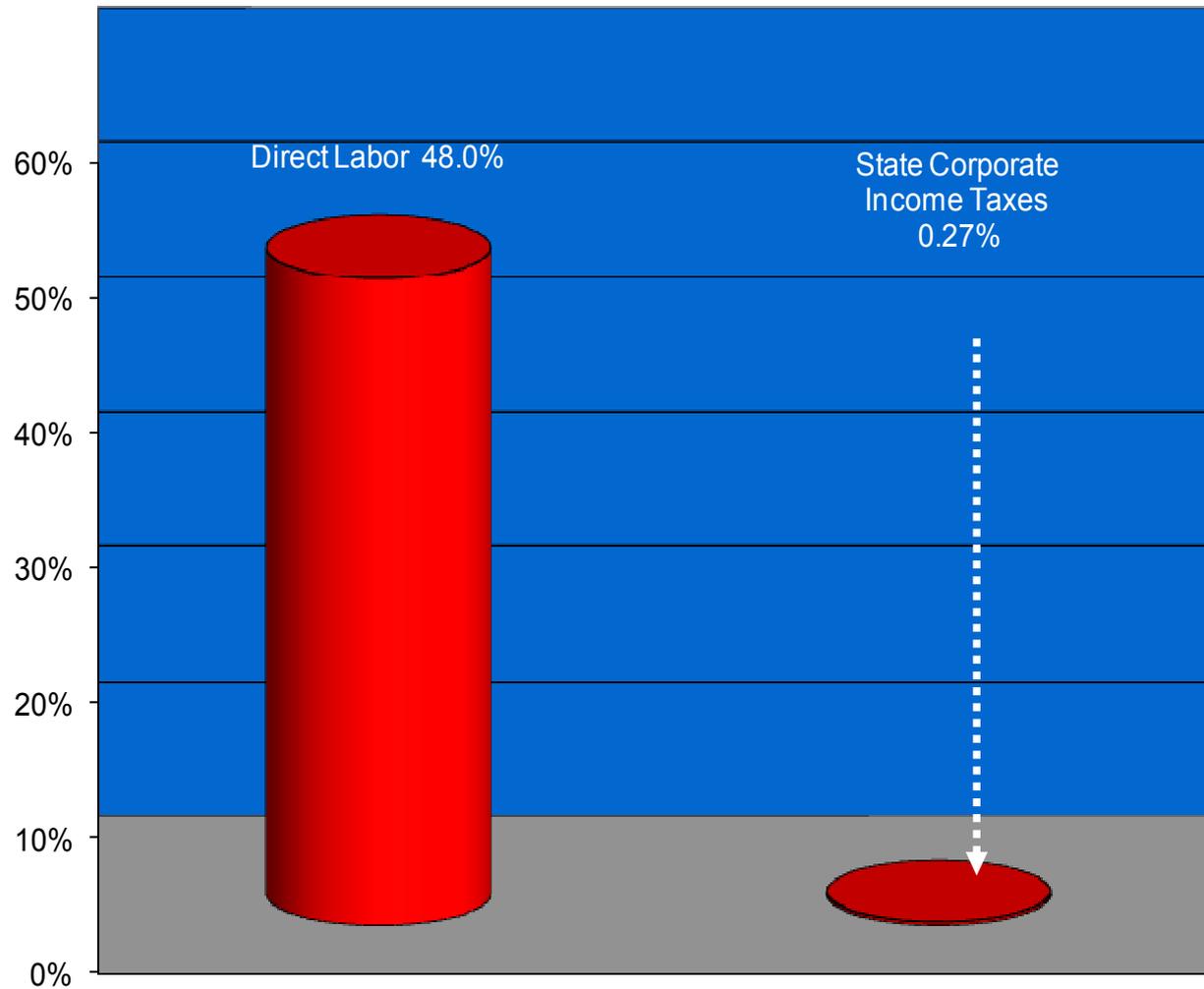
According to the November 2008 issue of
Site Selection magazine

► Of the top 10 ranked states, zero 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 50 state average.

► Of the top 25 “Best Business Climate” states were among the 10 worst performing states.

Shares of Total Business Costs



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

**For both business and individuals,
taxes matter—but other things matter
more.**

A series surveys by Fox News/Opinion Dynamics found that 7 out of 10 respondents said that how their taxes were spent mattered more to them than how much they paid.

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.

From the previous article published 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.”

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.

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

August, 2008

Among the findings--

“The literature we reviewed concluded that, thus far, negative and inconclusive findings are far more numerous than positive findings. Most reviews of economic development assistance find few results are achieved – a theme that audits in Kansas and other states commonly find, as well. Findings of ineffectiveness include promised jobs weren’t created, return on investment is low or negative, and incentives offered weren’t a determining factor.”

“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.)”



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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 U.S. Economic Development Administration Study Concluded-

“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.

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.”

