POLICY BRIEF

from the COMMONWEALTH FOUNDATION

Vol. 25, No. 01
May 2013

The Economic Impact of Gov. Corbett's Proposed Tax Reform

NATHAN A. BENEFIELD AND MICHAEL HEAD

Summary

Governor Corbett's fiscal year 2013-14 budget proposal includes a tax reform package aimed at "improving Pennsylvania's tax climate by reducing tax burdens that inhibit job creation and economic growth."

Accordingly, by 2017-18, these reforms would result in: 1,259 additional private sector jobs, nearly $460 million in additional disposable income, and more than $1 billion in additional investment.

The centerpiece of this proposal is a long-term reduction in the corporate income tax rate, reducing the rate from 9.99% to 6.99% between 2015 and 2025. This tax reform package also includes a number of minor, short-term tax policy revenue changes.

This policy brief utilizes *PA-STAMP* to estimate the impact of Gov. Corbett's proposed tax reform package. Accordingly, by 2017-18, these reforms (compared with current policy) would result in:

- 1,259 additional private sector jobs,
- nearly $460 million in additional disposable income, and
- more than $1 billion in additional investment.

Overview

Economists utilize "static" and "dynamic" economic modeling programs to estimate the impact of tax policy changes on an economy. The differences between these two approaches, however, can be dramatic. For example, a "static" model would assume that a 20% increase or decrease in a particular tax would generate a 20% increase or decrease in tax revenue. The problem with such a projection is that it fails to consider changes in economic behavior by citizens.

The Commonwealth Foundation has partnered with economists at the Beacon Hill Institute at Suffolk University in Boston, Massachusetts to utilize a Pennsylvania specific Computable General Equilibrium (CGE) economic modeling program—known as the Pennsylvania State Tax Analysis Modeling Program (*PA-STAMP*)—to analyze the impact of policies on Pennsylvania businesses, households and government. The model calculates the impact of tax changes on job creation, wages, investment and income.[1]

Technically speaking, *PA-STAMP* is a computerized method of accounting for the economic effects of tax policy changes. The model is specified in terms of supply and demand for each economic variable, where the quantity supplied or demanded of each variable depends on the price of each variable. Tax policy changes are shown to affect economic activity through their effects on the prices of outputs and on the factors of production (principally, labor and capital) that enter into those outputs.

This policy brief utilizes the *PA-STAMP* dynamic economic modeling program to estimate the impact of Gov. Corbett's proposed tax reform package through fiscal year 2017-18. The estimates contained within differ from projections used by the Pennsylvania Office of the Budget largely due to the time frame used, as many of the proposed tax changes would not be fully implemented during this time frame.

The most significant of these changes is the reduction of the Corporate Net Income Tax (CNIT) from its current rate of 9.99% to 6.99% by 2025.

Governor Corbett's proposed fiscal year 2013-14 budget includes a myriad of tax changes. The most significant of these changes is the reduction of the Corporate Net Income Tax (CNIT) from its current rate of 9.99% to 6.99% by 2025. Table 1 shows the proposed reduction of the CNIT over ten years.

Table 1: Proposed Corporate Net Income Tax Rate

Year	CNIT
Current rate - through Dec 2014	9.99%
2015	9.89%
2016	9.69%
2017	9.49%
2018	9.29%
2019	8.96%
2020	8.63%
2021	8.30%
2022	7.97%
2023	7.64%
2024	7.31%
2025	6.99%

There are a number of additional policy changes. Among the major tax reforms proposed are:

- Increasing the cap on net operating loss deductions from $3 million, or 20% of income, to $5 million, or 30% of income, by 2015. This net operating loss carry-forward allows corporations who lose money in one tax year to carry over those losses to a future year in which they earn profits to reduce their tax burden; the amount they can carry forward in any single year is capped.
- Shifting to "sales factor market sourcing" in determining CNIT liability. Pennsylvania recently shifted to a single-sales factor, meaning the percentage of a corporation's sales that occur in Pennsylvania determines what percentage of its profits are subject to the state CNIT. The proposed change would complement this single-sales factor by using the customer's location (not place of sale) to determine the percentage of sales occurring in Pennsylvania.
- Modifying Personal Income Tax rules to match federal rules for like-kind exchanges and start-up business deductions.
- Repealing the corporate loans tax.
- Eliminating the "89-11 loophole" which increases circumstances when real estate companies may be subject to taxation.

Gov. Corbett's budget also includes the elimination of the Capital Stock and Foreign Franchise Tax in January 2014. This elimination is already set to occur under current the current tax code, and thus is included in our baseline estimates.

Revenue Analysis

The Pennsylvania Office of the Budget estimates the tax reform package will result in a net state revenue *increase* of $1.8 million in 2013-14 (not including changes to tax credit programs, which were not included in this analysis), but produce a net state revenue *decrease* of $159 million by fiscal year 2017-18.

