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PAYCHECK$ and POLITICS

*Arkansas Advocates for Children & Families*
*Issue 21: Fall 2003*

# Using Corporate Income Taxes to Fund Education:
## What's the Likely Impact on State Economic Development and Taxpayers?

When the Arkansas General Assembly convenes in December to reform the state's education system, they will have tough choices to make about how to pay for these reforms (estimated at $847 million). One of the options the legislature will likely consider is raising the corporate income tax. What would be the impact on state economic development? Would it hurt the economy as some would claim, or would it provide new revenue for education that would fuel long-term state economic growth? Who would bear the burden of a corporate tax increase?

### How Do State Corporate Taxes Impact State Economic Development?

There has been a great deal of research on the impact of corporate taxes on state economic development over the years. The best studies control for other factors that impact state economic development, such as the proximity to customer markets and suppliers, utility prices, and the quality of public services, etc. Here's what the research currently tells us about the impact of corporate taxes on state economic development.[1]

1. State and local taxes represent only a small part of a company's cost of doing business (typically 2-3 percent of the total cost of doing business).[2] Small differences in other costs, such as personnel and transportation costs, are much bigger costs. According to one study, a 34 percent change in state and local taxes has the same impact on a company's cost of doing business as a 3.8 percent change in wage rates paid by the company.[3] Because taxes represent such a small part of the cost of doing business, any modest increase in corporate income taxes will have a very small impact on the company's bottom line.

2. The level of state and local taxes has little impact on business location decisions.[4] Other factors, such as the cost and quality of labor (e.g., a well educated/trained workforce), quality of public services (infrastructure, water, sewer, etc.), proximity to customer markets, and access to supplier are more important.

3. Taxes impact economic development only to the extent that a state's tax burden is significantly higher than that of states against which it competes.[5] However, there's an important caveat to this finding. The research shows that it's true only after holding other factors constant, such as the quality of infrastructure and education systems.[6] If the level of taxes cannot generate enough revenue to provide adequate public services (e.g., the state can't provide a quality education system), then lower taxes can actually harm state economic development more than it helps.

4. At best, state and local taxes have only a small impact on state economic growth (as measured by new jobs created and the value of the state's economy). According to conventional estimates, a 20 percent reduction in taxes would yield less than a 4 percent increase in a state's growth rate.[7] This 4 percent effect is actually quite small. For example, for a state with a growth rate of 10 percent, a 20 percent reduction in taxes would have meant a growth rate of 10.4 percent instead. A state with a growth rate of 5 percent would have had 5.2 percent growth instead.

5. Arkansas ' corporate income tax has been on the decline in recent years. Although Arkansas' corporate income tax burden ranks 23rd in the country (4.0 percent as a percent of state personal income), the state's corporate tax collections have declined relative to the personal income tax. In 1972, the corporate income tax generated 31 percent of all state income tax revenue (the personal income tax generated 69 percent). In 2000, the corporate tax generated only 14 percent (86 percent now comes from the personal income tax).

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## What Would Be The Long-Term Impacts on the Arkansas Economy?

A major investment in Arkansas' public education system would produce two kinds of benefits for the state's economy. First, the new spending would have direct effects such as higher teacher wages, leading to greater spending in the local economy; the building of new schools would require local construction services; and purchases by schools would lead to greater sales for local businesses.

More importantly though, a greater investment in public education — if spent wisely, more efficiently, and with greater accountability – would produce a better educated, well-trained, and more productive workforce. In the long run, this should lead to a state economy that is better able to compete for companies offering higher skilled, better paying jobs, while at the same time increasing the likelihood that our workforce has the technological skills to launch innovative, start-up companies here at home that can compete internationally.

A recent study by the Winthrop Rockefeller Foundation examined the potential economic impacts of a major investment in public education.[8] The study examined the effects of increasing new funding for education by $839 million annually by 2009, using a broad mix of new funding sources including increases in the personal income tax, corporate income tax, sales tax, natural gas severance tax, capital gain taxes, etc.

The study found minor losses to the economy during the first two years, but large net economic benefits of $200 million after ten years (as a conservative estimate). The study ran scenarios using different combinations of taxes. While the results varied depending on the types of taxes used, they remained significantly positive and didn't vary much depending on the types of taxes used. Overall, the study found a significant investment in education would produce long-term economic gains that would more than outpace any short-term losses resulting to the economy from tax increases.

