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Kansas 'Real Live Experiment' in Trickle-Down Tax Cuts

A Flashing Warning Sign for Congress

By Alexandra Thornton and Galen Hendricks November 2, 2017

"Our new pro-growth tax policy will be like a shot of adrenaline into the heart of the Kansas economy. It will pave the way to the creation of tens of thousands of new jobs…"

—Gov. Sam Brownback (R-KS), July 29, 2012[1]

"This huge tax cut … will be rocket fuel for our economy. … The biggest winners from this transformation will be everyday families, from all backgrounds, from all walks of life, and our great companies, which will produce the jobs. They are going to produce jobs like you've never seen before."

—President Donald Trump, October 11, 2017[2]

In 2012, Kansas enacted massive tax cuts that supply-side proponents said would turbocharge the state's economy and pay for themselves

In a column published in *The Wichita Eagle* that year, Gov. Sam Brownback (R-KS) claimed that the steep tax cuts, which the Kansas Legislature passed and he signed, would lead to the expansion of the state's economy, boosting investment, increasing employment, and directly benefiting schools and local governments in the state. "Now is the time to grow our economy," he said, "not state government, and that's what our policies will do."[3]

Kansas' tax cuts were similar in nature to and based on the same flawed theories as the Trump-McConnell-Ryan tax plan

This should come as no surprise since Stephen Moore, Larry Kudlow and Arthur Laffer—all of whom consulted with Trump on his campaign tax plan—helped to design the 2012 Kansas tax plan.[4] And when Brownback was in Congress, Paul Ryan—now the speaker of the House—served as his legislative director.[5]

In addition to the same fairytale claims of economic and job growth, which are illustrated by the quotes above, the actual tax plan passed by the Kansas Legislature looked similar to what Trump and congressional GOP leaders now propose.

1. Regressive collapse of individual tax rates and brackets

The Kansas tax plan collapsed the state's three individual marginal income tax rates of 3.5, 6.25, and 6.45 percent down to two rates of 3.0 and 4.9 percent.[6] In a similar fashion, the Trump-McConnell-Ryan tax plan would collapse the number of individual brackets from seven down to three, with rates of 12, 25, and 35 percent—with a possible fourth bracket between 35 and 39.6 percent.[7] These changes both reduce the progressivity of the respective tax codes and give the biggest benefit to those with the highest income.

2. Business income tax loophole

A key feature of the 2012 Kansas tax plan was its elimination of taxes on pass-through business income. Pass-throughs are businesses—such as sole proprietorships, S corporations, partnerships, and limited liability companies (LLCs)—that do not pay the corporate income tax. Their income is passed through to the owners and taxed at their individual tax rates. Together with the lower marginal tax rates also enacted in Kansas that year, this created a 4.9 percent difference between the tax treatment of business income, taxed at a zero rate, and that of other individual income, taxed at a top rate of 4.9 percent. Recent analysis has shown that this differential overwhelmingly caused tax avoidance rather than economic growth, with many individuals recharacterizing their personal income as business income in order to take advantage of the zero tax rate rather than increasing real business activity.[8] Kansas had estimated that about 200,000 pass-through businesses would use the pass-through tax break, but about 330,000 actually used it.[9]

The Trump-McConnell-Ryan plan would also create a differential between the top tax rates on personal and business income—only with a much larger difference of 10 percent. Just as analysts predicted for the Kansas pass-through tax cuts, the Tax Policy Center predicts that under the "Unified Framework for Fixing Our Broken Tax Code," individuals will recharacterize wage income in order to qualify for the lower pass-through rate. The center estimates that the pass-through tax cut alone will cost nearly $770 billion over the first 10 years.[10] And if the differential in the final legislation is larger, the behavioral effect—the shifting of income into pass-through businesses—and the associated revenue loss will likely be even greater.

3. A mixed bag for low- and middle-income people

The Kansas plan included selected tax cuts for low- and middle-income families, such as an increased standard deduction, that nevertheless were estimated to leave many of those families with tax increases.[11] In a very similar manner, the Unified Framework would increase the standard deduction and possibly the child tax credit but would take away personal and dependent exemptions as well as other tax benefits, leaving many low- and middle-income families with a tax increase.[12]

4. Warnings of large revenue losses

At the time, conventional estimates showed that the Kansas tax cuts would be harmful. However, GOP leaders relied on rainbow scenarios to predict outsized economic growth. Referring to this scenario, Sen. Dinah Sykes (R-KS) recently said, "Today, we know which forecasts were correct."[13]

Estimates for the Trump-McConnell-Ryan plan follow a similar pattern. The Tax Policy Center's preliminary estimates found that in the first 10 years, the plan would lead to a net revenue loss of $2.4 trillion.[14] Yet President Trump and congressional leaders have continuously proclaimed that economic growth will outpace any losses, resulting in greatly enhanced revenues—even though no serious economist believes tax cuts pay for themselves.

