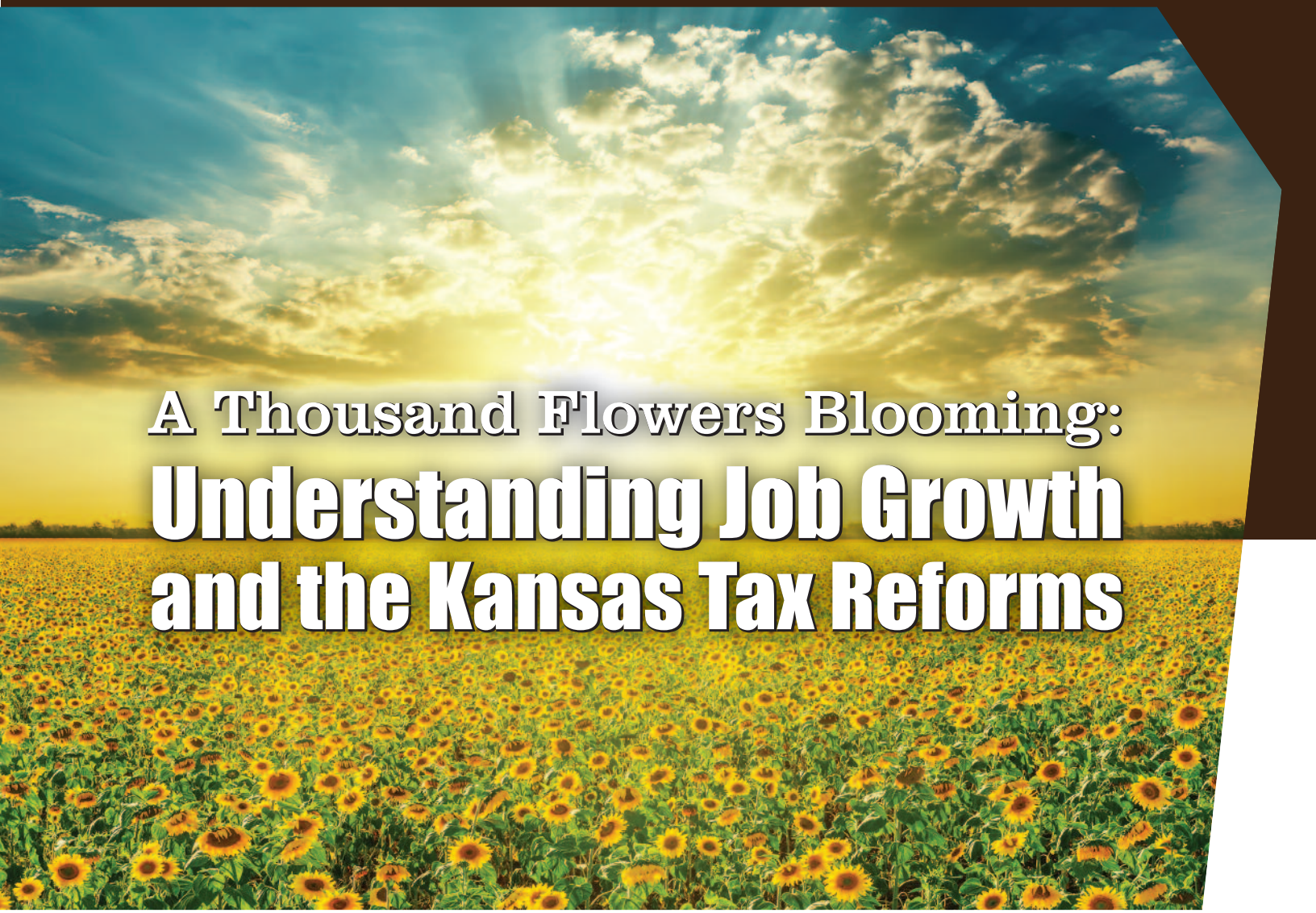

A Thousand Flowers Blooming: Understanding Job Growth and the Kansas Tax Reforms

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by

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Executive Summary

Much of the discussion over economic growth in Kansas after the tax cuts of 2012 were enacted is misguided, hobbled by a misunderstanding of what the tax cuts were trying to accomplish and reliance on incomplete data. Additionally, it fails to take into account the fact that most job growth in Kansas has been – and will continue to be – from pass-through businesses (i.e., sole proprietorships, S-corporations, limited liability corporations, and joint partnerships). In fact, the 36,135 jobs created by pass-through entities in Kansas represent 82 percent of all private sector jobs created in 2013 and 2014, the latest data available from the U.S. Census Bureau, and the growth is more than three times as great after tax reform than before.

Using this Census data and other appropriate private sector data our analysis indicates that the impact of the tax reforms has been positive. Kansas comes out on top or at least shows strong growth in almost every relevant state comparison of the most comprehensive private sector job growth metrics. Kansas also matches up with other states well even when the less-comprehensive data often used to make comparisons is adjusted for the size of the state.

It is also important to consider the source of job creation data, the structure of a state's economic make-up, and a state's population when comparing job numbers. In short, just as it would not be appropriate to compare student achievement for the Kansas City and Blue Valley school districts for obvious demographic differences, it is not appropriate to compare certain states just because of geographic proximity. The monthly employment numbers from the Bureau of Labor Statistics (BLS) use a different methodology to count employment than does a more comprehensive, but less frequent, analysis from the Bureau of Economic Analysis (BEA). For instance, the BLS data estimates that in 2015, Kansas had an employed private-sector workforce of nearly 1.4 million, while the BEA data puts it at 1.9 million. So while the BLS data warrants monthly media coverage this paper puts more emphasis on the BEA analysis as it better captures those employed by proprietorships and in farm employment.

This study also uses new data from the Kansas Department of Revenue (KDOR) to clearly demonstrate that tax evasion or strategic corporate tax planning has not been widespread. KDOR records also make clear that the total value of the tax cuts from 2012 was primarily driven by lowering the income tax burden on individual wage earners. This is yet another overlooked aspect of the tax cut, as 71 percent of the overall tax relief went to individual taxpayers and 29 percent went to pass-through businesses through the income tax exemption. A final data point from KDOR also makes clear who is benefitting from the pass-through exemption. Median family income in Kansas is around $52,000 and 88 percent of the filers in 2014 with business income had Kansas adjusted gross income that year of less than $50,000.

While there is still more analysis to be done and more data to be released over the coming years, we believe the preliminary signs indicate that tax reform in Kansas has had and, more importantly, will continue to have a positive impact on state job growth.

Introduction

The tax reforms enacted in Kansas over the past few years have sparked a national discussion that primarily focused on budget deficits and less on the economic impacts of the reforms. While budget deficits did occur in Kansas following the tax reform, state government spending contributed critically to the deficits. Simply put, Kansas cut revenue while simultaneously increasing expenditures. Although budget deficits and government spending are not the focus of this study, other studies help chart the way to budget discipline.[1]

The purpose of this study is to clarify the data on job growth in Kansas and to determine whether the tax reforms enacted in Kansas impacted the state's job growth. To date, much criticism has been aimed at the so-called "pass through" income tax exemptions, which allowed businesses that are structured in a certain way to exempt their income from the income tax. This was but one of the provisions in a multi-year and wide-reaching set of reforms passed in 2012. While more data analysis in the coming years will provide for a more complete analysis, there is substantial evidence to date that this tax reform delivered quite a bit of bang for the buck.