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

For taxpayers, education is a smart 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:** 13.3%

**Includes both price changes and dividends.*

***Fiscal returns to public elementary and secondary, includes additional taxes associated with improved education minus the public costs involved with providing the education services.*

Sources: Stockmarket evaluations from a literature survey reported in "Long-term Returns," by Victor Niederhoffer and Alex Castaldo, April 2004; Education returns from Education at a Glance, by the OECD, 2006.

So, how is California doing?

	Spending		Graduation		Percent		
	Rate	Rank	Rate	Rank	Proficient	Rank	Sum of Ranks
U.S. Average	9,963		70.6		31.0		
California	7,571	47	70.1	34	23.9	41	122

Source: Education Week, Quality Counts, 2009.

Who are your competitors?

	Spending		Graduation		Percent		Sum of Ranks
	Rank	Rate	Rank	Proficient	Rank		
U.S. Average	9,963	70.6		31.0			
Vermont	15,139	1	80.2	5	41.4	3	9
New Jersey	13,238	3	83.3	1	40.4	5	9
Pennsylvania	11,252	12	80.4	4	38.3	8	24
North Dakota	10,885	17	79.2	7	41.0	4	28
Massachusetts	11,545	10	74.7	19	50.7	1	30
New Hampshire	11,169	14	77.1	11	37.9	9	34
Wisconsin	10,529	18	80.5	3	37.0	13	34
Montana	11,660	9	75.7	17	37.6	10	36
Wyoming	14,126	2	74.2	21	36.0	15	38
Connecticut	11,885	8	77.1	11	34.7	21	40
Maine	12,985	5	77.2	10	34.1	25	40
Minnesota	9,476	30	78.1	9	43.1	2	41
South Dakota	10,223	20	75.6	18	39.1	7	45
Iowa	9,977	25	82.8	2	35.2	18	45
Nebraska	11,023	16	79.6	6	34.6	23	45
Kansas	10,216	21	74.3	20	40.2	6	47
Ohio	10,119	22	75.9	16	35.4	17	55
Maryland	10,088	23	73.6	23	36.5	14	60
Indiana	10,053	24	73.6	23	35.1	19	66
Rhode Island	12,478	6	71.1	30	27.7	35	71
Colorado	8,514	40	74.2	21	37.4	12	73
Alaska	12,090	7	67.6	38	32.2	28	73
New York	13,064	4	68.0	37	30.2	32	73
Virginia	8,725	37	72.9	27	37.5	11	75
Illinois	8,829	34	76.7	13	30.8	31	78
Missouri	9,146	32	76.5	15	29.9	33	80
Idaho	8,034	43	76.6	14	34.1	25	82
Oregon	9,460	31	70.4	33	34.8	20	84
Utah	5,964	51	78.6	8	32.4	27	86
Delaware	11,426	11	60.1	45	31.3	30	86
West Virginia	11,150	15	72.8	28	18.5	47	90
Michigan	9,809	26	70.5	32	28.9	34	92
Arkansas	9,756	28	73.2	26	24.4	40	94
Washington	7,688	45	68.8	35	35.9	16	96
Hawaii	10,426	19	67.4	39	21.2	45	103
Kentucky	8,681	38	71.5	29	27.3	37	104
Texas	7,561	48	68.5	36	34.7	21	105
North Carolina	7,835	44	67.0	40	34.5	24	108
South Carolina	9,008	33	55.6	48	31.9	29	110
DC	11,193	13	57.6	47	8.0	51	111
Arizona	7,112	50	73.3	25	26.3	38	113
Oklahoma	8,255	42	70.8	31	21.3	44	117
Florida	8,437	41	60.8	44	27.4	36	121
Georgia	8,754	36	58.1	46	24.7	39	121
California	7,571	47	70.1	34	23.9	41	122
Louisiana	9,787	27	54.7	49	19.0	46	122
Alabama	8,769	35	61.3	43	18.2	48	126
New Mexico	9,525	29	54.1	50	17.4	49	128
Tennessee	7,620	46	65.4	41	23.1	42	129
Mississippi	8,635	39	61.8	42	13.6	50	131
Nevada	7,213	49	45.4	51	23.0	43	143

Source: Education Week, *Quality Counts 2009*

What a high drop-out rate means to taxpayers--

- > **TAXES:** A high school drop-out pays \$3,666 less in taxes than someone who completed H.S.
- > **HEALTH CARE:** Each high-school non-completer is estimated to cost taxpayers \$39,000 in additional publicly provided health care
- > **CRIME:** A 2007 study from the University of California /Berkley* found that a 1% increase in the high school completion rate for men age 20 to 60 would save the nation as much as \$1.4 billion a year in reduced costs from crime incurred by victims and by society at large. This would save taxpayers as much as \$2,100 a year for each additional high school graduate.

Sources: Cecilia Elena Rouse, "Consequences for the Labor Market," Princeton University, 2007; Peter Muennig, "Consequences in Health Status and Costs," Columbia University, 2007; Enrico Moretti, "Crime and the Costs of Criminal Justice," UC/Berkley, 2007.