There are other similarities between the 2012 Kansas tax cuts and the Trump-McConnell-Ryan plan. Kansas legislators failed to follow the normal deliberative process and the plan was rushed through at the end.[15] Meanwhile, President Trump and congressional GOP leaders are determined to pass their tax cuts before the end of the year. The chance that they will do so, and without meaningful input from their Democratic colleagues, is all but assured under the budget reconciliation process they have chosen for passing the tax cut bill—a process that will enable them to pass the tax cuts with a simple majority of only 51 votes.[16]

Economic growth and jobs promises never happened

What has been described as "one of the cleanest experiments for measuring the effects of tax cuts on economic growth in the U.S." was a resounding failure in almost every way.[17]

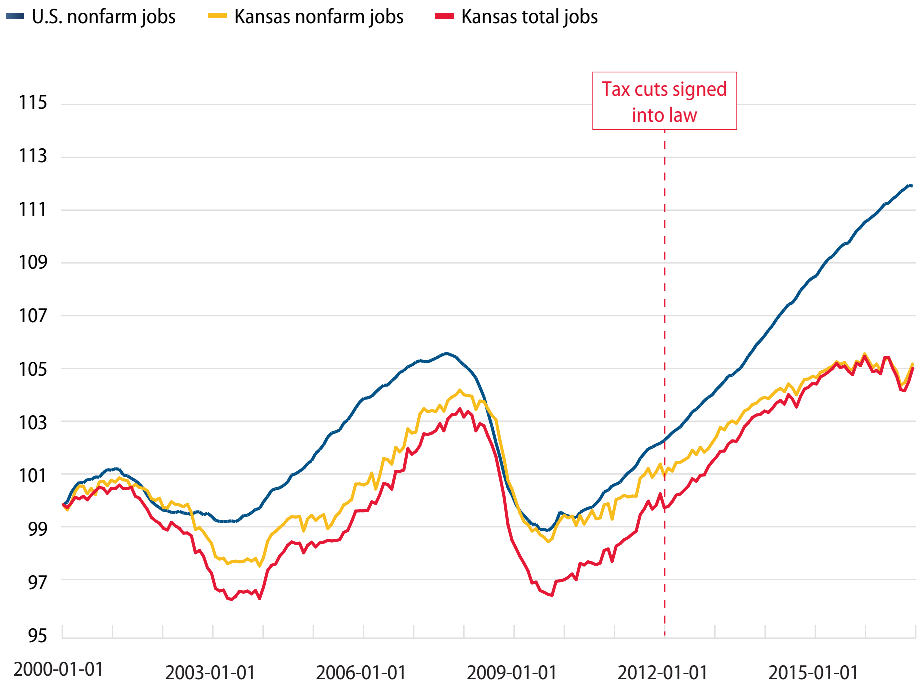
After the Brownback tax cuts, instead of a booming economy, Kansas residents witnessed a sharp decline in state revenues, sluggish growth, and brutal cuts to government programs.[18] Indeed, between 2013 and 2016, Kansas' real gross domestic product only grew by 3.8 percent, while national GDP growth was nearly double that at 7 percent.[19]

Employment growth in Kansas has also lagged far behind the rest of the nation. Since the tax cuts took effect in 2013, total employment rose just 2.6 percent, compared with the 6.5 percent average increase experienced by the rest of the nation. And the story for private sector employment was similar, with Kansas' 3.5 percent growth falling far behind the national growth rate of 7.6 percent.[20]

FIGURE 1

Kansas job growth lags behind the nation

While employment continues to grow nationwide, it flattened in Kansas after the 2012 tax cuts



Notes: All data are seasonally adjusted. Kansas farm employment is included for reference, as it is a top agriculture producing state. January 2000 data are indexed to 100.
Sources: Federal Reserve Economic Data, Federal Reserve Bank of St. Louis, "All Employees: Total Nonfarm Payrolls (PAYEMS)," available at https://fred.stlouisfed.org/series/PAYEMS (last accessed October 2017); Federal Reserve Economic Data, Federal Reserve Bank of St. Louis, "All Employees: Total Nonfarm in Kansas (KSNA)," available at https://fred.stlouisfed.org/series/KSNA; Federal Reserve Economic Data, Federal Reserve Bank of St. Louis, "All Employees: Total Private in Kansas (SMS20000000500000001)," available at https://fred.stlouisfed-.org/series/SMS20000000500000001.

Dynamic revenue never materialized; Kansas' budget was thrown into crisis; and law makers were forced to slash basic services

"In the following five years," Dinah Sykes explained in a message to the U.S. Congress, "Kansas experienced nine rounds of budget cuts, stress on state agencies and the inability to effectively provide the core functions of government for our citizens."[21]

As a result of the 2012 tax cuts, revenues plummeted and the state general fund debt load more than doubled from its 2010 level, leading both Moody's Investors Service and Standard & Poor's 500 Index to downgrade the state's credit rating twice.[22] After several years of draining the state reserves of cash, diverting funds from roads, delaying payments from pension funds, and reducing spending on critical programs such as Medicaid, housing, public safety, and education, the state government still began 2017 with a $350 million deficit.[23]

Kansas citizens continue to pay the price. College tuition in the state has increased by 21 percent.[24] In May of this year, block granting of funds to local school districts was struck down by the state supreme court, which ruled it inadequate and found one-quarter of the state's students to be underserved in violation of the state's constitution.[25] Even increases in sales and property taxes—regressive taxes that place a heavier burden on low-income taxpayers—have failed to fix the budget shortfall.[26]

In 2017, Kansas legislators came together on a bipartisan basis to end the failed tax cut experiment

Just like with federal tax cuts in the recent past, the Kansas tax cuts were rolled back on June 6, 2017, over Gov. Brownback's veto, with the support of many Republicans. The exemption for pass-through income was ended and most of the other tax cuts were repealed. At least one of those Republican legislators, along with a number of conservative analysts in the state, are now specifically warning Congress not to repeat their state's mistake.[27] With the reversal of the governor's veto, the resounding message from Kansas legislators on both sides of the political aisle is clear: Don't buy into claims that huge, regressive tax cuts will create incredible economic growth and job creation.

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Endnotes

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