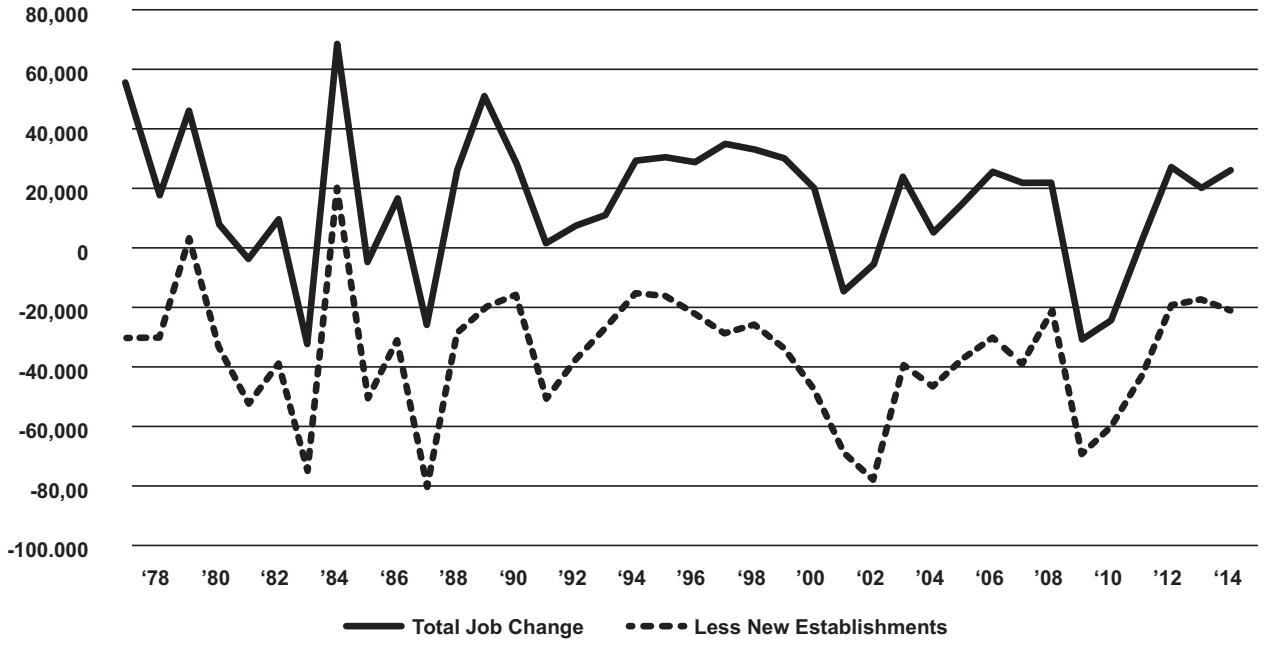
Job growth is critically dependent on new business formation. Several studies have found that start-ups and young firms drive overall job creation.[2] A key academic study found that "firm births contributed substantially to both gross and net job creation."[3] To see how this has played out over time in Kansas, Figure 1 shows the trend of total job creation and jobs created excluding those created by new establishments from 1977 through 2014, the most current data available from the Census Bureau, while Figure 2 shows the same data across the country.

Census defines an establishment as "a single physical location where business is conducted or where services or industrial operations are performed;" they define a firm as "a business organization consisting of one or more domestic establishments that were specified under common ownership or control, with the firm and the establishment being the same for single-establishment firms."[4] For example, new establishments could be a new bio-tech startup, a proprietor opening a new restaurant or even a new Wal-Mart location.

In Kansas, with the exception of 1979 and 1984, the total number of jobs created would actually have been negative if not for the job creation from new establishments. This phenomenon is not unique to Kansas. Figure 2 shows the United States would not have had a single year of positive job growth since 1977 if not for jobs created by new establishments.

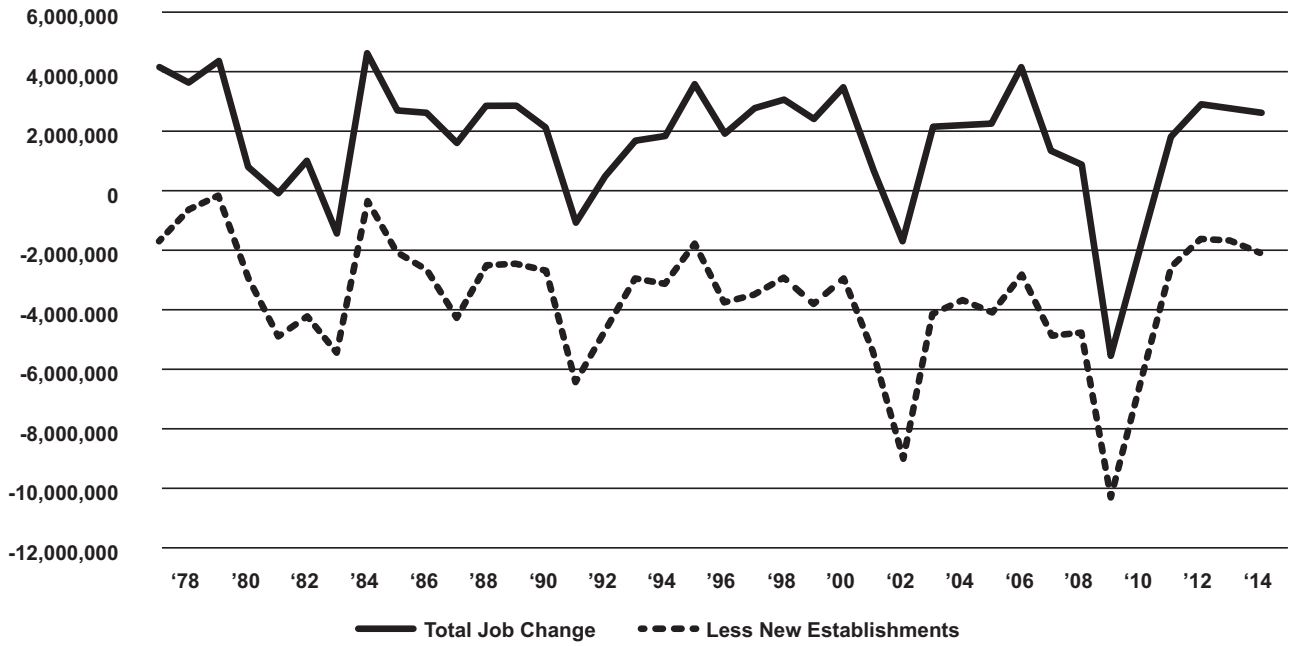
This economic dynamism is a good thing: states that are more dynamic – have more of this "economic churn" – actually have greater economic growth rates, as reported by Dr. Arthur P. Hall of the University of Kansas.[5] Investors and business owners – and certainly state policymakers – do not know which bets will pay off at the beginning, however. So, the economic policy strategy that has the best chance of increasing net job growth is one that, to borrow an old saying, allows "a thousand

Figure 1. Kansas Private Job Change – Only 2 Gains without New Establishments



Source: U.S. Census Bureau's "Business Dynamic Statistics, jobs by age of establishment."

