Executive Summary
The Economic Impact of Lowering Income Tax Rates in Wisconsin*
Center for Research on the Wisconsin Economy

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- Individual income tax rates in Wisconsin 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. The tax has become more progressive as well: The difference between the top and the bottom statutory rates has more than doubled since 2000.

- We construct a model that captures the salient features of the Wisconsin economy and its tax system and use it to measure the effects of tax policies on gross state product, household consumption, business investment, and tax revenue.

- A key feature of our approach is modeling the behavioral responses from households and firms. Lower taxes increase business activity and household income, increasing the tax base and partially offsetting the loss of revenue from lower tax rates.

- Lower tax rates increase business investment and worker skill attainment. Both of these channels increase wages and household private consumption.

- Even low-income households who pay no income tax, and thus are not directly affected by a rate reduction, benefit from the higher wage rates induced by the lower tax rates.

- We consider 12 policies that lower the state's individual income tax rates, keeping intact other features of the tax structure, e.g., personal exemptions, standard deductions, and tax credits. We focus on the long-run impacts. We find that all 12 options would increase output and household well being. As an example, switching from the current tax system to a flat tax of 3.25% would

  - Increase gross state product by 4.5% ($13.7 billion). Because most income from pass-through businesses is subject to the top statutory rate, reducing the top rate is more effective in promoting investment and capital formation. Lowering the tax rates for other income brackets leads to more skill investments and higher levels of worker productivity.
  - Increase household consumption by 4.4% and after-tax income by 5.27%. Lower taxes increase household well being, even if they reduce government consumption expenditures valued by the household.
  - Lower tax revenue by 16.8%. The Legislative Fiscal Bureau forecasts a 21.5% decrease in revenue. The difference, about $1.1 billion, arises because our estimate accounts for the increased economic activity that results from lower tax rates.

The views expressed herein are those of the authors and not necessarily those of the Center for Research on the Wisconsin Economy, the Department of Economics, or the University of Wisconsin – Madison. The full report summarized here can be found at: crowe.wisc.edu