### Share of Arkansas Corporate Stock Ownership, By Income Group

**Income Group A**: Top 1 percent
35% of stock ownership

**B**: Next 4 percent
23% of stock ownership

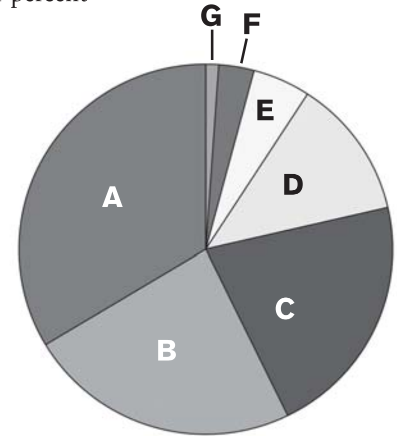
**C**: Next 15 percent
21% of stock ownership

**D**: Fourth 20 percent
12% of stock ownership

**E**: Middle 20 percent
5% of stock ownership

**F**: Second 20 percent
3% of stock ownership

**G**: Lowest 20 percent
1% of stock ownership




Source: Institute on Taxation and Economic Policy

## Who Would Bear the Burden of Corporate Tax increase to Fund Education?

The corporate income tax is one of the most progressive taxes that states can levy. Unlike sales taxes (which are simply passed along to consumers to pay) corporate income taxes are generally passed through to corporate stockholders. The make-up of corporate stockholders greatly influences who would bear the burden of a corporate tax increase.

Corporate stock ownership by Arkansas residents is heavily concentrated among the state's upper-income taxpayers.[9] The top 20 percent of Arkansas taxpayers (those making more than $55,000 annually) own three-fourths (77 percent) of the corporate stock held by Arkansas residents. The top one percent alone (those making more than $242,000) own more than 33 percent of corporate stock. To the extent that any corporate income tax increase would be passed through to Arkansas residents, the burden would fall mostly on the state's wealthiest taxpayers, not by Arkansas' low- and middle-income families.

Consider that out-of-state residents own over 80 percent of the stock in Arkansas' publicly traded corporations.[10] Arkansas residents own less than one-fifth (19.6 percent) of Arkansas' corporate stock. Since most of the stock in companies is owned by outside stockholders, a corporate income tax increase would be borne heavily by out-of-state shareholders.

Because most stockholders either have higher incomes (or, in the case of publicly traded companies, live out of state), the burden of a corporate tax increase would fall on the wealthiest taxpayers or those living out-of-state.

## Notes

1. For an excellent summary of this research, see Peter S. Fisher and Elaine Ditsler, "Taxes and State Economic Growth: The Myths and the Reality," the Iowa Policy Project, May 2003. Also see Timothy Bartik, *Who Benefits from State and Local Economic Development Policies?* Kalamazoo, Michigan: W.E. Upjohn Insitute for Employment Research, 1991; and Michael Wasylenko, "Taxation and Economic Development: The State of the Economic Literature," *New England Economic Review* (Federal Reserve Bank of Boston), March/April 1997, pp. 37-52.
2. Robert G. Lynch," Do State and Local Taxes Work?" Washington D.C.: Economic Policy Institute, 1996.
3. Alan Peters and Peter Fisher, State Enterprise Zones: Have They Worked? Kalamazoo, Michigan: W.E. Upjohn Institute for Employment Research, 2002.
4. Lynch, "Do State and Local Taxes Work?"
5. Wasylenko, "Taxation and Economic Development."
6. Ronald Fisher, "The Effects of State and Local Public Services on Economic Development," *New England Economic Review* (Federal Reserve Bank of Boston), March/April 1997, pp. 53-67; and Lynch, "Do State and Local Taxes Work?"
7. Fisher and Ditsler, "Taxes and State Economic Growth: The Myths and the Reality."
8. The Winthrop Rockefeller Foundation, "Tax Options for Arkansas: Funding Education After the Lake View Case, July 2003.
9. Unpublished data from the Institute on Taxation and Economic Policy.
10. Unpublished data from the Institute on Taxation and Economic Policy.