Figure 2. U.S. Private Job Change - No Gains without New Establishments



Source: U.S. Census Bureau's "Business Dynamic Statistics, jobs by age of establishment."

flowers to bloom" and maximizes the chances a company will succeed and grow and employ more Kansas workers.

Meanwhile, pass-through firms – like sole proprietorships, S-corporations, joint partnerships, and many LLCs – accounted for 46 percent of the for-profit private-sector Kansas workforce in 2014 based on U.S Census County Business Patterns data, which uses BLS data that excludes proprietors; pass-through firms may well employ the majority of the for-profit private sector workforce if full time proprietors are included.[6] As we will see later in this study, most pass-through firms are small. Thus, the reality of the amount of job creation due to new establishments and the proportion of overall employment growth attributed to pass-through firms suggests that many new establishments are also pass-through firms. This should have real consequences in terms of how employment changes can be influenced by tax policy in Kansas.

Analysis of employment outcomes that followed these tax policy changes needs to take into account employment growth across the entire spectrum of job losers and job creators, particularly among new firms and pass-through firms. Making sure that Kansas is being compared to other states that are economically similar is also important. It is also vital that policy changes are viewed over the long-term and include a recognition of relevant trends that exist notwithstanding the policy change. Finally, in tax policy, patience is a virtue. It can take upwards of five years for tax policy's effects to be fully seen.[7] It could take even longer if the initial change was diminished shortly thereafter as was the case in Kansas; the 2012 tax plan was reduced in 2013 and modified again in 2015. It is essential that the pass-through exemption be allowed to exist long enough for measurable results to be collected, and tested. Moreover, legislators should keep in mind that the businesses in Kansas are also planning with an expectation of consistency in the tax rules over a long time period so they can make stable long-term business plans going forward. Dramatically changing the tax treatment of pass-through firms could have adverse economic consequences by upsetting the growth potential of these new firms.

These considerations are often lost in the reporting on the Kansas reforms. This study is an attempt to add more context, nuance, and factual basis to the discussion and to connect readers to the economic logic and importance of the tax policy reforms.

Pass-through Activity in Kansas

The "pass-through exemption," which took effect in January 2013, allows anyone who had business income in a tax year to exempt that income from their income tax liability. The exemption applies to businesses – often called "pass-through" businesses – that are incorporated as S-corporations, limited liability corporations, sole proprietorships, and partnerships. (It does not; however, apply to companies that are C-corporations.) They are called pass-through businesses because their profit is "passed through" to their owners and is taxed as individual income of those owners. This profit is not taxed by the corporate income tax as it would be for C-corporations.

Critics of the policy change suggested that it would encourage tax evasion by either encouraging C-corporations

❀ The Economic Logic of Tax Cuts

The potential for economic growth from cutting taxes broadly on companies and workers comes from two main sources. The first is the effect on the "supply side" of the economy - lowering the "tax cost" to start and operate a business, which in turn makes it possible to expand a business and hire new workers, as well as passing the tax savings on to customers in the form of lower prices. The second is through the "demand side" of the economy, which results from workers and consumers having more after-tax money with which to consume, invest, or save. Each side of this equation can reinforce the other: consumers buying more can lead to greater employment while businesses employing more people can increase the potential for economic growth through increased demand from workers who have more discretionary income.[8]

The Kansas tax reforms of 2012 were broad-based, meaning they not only provided relief to businesses but also provided tax relief to individuals through across-the-board income tax rate cuts for individuals. In fact, the Kansas Department of Revenue reports that 71 percent of the overall tax relief went to individual taxpayers and 29 percent went to pass-through businesses via the income tax exemption.[9] Although it is too soon to tell authoritatively, early data suggests the Kansas tax package of 2012 had a positive impact on state job growth. Academic studies on this subject indicate that it can take up to five years to see the full impacts of a tax cut given that there is always a lag in the data necessary to analyze those impacts, and the time frame could be even longer if tax cuts are diminished shortly after passing, as was the case in Kansas. Yet, the immediate substantial benefits to consumers should not be overlooked either. The increased buying power that comes from lower tax burdens on consumers can help drive some of the economic growth following tax reform. ❀

to re-incorporate as a pass-through firm or enticing wage earners to convince employers to hire them as subcontractors instead of as traditional employees in order to avoid income taxation.[10] For individuals, the choice comes down to whether they want to maintain traditional employment – with the advantages that come with being a full-time employee, such as the employer 401(k) matching contributions and group health insurance benefits – or transition to self-employment, even if it is an arrangement in which that employee simply becomes a "freelance" contractor (i.e., Schedule C) while continuing to do the same full-time job. The loss of these benefits and various legal protections that come with being a traditional employee suggests that maintaining their status as a traditional employee is likely a better option than going through the accounting gymnastics involved in becoming a Schedule C worker just to avoid state income tax.

The decision to reincorporate as a pass-through entity is complex from the perspective of the taxpayer or a business. However, the ability of an individual or company to transition to pass-through status for the purpose of avoiding taxes is very limited. Tax case law and tax court precedent surrounding something called the "sham transactions" doctrine severely restrict attempts to avoid taxes by using the pass through.[11] Of course, changing the business incorporation status at the state level also requires doing so for federal tax purposes. Re-classifications of this sort would also add another level of scrutiny and a new set of tax-planning considerations, as well as additional filing requirements, that individuals or businesses may not want to contend with (e.g. specific rules on ownership and stock issuance).

If a large number of firms that once were incorporated as C-corporations, for instance, decided to re-incorporate as S-corporations or other types of pass-through entities in the wake of the Kansas tax reforms, it would be harder to argue that there were substantial positive net effects resulting from the reforms. It might instead indicate that existing economic activity was simply being shifted to a different tax category instead of spurring new economic activity.

New data from the Kansas Department of Revenue (KDOR) seem to indicate that this concern is overstated. Table 1 shows the number of entities that filed Kansas taxes as pass-through entities. It also shows the number of those filers that once were C-corporations

As you can see, the number of former C-corporation filers is less than 1 percent of the overall number of pass-through entities in each year for which the detailed data is available. (KDOR only has the data for tax years 2012 through 2014). The number grew a bit in the first year of the tax reform (from 0.40 percent to 0.65 percent) but dropped in 2014.

Table 1. Pass-through Entities and Corporate Switchers

	Pass-through entities	# of C-corps switching to pass-through status	% of total attributable to switchers	% of difference attributable to switchers
TY 2012	85,407	343	0.40%	—
TY 2013	87,954	575	0.65%	22.6%
TY 2014	90,089	368	0.41%	17.2%

Source: Kansas Department of Revenue

Note: This does not include sole proprietors and counts only one partner per partnership

❀ Kansas Pass-through Employment Before and After Tax Reforms

One of the long-term goals for the tax reform embarked upon in Kansas is to take the tax burden off job creation. It is intended to encourage new business start-ups and business expansions that drive employment growth in the state.

