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# The Economic Impact of JFC's Plan to Cut Income Tax Rates in Wisconsin\*

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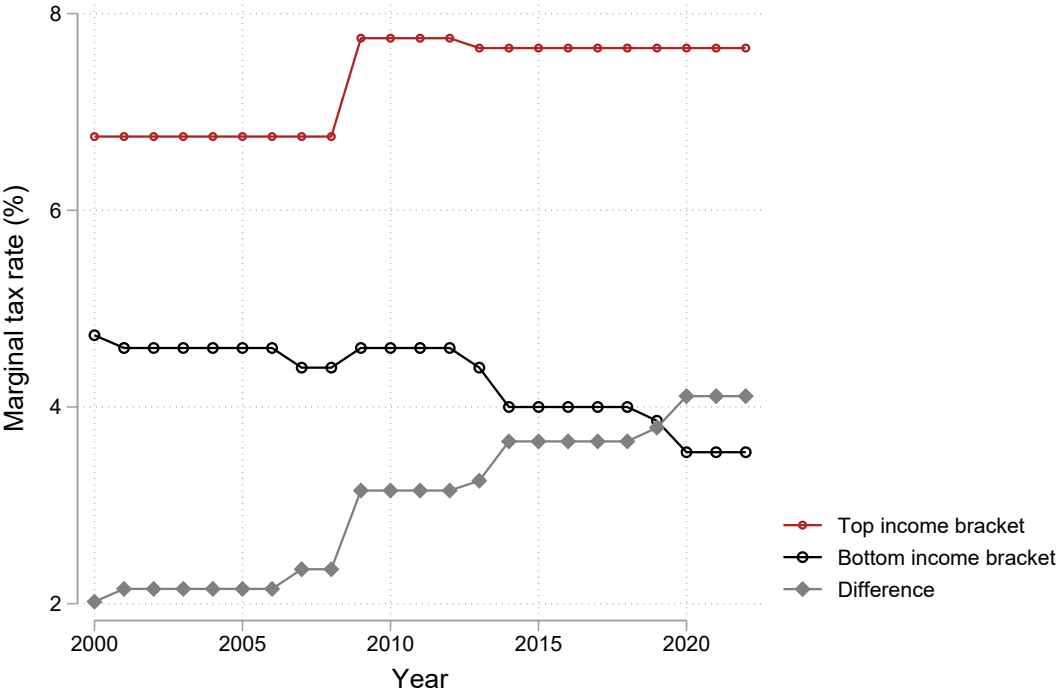
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**Wisconsin’s individual income tax rates are higher than the rates in most other states.** The state’s statutory rate for the bottom-income bracket is the 14th highest among all states and the District of Columbia, and its statutory rate for the top-income bracket is the 10th highest (Vermeer, 2023).

**The state’s income tax structure has become more progressive as well.** Figure 1 shows that the statutory rate for the bottom-income bracket dropped from 4.77% in 2000 to 3.54% in 2022. During the same period of time, the statutory rate for the top-income bracket increased from 6.77% to 7.65%. As a result, the difference in the statutory rates for the two income brackets, a measure of the progressivity of the income tax structure, has more than doubled from 2% in 2000 to 4.11% in 2022. This is the fifth largest increase among all states and the District of Columbia.

**Figure 1: Statutory Marginal Tax Rates in Wisconsin**



**Related to high income tax rates, Wisconsin has a low rate of entrepreneurship, and has been losing population to other states.** In 2021, Wisconsin’s rate of new entrepreneurs was the fifth lowest among all states and the District of Columbia (Kauffman Foundation, 2022). Due to interstate migration, Wisconsin’s population dropped by 72,006 between 2010 and 2019, and it dropped again by 11,383 between 2020 and 2022. Partly because of this, Wisconsin’s civilian labor force has declined by over 80,000 from its peak in July 2017, compared to an increase of over 6 million for the U.S. during the same period.

**Research shows that both high income tax rates and the progressive income tax structure have a negative impact on the economy.** For example, Mertens and Ravn (2013) find that a one percentage point cut in the average personal income tax rate raises real GDP per capita by 1.4% on impact and by up to 1.8% after three quarters. Erosa and Koreshkova (2007) find the progressive income tax system in the U.S. reduces the incentive for workers to accumulate human capital, and switching to a proportional tax system increases output by 12.6%, capital by 21.8%, and consumption by 13.2% in the steady state.