Table 2: Estimated Revenue Impact of Tax Reforms (millions)

	2013-14	2014-15	2015-16	2016-17	2017-18
PA Office of the Budget - Static Revenue Model					
Corporate Net Income Tax	-$4.4	-$25.9	-$63.2	-$99.8	-$137.6
Personal Income Tax	$2.6	$12.4	$11.9	-$19.6	-$20.4
Corporate Loans Tax	-$0.7	-$9.2	-$12.1	-$13.4	-$14.4
Realty Transfer Tax	$4.3	$11.5	$12.9	$13.1	$13.4
Total State Revenue	$1.8	-$11.2	-$50.6	-$119.6	-$159.0
PA-STAMP - Dynamic Model					
State Tax Revenue		-$3.4	-$34.6	-$95.3	-$125.8
Local Tax Revenue		$5.1	$10.8	$17.7	$24.5
Total Tax Revenue		$1.7	-$23.8	-$77.6	-$101.3

Utilizing dynamic modeling, *PA-STAMP* finds some of the revenue decrease will be offset in future years by increased economic activity resulting from favorable tax policy. Moreover, state economic growth will result in higher local tax revenue, which will also offset state revenue losses. The results are compared to current forecasts absent these tax reforms—*under both the baseline and the model, overall state and local tax revenue is projected to increase each year.*

Economic Impact

In addition to the effect on state tax revenue, Gov. Corbett's proposed tax reforms will impact the private sector economy. Table 3 illustrates how tax cuts can improve Pennsylvania's job growth. The model estimates the proposed tax cuts will accelerate growth in private sector employment by more than 1,200 additional jobs by 2018.

Table 3: Pennsylvania Private Sector Employment

	2014-15	2015-16	2016-17	2017-18	4 Year Cumulative Impact
Baseline Estimates	5,039,937	5,056,083	5,072,281	5,088,530	1,259 Additional Jobs
Under Tax Reform	5,039,998	5,056,446	5,073,215	5,089,789	
Difference	61	363	935	1,259	

Tables 4 and 5 reflect the stimulating effect tax cuts will potentially have on the state's overall economy. By 2018, Gov. Corbett's proposed tax reform will result in nearly $460 million in additional disposal income for Pennsylvania families over four years, and more than $1 billion in additional investment (savings and purchases of capital goods).

Table 4: Pennsylvania Total Disposable Income (billions)

	2014-15	2015-16	2016-17	2017-18	4 Year Cumulative Impact
Baseline Estimates	$534.78	$554.50	$574.94	$596.14	$460 million Additional Income for Pennsylvania Familes
Under Tax Reform	$534.80	$554.57	$575.10	$596.35	
Difference	$0.02	$0.07	$0.15	$0.21	

Table 5: Pennsylvania Total Investment (millions)

	2014-15	2015-16	2016-17	2017-18	4 Year Cumulative Impact
Baseline Estimates	$102,685	$105,189	$107,754	$110,381	$1.07 billion Additional Investment in Pennsylvania
Under Tax Reform	$102,791	$105,397	$108,071	$110,820	
Difference	$106	$208	$317	$439	

Our economic effects are significantly lower than those mentioned in a February 5 press release entitled "Governor Corbett Introduces Jobs-Focused Budget; Positions PA for Continued Economic Success." To quote:

> "Economic modeling shows that these initiatives will create more than 18,000 jobs over the next 10 years, as well as increase the state gross domestic product by $2.8 billion and grow personal income by $1.9 billion by 2030," Department of Revenue Secretary Dan Meuser said. "These positive economic effects also increase state tax revenue, creating more than $1 billion in new tax revenue through 2030." [2]

The main reason for the difference is that the numbers cited by the Governor are for 2030, compared to the results for *PA-STAMP* which is for 2018. Over those additional 12 years, the corporate income tax cut of 3% will be fully implemented which, according to the Office of the Budget, will result in a tax cut more than 5.5 times greater than what is modeled for 2018.

Conclusion

According to the Pennsylvania State Tax Analysis Modeling Program, the projected cumulative four-year impact of Gov. Corbett's proposed tax cuts will result in more than 1,200 additional jobs, nearly $460 million in additional disposable income, and more than $1 billion in additional investment. Moreover, while the tax reform package represents a cut over future tax projections, state revenue will continue to grow, and faster economic growth will offset some of the propose tax reductions.

Endnotes

1. For more details on the STAMP methodology see: http://www.beaconhill.org/STAMP-Method/STAMP.pdf
2. "Gov. Corbett Introduces Job-Focused Budget, Positions PA For Continued Economic Success," Department of Revenue Press Release, February 5th, 2013, http://www.revenue.state.pa.us/portal/server.pt?open=18&objID=1320340&mode=2.

ABOUT THE AUTHOR AND THE COMMONWEALTH FOUNDATION

Nathan A. Benefield is director of policy analysis with the Commonwealth Foundation and Michael Head is a research economist with the Beacon Hill Institute at Suffolk University.

The Commonwealth Foundation (CommonwealthFoundation.org) is Pennsylvania's free-market think tank. The Commonwealth Foundation crafts free-market policies, convinces Pennsylvanians of their benefits, and counters attacks on liberty. More information is available at www.CommonwealthFoundation.org.