Pass-through businesses actually did drive the job creation that has been evident in Kansas the past few years. Data from the U.S. Census Bureau's "County Business Patterns" tells this story.[12]

Table SB-1 shows that pass-through entities in Kansas (sole proprietorships, limited liability corporations, partnerships, and S-corporations – in other words, businesses not organized as C-corporations) added 36,135 jobs and grew by 8.4 percent compared to C-corporation growth of just 1.4 percent and 7,381 jobs.[13]

Some of the pass-through job additions are attributable to C-corporations that converted to pass-through status but most likely fewer than the number of new proprietors added, which aren't included in the Census database; their employment data is provided by the Bureau of Labor Statistics which excludes proprietors and farm workers.[14] The Kansas Department of Revenue reports that only 3.3 percent of C-corporations converted and the total number of W2s for all C-corporations declined by 10,396. Even if every W2 decline resulted from a conversion, the job transfer would still be less than the 15,134 new proprietors reported by the Bureau of Economic Analysis.[15]

Table SB-2 depicts the national averages for employment in each business type and shows Kansas' pass-through job growth rate of 8.4 percent is slightly lower than the national average of 9.5 percent.

However, it is much more competitive after tax reform than before tax reform, being at 88 percent of the national average (8.4 percent compared to 9.5 percent) after 2012 versus 52 percent (2.4 percent compared to 4.6 percent) before 2012.

Kansas is also more competitive relative to its economic peer states. In the two years preceding tax reform, Kansas performed at only 62 percent of the other states' average (2.4 percent vs. 3.9 percent) but since then is at 111 percent of the group's average (8.4 percent vs. 7.5 percent). Michigan is excluded from this comparison because one of its pass-through categories was not reportable in 2014.

Nor is this an example of C-corps simply shifting their operations into pass-through entities. As we have already seen, the data from KDOR suggest that the number of C-corps switching to pass-through status was minimal and not enough to explain the job growth attributable to pass-throughs. Additionally, over 76 percent of the pass-throughs in Kansas are small – only ten employees or less. Nearly two-thirds of the new jobs created by pass-throughs during this period (over 62 percent of all the jobs created by pass-through entities) were created by companies with under 100 employees. This appears to be a classic story of small business – quite likely new business start-ups – exhibiting healthier growth than before.

Tables SB-1 and SB-2 and the C-Corp data from KDOR is not the only evidence, or even the most comprehensive evidence, that the pass-through income tax exemption is driving job growth in Kansas. But the job gains outlined here and later in this study are undeniable and this information raises important

Table SB-1. Kansas Employment by Legal Entity Type

	Number of Employees on March 12			2010-12 Change		2012-14 Change	
Entity Type	2010	2012	2014	# Jobs	Percent	# Jobs	Percent
Corporations	535,839	530,567	537,948	(5,272)	-1.0%	7,381	1.4%
Pass-Through	418,544	428,593	464,728	10,049	2.4%	36,135	8.4%
Non-profits	143,726	143,815	145,355	89	0.1%	1,540	1.1%
Other	10,834	11,788	10,994	954	8.8%	(794)	-6.7%
Private	1,108,943	1,114,763	1,159,025	5,820	0.5%	44,262	4.0%

Source: U.S. Census, County Business Patterns database

Table SB-2. U.S. Employment by Legal Entity Type

	Thousands of Employees on March 12			2010-12 Change		2012-14 Change	
Entity Type	2010	2012	2014	# Jobs	Percent	# Jobs	Percent
Corporations	51,829	53,510	53,961	1,681	3.2%	450	0.8%
Pass-Through	43,387	45,374	49,697	1,987	4.6%	4,323	9.5%
Non-profits	15,020	15,238	15,591	218	1.5%	353	2.3%
Other	532	530	539	(3)	-0.5%	10	1.8%
Private	1110,768	114,652	119,788	3,884	3.5%	5,137	4.5%

Source: U.S. Census, County Business Patterns database

Table SB-3. Pass-through Employment Change

State	2010-2012	2012-2014
Kansas	2.4%	8.4%
Alabama	3.1%	7.3%
Arkansas	2.6%	6.2%
Kentucky	-1.1%	8.4%
Iowa	0.4%	5.6%
Missouri	2.1%	9.5%
Nebraska	2.5%	11.7%
Ohio	6.6%	6.5%
7-State Group	3.9%	7.5%

Source: U.S. Census

policy questions for legislators. With pass-through firm employment approaching parity with C-corporation employment, legislators should consider whether their policies on taxation and incentives are proportionally aligned with the realities of their employment base. Given that new establishments have driven employment growth in virtually every year over the past three decades, legislators should also consider how their actions impact new business start-ups. ❀

These C-corporation "re-filers" were hardly the driver of the change in the overall growth of pass-through entities. The fourth column of Table 1 shows what share of the difference between each year can be attributed to these "switchers." It is not as large a number as some critics might have expected. In fact, for the years that KDOR has data, nearly 80 percent of the increase in pass-through entities was decidedly not due to companies trying to game the system – and that is assuming that all those incorporation shifts were solely an attempt to take advantage of the pass-through exemption (which is itself a contestable notion) and not something that a company was planning to do anyway. Additionally, data on existing C-corporations indicate that the number of them that re-form as a pass-through company in any given year accounts for no more than two percent of all C-corporations in Kansas.[16] Generally speaking, re-incorporating into a pass-through entity may not be all that attractive relative to the advantages of remaining a C-corporation.

The number of pass-through entities just discussed excludes sole proprietorships and partnerships are counted as a single entity rather than the number of partners. When proprietors and all partners in partnerships are included, the number of filers taking advantage of the business-income exemption rises to 333,792 in 2013 and 331,174 in 2014.[17] The larger figures heard about most frequently in the press represent the number of filers, not the number of businesses. For example, KDOR typically would report a business with five partners as five entities but in providing the data for Table 1 KDOR only counts that business as one entity. This equals around 18 percent of all income tax (in-state and out-of-state) filers.[18] Again, these percentages are in-line with estimates in prior tax years.[19] Some of those filers could be individuals who earned a bit of self-employment business income only on the side from a part-time job or even from a hobby. Many others are small businesses who have employees and provide services and continued investment in their communities and the state of Kansas. In any case, this does not seem to indicate that there was a rush by individual workers to abandon traditional employment and re-incorporate as a pass-through corporation to avoid income taxes.

It is also worth noting that about 30 percent of the Kansas tax filers with business income experienced a net business income loss. A more accurate number for the total number of filers who had net positive income and, as such, benefited directly from the new business income tax exemptions was 239,747 in 2013 and 241,451 in 2014. That is closer to 13 percent of all Kansas income tax filers.

Critics have also suggested that wealthy Kansans who earn all of their income through pass-through entities are benefiting by avoiding income taxes. University of Kansas head men's basketball coach Bill Self has been made the poster child for this criticism since he earns over $2.75 million dollars annually through a limited liability corporation that would remain tax free under the Kansas reforms.[20] Yet, these types of sports business arrangements are quite typical for reasons that are not likely driven by state tax considerations, a point clarified by the fact that Self's contract pre-dates the Kansas tax reforms.