**The impact of the tax rate for households at the top of the income distribution is particularly large.** In addition to the negative effect on human capital accumulation, the top tax rate has two other effects. First, it has a negative impact on business formation and investment, because income from pass-through businesses is highly concentrated among households at the top of the income distribution. For example, in 2019, over 55% of the pass-through income in Wisconsin was reported by households whose income was \$500,000 or more. These households face the top tax rate of 7.65% at the state level. Second, a high top tax rate causes out-migration of top earners, who are more mobile and more likely to move across states in response to spatial differences in the income tax rates (Rauh, 2022). The out-migration of top earners from a state reduces the state’s tax revenue and productivity. Rauh (2022) finds that total taxable income of people who moved out of California in 2020 surpassed that of those who moved into California in the same year by \$10.7 billion, which leads to a potentially permanent annual net loss of about \$1.17 billion in tax liability. One particular group of top earners are star scientists. The presence of star scientists in a state is typically associated with the fostering of new industries, from biotech to software to nano-tech. Moretti and Wilson (2017) find that, by cutting its statutory personal income tax rate on the top 1% of earners from 7.5% to 6.85% in 2006, the state of New York increased the net inflow of star scientists to the state by 2.6% over a ten-year period.

On June 22, the **Wisconsin State Legislature’s Joint Finance Committee (JFC) passed a plan to cut the state’s individual income tax rates.** As shown in table 1, the plan would reduce the tax rate for the bottom-income bracket from 3.54% to 3.5%, collapse the third bracket into the second and reduce the corresponding rate to 4.4%, and reduce the top rate from 7.65% to 6.5%.

**Table 1: Current and Proposed Individual Income Tax Rates in Wisconsin (%)**

Income bracket	Current	JFC	Evers
First (bottom)	3.54	3.5	3.186
Second	4.65	4.4	4.185
Third	5.30	4.4	4.77
Fourth (top)	7.65	6.5	7.65

According to Wisconsin Legislative Fiscal Bureau (2023a), JFC’s plan would reduce individual income tax collections by about \$1.49 billion in 2023–24 and \$1.42 billion in 2024–25. These estimates represent the static impact in the absence of behavioral responses. As households increase their labor supply and firms increase their investment in response to the lower tax rates, the dynamic impact of the tax cuts on the state’s economy could be very different. One approach to the dynamic impact is to use multipliers and elasticities derived from other studies. The problem, however, is that the multipliers and elasticities are not Wisconsin specific and thus not able to produce reliable estimates for the Wisconsin economy.

**We present a comprehensive model of the Wisconsin economy and its tax system to account for the behavioral responses from households and firms** (Guo et al., 2023). In our model, income from pass-through businesses is subject to the top tax rate. A lower value of the top tax rate raises the incentive for firms to invest. Lower tax rates also raise households’ incentives to work and accumulate more skills. The increased economic activity leads to a larger tax base and partially offsets the loss of revenue from lower tax rates. We now use our framework to evaluate the economic impact of JFC’s plan. For comparison, we also evaluate Governor Evers’ plan to cut the income tax by 10% for low- and middle-income households. We model this as a 10% reduction of the first three rates from their current values, as shown in the last column of table 1.

Table 2 reports the impact of the two plans. Measured in percentage differences by comparing the steady state of the economy under each plan with the steady state under the current tax rates, the estimates represent the long-run effects accounting for behavioral responses.

**Table 2: Economic Impact of the Two Plans (%)**

	JFC	Evers
State aggregate		
Capital	1.51	0.38
Labor	1.08	0.38
Output	1.25	0.38
Wage rate	0.17	0.00
Corporate tax revenue	0.82	0.38
Sales tax revenue	1.17	0.43
Total tax revenue	-4.98	-3.54
Median-income household		
Income tax paid	-10.36	-9.43
After-tax income	1.48	0.61
Consumption	1.17	0.43

**JFC's plan would increase capital by 1.51%, labor by 1.08% and output by 1.25%.** The increased economic activity leads to more revenue for the state government from corporate taxes (0.82%) and sales taxes (1.17%). The increased earnings from the extra labor and the higher wage rate (0.17%) also partially offset the loss of revenue from individual income taxes. Together, the loss of total tax revenue (-4.98%) in the long run is significantly smaller than the loss in the short run. Legislative Fiscal Bureau (2023b) estimates that the total tax revenue for 2023-24 is \$21.39 billion. Multiplying this by -4.98% implies a loss of \$1.07 billion, which is about 71.8% of the static impact mentioned above.

For the median-income household, JFC's plan would cut the income tax by -10.36%, raise after-tax incomes by 1.48%, and raise consumption by 1.17%.

The impact of Governor Evers' plan on Wisconsin's economy is much smaller. In particular, **because Governor Evers' plan has no impact on the top tax rate, which is the tax rate faced by most pass-through businesses, it also has no impact on the capital-labor ratio and, thus, has no impact on the wage rate.**

The impact on the wage rate is especially important for low-income households who pay zero tax and thus are not directly affected by the lower tax rates. Among the 3,143,440 filers for Wisconsin income tax in 2021, 26% had zero net tax. **Even these households benefit from the higher wage rate induced by JFC's plan.**

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