Data from KDOR provides a sense of the actual overall wealth of the filers who have taken advantage of the pass-through exemption. As it turns out, most of the filers taking the pass-through exemption are those with income close to the average family in Kansas. As shown in Table 2, in 2013 89 percent of the filers with business income had Kansas adjusted gross income that year of less than $50,000.[21] The share for 2014 was 88 percent. To put this into perspective, the median family income in the state is around $52,000.[22]

Critics have attempted to claim that the tax savings for most filers could not possibly have led to job creation but no such determination can be made from taxable income data, as that is what is left after a business may have hired more people or made other investments in the business.

Table 2. Pass-through Income

Pass-Through Income		Tax Year 2013			Tax Year 2014		
Minimum	Maximum	Returns	% Total Returns	Income (millions)	Returns	% Total Returns	Income (millions)
	Loss	94,024	28.2%	($1,906)	89,723	26.9%	($1,962)
$0	$24,999	176,920	53.0%	$1,015	178,006	53.3%	$1,177
$25,000	$49,999	26,909	8.1%	$906	26,837	8.0%	$952
$50,000	$74,999	11,510	3.4%	$684	1,846	3.5%	$724
$75,000	$99,999	6,313	1.9%	$530	6,350	1.9%	$548
$100,000	$249,999	12,021	3.6%	$1,790	12,073	3.6%	$1,848
$250,000	$499,999	3,800	1.1%	$1,268	3,904	1.2%	$1,338
$500,000		2,274	0.7%	$3,156	2,435	0.7%	$3,442
	Total	**333,771**		**$7,443**	**331,174**		**$8,067**

Source: Kansas Department of Revenue

The Importance of Comparing Similar States

When analyzing the economic effects of policy changes, simply setting an arbitrary standard of success is not useful, whether that be the promise of a specific number of jobs created or a rate of job growth pulled out of thin air. Instead, comparing how states perform relative to each other provides a more realistic basis for discussion of economic growth in the states.

Additionally, comparing states that are the most alike – instead of solely those that just happen to be close together geographically - allows observers to neutralize the macroeconomic impact of economic tides beyond the control of individual state lawmakers. If a state is heavily reliant on a certain kind of manufacturing (i.e., Wichita's aerospace industry) an increase or decrease in international demand for the product manufactured would influence that state in a different way than a state that had only a small portion of its workforce engaged in that manufacturing sector.

A common approach is to make regional comparisons using the Census Bureau grouping of Midwestern states: Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin. However, comparisons of geographically contiguous states fail to consider whether the states have anything else in common.

We measure the similarity of states by calculating correlation coefficients of the private sector workforce by sector for each of the 50 states. (For a full explanation and table of results, see the Appendix.) Table 3 shows the eight states that were most similar to Kansas (alongside their correlation coefficient, which measures how similar each state is to Kansas – the closer the coefficient is to 1, the more like Kansas they are in terms of the employment profile of the state).

Some of the states in the Census grouping of the Midwest region appear less similar to Kansas than geography would predict. For instance, North Dakota actually syncs up very poorly with Kansas due in part to the predominance of both mining and farming in that state. (Kansas actually has only half-as-large a percentage of its workforce engaged in farming as North Dakota does). Meanwhile, a state like Ohio may not seem that similar to Kansas. Yet, other than mining and farming, in which Kansas has a heavier footprint than Ohio, both states are quite similar in terms of the share of their labor force included in the major industrial categories. (The main exception is health services, in which Ohio has the advantage, but not by enough to alter the overall correlation averages.)

Table 3. Employment and Industry Correlation with Kansas

State	Correlation Coefficient	State	Correlation Coefficient
1 Kentucky	0.980	5 Missouri	0.964
2 Arkansas	0.969	6 Alabama	0.961
3 Ohio	0.966	7 Nebraska	0.961
4 Michigan	0.965	8 Iowa	0.961

Using the Correct Employment Metrics for Comparison

How do we measure the impacts of tax reforms on job growth? The most logical approach is to compare states in terms of policies and resulting job growth. A crucial aspect of any comparison between states is selecting the dataset on which to base the comparison.

The two major publicly-available employment datasets are compiled by the Bureau of Labor Statistics (BLS) of the U.S. Department of Labor and the Bureau of Economic Analysis (BEA) of the U.S. Department of Commerce. Although both measure employment in each state, they are based on different surveys and make different assumptions about what to include.[23]

The BEA dataset is more comprehensive than the BLS dataset. The BEA dataset includes pass-through firms in their broad category of farm and non-farm proprietors. These categories include partnerships, sole proprietorships, and S-corporations.[24] (The distinction of "LLC" is not a separate category of proprietor since it is a legal incorporation category that can apply to partnerships and sole proprietorships. Therefore, it is not possible to disentangle LLCs from the broad category of the self-employed that is counted in federal and state data.) As a result, the BEA dataset includes 432,270 people who would be considered "self-employed" in their employment count while BLS does not.[25]

The BLS data also do not include farm employment (which accounted for 64,810 jobs in 2015) in its totals. As a result, the BEA typically indicates a higher level of employment than the BLS surveys do. For instance, the BLS data estimates that in 2015, Kansas had an employed private-sector workforce of nearly 1.4 million, while the BEA data puts it at 1.9 million.[26]

These differences point to the fundamental problem with using BLS data to measure post-tax reform job growth in Kansas. By excluding unincorporated self-employment and farm employment, BLS data fails to capture job growth in some of the very segments of the Kansas economy that stand to benefit most from tax reform.[27]

The BLS employment data are often used in state comparisons because they are the most current available. Their employment reports are released monthly and reported on widely in the press. The comprehensive nature of the BEA dataset means it takes more time to compile: the most current year for the publicly-available BEA employment data for the states is 2015. Despite

this lag, we prefer using the BEA data because of its comprehensive nature.

There is an additional consideration when analyzing the data. Total employment figures in both the BEA and BLS releases include employment by state, local, and federal government. These public sector jobs must be subtracted from the total before comparisons are made between states. The mark of successful tax reform designed to increase economic growth would be net positive job growth in the private sector specifically.

The Growth in Kansas Private-Sector Employment

Table 4 illustrates how the comparison states have grown over the past decade. The period of time covered here is long enough to give some long-term perspective to growth trends in these states. The ten-year timeframe also has the advantage of including the last recession, thereby allowing us to see how these states fare amidst the current recovery. Kansas comes in second in percentage growth in private employment between 2005 and 2015, roughly two-percentage points higher than the states below it in the ranking.

Table 4. Private-Sector Employment Growth and Number of Private-Sector Jobs Created (2005-2015)

State	% Growth	Number of Jobs	State	% Growth	Number of Jobs
Alabama	5.09	106,281	Michigan	2.18	104,690
Arkansas	5.25	69,162	Missouri	4.41	134,904
Iowa	7.25	121,583	Nebraska	10.49	107,353
Kansas	9.01	133,805	Ohio	3.55	208,564
Kentucky	6.90	137,063			

Source: U.S. Bureau of Economic Analysis
(BEA data release/publication on September 28, 2016)

The number of jobs created, which is listed in the third column of Table 4, provides some additional information. It helps illustrate how just reporting the number of jobs created can tell a misleading story. The largest number of jobs was created in Ohio, and yet it had one of the lowest employment growth rates. Iowa created around 15,500 fewer net new jobs than Kentucky, but yet it has the higher employment growth rate. That is because bigger, more populous states need more job growth to reach a percentage-point increase in growth than smaller states.

❀ Comparing the Employment Surveys

The main difference between the BLS and BEA employment data surveys is that the BLS survey does not include farm employment and most proprietors while the BEA survey does, as explained on page 8 of this report. This will certainly impact all comparisons between states, but it impacts individual states differently. Table SB-4 shows the percentage of the total private employment covered by BEA that is also covered by the BLS private employment data. Some states have a more substantial "undercount" in the BLS data than others, but most states have a substantial chunk of their employment base left out of the BLS survey. In our group of comparison states, Kansas has the smallest share of its overall employment base reported in the BLS data than others. This is mainly due to the absence of proprietor employment from the BLS while a higher-than-average portion of the Kansas employer base is in the "proprietor" category.

As a result of these differences, the BLS total annual private employment growth rate for a state is also usually lower than the growth rate that is reported by the BEA. However, adjusting for the differences is tricky because the reported growth rates do not deviate by the same amount for each state. While most states in our comparison group see a BLS growth rate "undercount" of around 0.10 percent, Kansas experiences a more substantial 0.30 percent difference, per Table SB-5. Missouri, on the other hand, experienced no significant difference between the reported BLS growth rate and the BEA growth rate. This indicates that any side-by-side comparison between Kansas and Missouri that relies only on BLS data would actually give a substantial advantage to Missouri over Kansas.[28] Indeed, almost every comparison state in the table has an advantage over Kansas in this regard. ❀

Table SB-4. Share of Total BEA Employment Covered by BLS Survey

State	Share of BEA	State	Share of BEA
Alabama	89.7%	Michigan	87.2%
Arkansas	72.0%	Missouri	73.7%
Iowa	72.6%	Nebraska	89.7%
Kansas	71.0%	Ohio	76.2%
Kentucky	73.8%		

Table SB-5. Difference Between Reported Growth Rates in BLS and BEA (average of 2013-2015 period)

State	Ave. %-point difference (BLS minus BEA)	State	Ave. %-point difference (BLS minus BEA)
Alabama	-0.2%	Michigan	-0.4%
Arkansas	-0.1%	Missouri	0.0%
Iowa	0.0%	Nebraska	-0.3%
Kansas	-0.3%	Ohio	0.1%
Kentucky	0.1%		

Source: Data from the Bureau of Economic Analysis and the Bureau of Labor Statistics

Table 5. Private-Sector Employment Growth per 10,000 Residents(2005-2015)

State	Emp. Growth	Pop. Growth	State	Emp. Growth	Pop. Growth
Alabama	-1.2%	6.33%	Michigan	3.5%	-1.28%
Arkansas	-1.7%	7.09%	Missouri	-0.6%	5.07%
Iowa	1.8%	5.38%	Nebraska	2.6%	7.65%
Kansas	2.8%	6.06%	Ohio	2.2%	1.31%
Kentucky	1.0%	5.79%			

Source: U.S. Bureau of Economic Analysis
(BEA data release/publication on September 28, 2016)

The size of the state can be taken into account to make a more careful comparison between states. In Table 5, the ten-year growth rate of private-sector employment is weighted by the population in the state (i.e., private-sector employment per 10,000 people). These are important adjustments to make since it helps differentiate the employment growth that occurs because of population growth and what occurs because of real increases in employment growth above and beyond the employment expected increase due to population growth.

As shown in Table 5, when comparing job growth as a share of the population in the state, Kansas also fares well. (The base data for these calculations appear in Table A-2 on page 12.) By the end of the ten-year period, Kansas had created more than 5,560 jobs per 10,000 people, well above the roughly 5,188 jobs per 10,000 people that was the average in the comparison sample.

However, it should be also noted that a state could have a high population-weighted growth rate if the state neither created nor lost jobs but had slow or no population growth. Therefore, Table 5 also includes the population growth rates for each state in the comparison group. Michigan's rank in this comparison was "helped" by a decline in population (although population loss is a crucial economic problem so this certainly is not a real benefit). For states that had positive population growth over the period, Kansas comes in first place. By comparison, Missouri had population growth slightly slower than Kansas yet experienced a decline in population-weighted job growth during the 10-year period. Meanwhile, Kentucky had population growth similar to Kansas but saw population-weighted employment growth that was less than half of what Kansas experienced. Alabama actually saw a decline in population-adjusted employment growth although their population growth was somewhat similar to that of Kansas too.

The strength of Kansas' job growth can also be shown by a comparison of a state's actual employment to what it would have been if it had experienced Kansas' job growth. In 2015, Missouri had a total of 3.2 million private-sector jobs (farm employment included). If it had the employment rate of Kansas that year, it would have actually had 3.38 million jobs – a difference of over 186,000 additional jobs than it actually had in 2015.

Kansas is fourth and Michigan is first in the employment growth rate comparison when population growth is considered. The reason is that Michigan (as well as Ohio, the second place finisher) had anemic population growth and, as explained above, this can have a large influence on population-weighted growth rates. Among states that have more than one percent growth in population, Kansas is second and Missouri is third. Although Kentucky ranks first in this table, Kansas still has a population-weighted employment base advantage: Kentucky has around 4,800 jobs per 10,000 people compared to Kansas' 5,558.

None of this should imply that population growth is not important. In fact, a growing population, especially if it is above an historical trend, could indicate an economy so healthy – and widely-known as healthy – that it attracts residents and companies from other states to move there. Adjusting the employment growth data for the size of the state is simply an attempt to acknowledge that population growth could either lead job growth or lag it. In either case, they usually grow together. The mark of an especially healthy economy, however, is how many new jobs each state produces per person above and beyond what you expect by mere population growth.

Another aspect to keep in mind is the timeframe. The timeframe of 2005 through 2015 includes some ebbs and flows. Employment declines occurred during the recession for all states between 2007 and 2010, for instance. Subdividing the ten-year time frame can help us get more clarity on how Kansas grew over that time, and how the tax reforms may have impacted the tail end of that period. Table 6 shows the periods for the comparisons states for most of the pre-recession growth period, the recession, the early post-recession period and then the first year of the tax reform onward.

Table 6. Total Population-Weighted Private Sector Employment Growth
(per 10,000 residents, subdivided by business cycle period)

State	Pre-recession (2004-2007)	Recession (2007-2010)	Post-recession (2010-2012)	Post tax reform (2012-2015)
Alabama	5.1%	-9.0%	1.9%	3.6%
Arkansas	1.5%	-6.1%	1.0%	3.1%
Iowa	3.9%	-4.6%	1.7%	2.5%
Kansas	3.8%	-6.0%	2.0%	3.9%
Kentucky	2.4%	-7.3%	3.0%	4.2%
Michigan	0.8%	-7.2%	5.1%	6.0%
Missouri	2.5%	-7.1%	1.8%	3.6%
Nebraska	3.0%	-4.2%	1.9%	2.5%
Ohio	2.0%	-6.6%	3.7%	4.3%

Source: U.S. Bureau of Economic Analysis
(BEA data release/publication on September 28, 2016)

Table 7. Annualized Population-Weighted Private Sector Employment Growth
(per 10,000 residents, subdivided by business cycle period)

State	Pre-recession (2004-2007)	Recession (2007-2010)	Post-recession (2010-2012)	Post tax reform (2012-2015)
Alabama	1.7%	-3.0%	0.9%	1.2%
Arkansas	0.5%	-2.0%	0.5%	1.0%
Iowa	1.3%	-1.5%	0.9%	0.8%
Kansas	1.3%	-2.0%	1.0%	1.3%
Kentucky	0.8%	-2.4%	1.5%	1.4%
Michigan	0.3%	-2.4%	2.5%	2.0%
Missouri	0.8%	-2.4%	0.9%	1.2%
Nebraska	1.0%	-1.4%	1.0%	0.8%
Ohio	0.7%	-2.2%	1.8%	1.4%

Source: U.S. Bureau of Economic Analysis
(BEA data release/publication on September 28, 2016)

Table 7 shows the annualized (i.e., per-year) rate of growth which allows us to see how the average growth rate of the economy declined or improved during each period.

Before the recession, Kansas actually had an (annualized) growth rate on average of 1.3 percent. Every state lost jobs in the recession, demonstrated by an average two percent annual shrinking in population-weighted employment for all states except Iowa (which saw a hardly-better 1.5 percent loss each year on average during the recession). However, after the recession, between 2010 and 2012, many states began to regain their momentum – most states matched or exceeded their annualized pre-recession growth rate during this period.

But, Kansas was a bit slower to recover. The big recovery occurs for Kansas starting in 2013. The annualized employment growth rate rose to 1.3 percent. Meanwhile, Iowa, Kentucky, Michigan, Nebraska, and Ohio saw a drop in their annual average growth rate when comparing the periods of 2010-2012 and 2012-2015. Finally, Kansas has the top growth rate among states that had a higher annual average growth rate in the 2013-2015 period than in the 2010-2012 period.

Conclusion

The evidence presented in this paper suggests a high likelihood that the 2012 tax reforms had a positive effect on overall job growth in Kansas. The reforms lowered taxes on small businesses that are also pass-through entities. These entities create a majority of the jobs in Kansas. Many of the misconceptions about the Kansas job growth record are based on datasets that paint an incomplete picture of where the job growth is occurring in Kansas. While there is still more analysis to be done and more data to be released over the coming years, we believe the preliminary signs indicate that tax reform in Kansas has had and, more importantly, will continue to have a positive impact on state job growth.

Appendix

Determining the Comparison States

The states were correlated with each other by the share of the overall private workforce that was employed in each major industry sector as measured by the Bureau of Economic Analysis. Then the correlations by sector were averaged for each state to get a statewide "similarity correlation coefficient," per Table A-1.

The similarity correlation coefficients represent how closely the Kansas economy is to the structure and behavior of other state economies. To illustrate, if a state is 100 percent identical to Kansas, it would have a correlation coefficient of 1. (Kansas, of course, correlates perfectly with itself and it is the only state to receive a correlation of 1 since no two states are exactly alike. Hence, we have not included Kansas in Table A-1.) Conversely, if a state was completely different from Kansas, its coefficient would be zero. Most states in the U.S. have some degree of similarity with each other in terms of their employment signature but there is certainly significant variance: the coefficients tend to fall between 0.98 and around 0.60 – or, to put it another way, the states exhibit between 98 percent similarity and 60 percent similarity with Kansas.

The coefficients in Table A-1 indicate that some of the states in the region look more like Kansas with respect to the economic signature of employment than others. Of the twelve states in the Census region, Iowa, Michigan, Missouri, Nebraska, and Ohio look the most similar. The states to the east and south of Kansas, and out of the Census region, but with a similar employment signature, are Alabama, Arkansas, and Kentucky. The top eight states most similar to Kansas also happen to share a correlation coefficient of 0.961 or better – which is roughly one-quarter of one standard deviation – appear in bold in Table A-1. These eight states are used as the comparison states to Kansas.

Table A-1. Employment and Industry Correlation with Kansas

State	Correlation Coefficient	State	Correlation Coefficient
1 Kentucky	**0.980**	26 Utah	0.918
2 Arkansas	**0.969**	27 Louisiana	0.917
3 Ohio	**0.966**	28 Vermont	0.916
4 Michigan	**0.965**	29 Georgia	0.912
5 Missouri	**0.964**	30 West Virginia	0.904
6 Alabama	**0.961**	31 Connecticut	0.900
7 Nebraska	**0.961**	32 California	0.886
8 Iowa	**0.961**	33 Rhode Island	0.881
9 Minnesota	0.959	34 Arizona	0.878
10 Mississippi	0.958	35 New Jersey	0.869
11 Tennessee	0.957	36 Delaware	0.864
12 Oregon	0.957	37 New Mexico	0.860
13 Idaho	0.953	38 Montana	0.856
14 Wisconsin	0.953	39 Colorado	0.844
15 North Carolina	0.951	40 Virginia	0.842
16 Washington	0.944	41 Massachusetts	0.837
17 Indiana	0.941	42 North Dakota	0.829
18 Illinois	0.937	43 Florida	0.828
19 New Hampshire	0.936	44 New York	0.827
20 Pennsylvania	0.935	45 Maryland	0.812
21 Texas	0.934	46 Alaska	0.792
22 South Dakota	0.928	47 Hawaii	0.724
23 South Carolina	0.925	48 Wyoming	0.661
24 Oklahoma	0.924	49 Nevada	0.596
25 Maine	0.918		

Source: U.S. Bureau of Economic Analysis

Table A-2. Private Employment per 10,000 Population - BEA

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Alabama	4,477	4,572	4,631	4,704	4,614	4,363	4,281	4,357	4,362	4,392	4,436	4,518
Arkansas	4,687	4,733	4,752	4,759	4,696	4,529	4,468	4,523	4,512	4,516	4,567	4,652
Iowa	5,567	5,655	5,721	5,782	5,754	5,591	5,518	5,579	5,615	5,669	5,698	5,755
Kansas	5,371	5,408	5,462	5,578	5,566	5,359	5,243	5,298	5,349	5,428	5,505	5,559
Kentucky	4,713	4,749	4,781	4,824	4,750	4,537	4,472	4,553	4,606	4,639	4,705	4,799
Michigan	4,753	4,785	4,768	4,792	4,710	4,446	4,446	4,597	4,671	4,764	4,849	4,952
Missouri	5,229	5,286	5,323	5,360	5,299	5,089	4,979	5,037	5,071	5,115	5,152	5,253
Nebraska	5,779	5,808	5,853	5,953	5,940	5,801	5,704	5,752	5,813	5,854	5,895	5,961
Ohio	5,091	5,132	5,159	5,192	5,129	4,899	4,851	4,955	5,029	5,088	5,152	5,245

Source: U.S. Bureau of Economic Analysis (BEA data release/publication on September 28, 2016)

End Notes

[1] Steve Anderson and Dave Trabert, "A Five-Year Budget Plan for the State of Kansas," Kansas Policy Institute, September 2014, available at: https://kansaspolicy.org/kpi-analysis-5-year-kansas-budget-plan/

[2] For a review of this literature, see Stephen J. Davis, John Haltiwanger, and Ron Jarmin, "Turmoil and Growth: Young Businesses, Economic Churning, and Productivity Gains," Ewing Marion Kauffman Foundation, June 2008, available at: http://www.kauffman.org/~/media/kauffman_org/research%20reports%20and%20covers/2008/06/turmoilandgrowth060208.pdf

[3] John Haltiwanger, Ron S. Jarmin, and Javier Miranda. "Who Creates Jobs? Small Versus Large Versus Young," The Review of Economics and Statistics, Vol. XCV, No. 2, May 2013, available at: http://www.mitpressjournals.org/doi/pdf/10.1162/REST_a_00288

[4] http://www.census.gov/ces/dataproducts/bds/definitions.html

[5] Ibid.

[6] See Table SB-1 on Page 6 of this paper.

[7] W. Robert Reed, "The Robust Relationship between Taxes and U.S. State Income Growth," National Tax Journal, Vol. 61, No. 1, March 2008, pp. 57-80.

[8] For an extensive review of the academic literature on this subject, see William McBride, "What is the Evidence on Taxes and Growth?" Tax Foundation Special Report No. 207, December 18, 2012, available at: http://taxfoundation.org/article/what-evidence-taxes-and-growth

[9] Correspondence with the Kansas Department of Revenue, September 7, 2016.

[10] See testimony of Scott Drenkard, Tax Foundation economist, before the Kansas House Committee of Taxation, March 15, 2016, available at: http://taxfoundation.org/article/kansas-pass-through-carve-out-national-perspective

[11] For a description of the "sham transaction doctrine" and the details on federal enforcement of tax status changes, see Internal Revenue Service Notice 2014-58, "Additional Guidance Under the Codified Economic Substance Doctrine and Related Penalties," available at: https://www.irs.gov/pub/irs-drop/n-14-58.pdf

[12] Available at: http://censtats.census.gov/cbpnaic/cbpnaic.shtml Census extracts data from the Business Register, the Census Bureau's file of all known single and multi-establishment companies. Data comes from a variety of sources, including the Economic Censuses, the Annual Survey of Manufacturers and Current Business Surveys, as well as from administrative records of the IRS, the Social Security Administration and the Bureau of Labor Statistics as documented at https://www.census.gov/programs-surveys/cbp/technical-documentation.html. Businesses without paid employees are covered by the Non-Employer Statistics series and are not included in CBP https://ask.census.gov/faq.php?id=5000&faqId=1711

[13] A small number of proprietors listed in the Census database are IRS designations, which says it treats LLCs "as either a corporation, partnership, or as part of the LLC's owner's tax return (a "disregarded entity"). Specifically, a domestic LLC with at least two members is classified as a partnership for federal income tax purposes unless it files Form 8832 and affirmatively elects to be treated as a corporation. And an LLC with only one member is treated as an entity disregarded as separate from its owner for income tax purposes (but as a separate entity for purposes of employment tax and certain excise taxes), unless it files Form 8832 and affirmatively elects to be treated as a corporation." https://www.irs.gov/businesses/small-businesses-self-employed/limited-liability-company-llc

[14] A small number of proprietors listed in the Census database are IRS designations, which says it treats LLCs "…as either a corporation, partnership, or as part of the LLC's owner's tax return (a "disregarded entity"). Specifically, a domestic LLC with at least two members is classified as a partnership for federal income tax purposes unless it files Form 8832 and affirmatively elects to be treated as a corporation. And an LLC with only one member is treated as an entity disregarded as separate from its owner for income tax purposes (but as a separate entity for purposes of employment tax and certain excise taxes), unless it files Form 8832 and affirmatively elects to be treated as a corporation." https://www.irs.gov/businesses/small-businesses-self-employed/limited-liability-company-llc

[15] BEA report of new proprietors per SA25N downloaded November 28, 2016

[16] The number of C-corps that switched in tax year 2014 did drop, which could indicate that a share of the switchers in 2013 might indeed have been the result of strategic corporate tax decisions intended to minimize their tax burden that year. Yet, if you assume that the difference between the "normal" rate of C-corp switchers is around 0.4% (which is the roughly the share of switchers in the year before the tax reform took effect), the highest estimate of the number of strategic switchers that became a pass-through solely to reduce their tax burden is no higher than 232. This means those strategic switchers account for no more than 10% of the increase in the rate of switchers in 2013 and accounts for even fewer in 2014.

[17] Data provided to authors by Kansas Department of Revenue, August 2014.

[18] The Kansas Department of Revenue reports that there were 1.81 million such filers in 2013. See Kansas Department of Revenue "Annual Report 2014," available at: http://www.ksrevenue.org/annualreport.html

[19] For instance, U.S. Internal Revenue data from 2007 suggests that proprietorships and partnerships account for around 15% of Kansas federal income tax filers. See Linda Morey, "Partnerships and Sole Proprietorships, by State, for Tax Year 2007," Statistics of Income Bulletin, Fall 2009, available at: https://www.irs.gov/pub/irs-soi/09fallbulsoleprop.pdf

While this does not account for all categories of pass-through entities the way that the Kansas Department of Revenue data does, it is comparable in that these two types of entities account for the largest share.

[20] Dan Margolies and Sam Zeff, "Thanks to Tax Cuts, Bill Self, Highest Paid State Employee, Owes Little in Kansas Income Tax," KCUR.org, May 16, 2016, available at: http://kcur.org/post/thanks-tax-cuts-bill-self-highest-paid-state-employee-owes-little-kansas-income-taxes#stream/0

[21] Data provided to authors by Kansas Department of Revenue, August 2014.

[22] See U.S. Census Bureau QuickFacts, available at: http://www.census.gov/quickfacts/table/PST045215/20

[23] For an explanation of the BLS dataset, see Bureau of Labor Statistics, "CES Overview," February 5, 2016, available at http://www.bls.gov/web/empsit/cesprog.htm. For an explanation of the BEA dataset, see Bureau of Economic Analysis, "State Personal Income and Employment: Concepts, Data Sources, and Statistical Methods," September 2015, available at: http://bea.gov/regional/pdf/spi2014.pdf

[24] Ibid. The BEA mainly uses IRS filing data to count proprietors in each state and augments that with data from the Bureau of Labor Statistics and the Census Bureau for a fuller picture of the amount of both farm and non-farm employment in a state.

[25] Bureau of Economic Analysis series SA25N, last updated September 28, 2016.

[26] Ibid.

[27] Steven F. Hipple, "Self-Employment in the United States," Bureau of Labor Statistics Monthly Labor Review, September 2010, available at: https://www.bls.gov/opub/mlr/2010/09/art2full.pdf

[28] The difference in growth rates between monthly or quarterly data may differ since there is a great deal of seasonal cyclicality. The percentage-point differences were computed using annual growth rates only. This differential is also one that relies on only the most recent three years of data. The differential may be different during future business cycles and it may also differ when choosing different base years or different segments of the overall business cycle.

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