



“High Rate” Income Tax States Are Outperforming No-Tax States

Don't Be Fooled by Junk Economics

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About ITEP

Founded in 1980, the Institute on Taxation and Economic Policy (ITEP) is a non-profit, non-partisan research organization, based in Washington, DC, that focuses on federal and state tax policy. ITEP's mission is to inform policymakers and the public of the effects of current and proposed tax policies on tax fairness, government budgets, and sound economic policy. Among its many publications on state and local tax policy are *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States* and *The ITEP Guide to Fair State and Local Taxes*. ITEP's full body of research is available at www.itepnet.org.

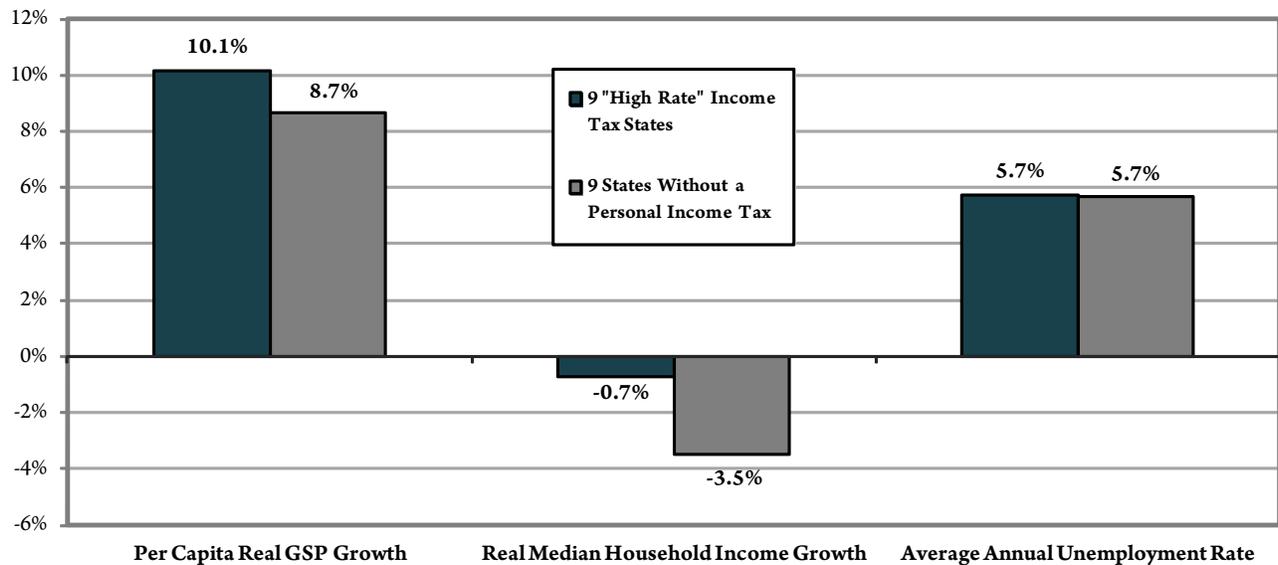
With the economy lagging, lawmakers seeking to reduce or eliminate state personal income taxes are touting their proposals as tools for boosting economic growth. Of particular note are the governors of Kansas and Oklahoma, both of whom justified income tax repeal in their State of the State speeches by claiming that states not levying personal income taxes are outperforming those levying their taxes at the highest rates.¹

These claims are based largely on misleading analyses generated by Arthur Laffer, long-time spokesman of a supply-side economic theory that President George H. W. Bush once called “voodoo economics” because of its bizarre insistence that tax *cuts* very often lead to *higher* revenues. Recently, Laffer’s consulting firm has been very successful (with the help of the American Legislative Exchange Council, Americans for Prosperity, and the *Wall Street Journal’s* editorial page) in spreading the talking point that the nine states without personal income taxes have economies that far outperform those in the nine states with the highest top tax rates.²

In reality, however, residents of “high rate” income tax states are actually experiencing economic conditions at least as good, if not better, than those living in states lacking a personal income tax.³ As Figure 1 shows, the nine “high rate” states identified by Laffer have actually seen more **economic growth per capita** over the last decade than the nine states that fail to levy a broad-based personal income tax. Moreover, while the **median family’s income**, adjusted for inflation, has declined in most states over the last decade, those declines have been considerably smaller in “high rate” states than in those states lacking an income tax entirely. Finally, the **average unemployment rate** between 2001 and 2010 has been essentially identical across both types of states.

The appendix includes state-specific findings for each of these three measures, and reveals that the economic problems in non-income tax states aren’t limited to just Florida and Nevada, as some observers have recently claimed.⁴

Figure 1: Three Measures of Economic Performance, 2001-2010



¹ Kansas Governor Sam Brownback **said** that he wants to “get us ever closer to the pro-growth states with no state income taxes - which are among the country’s strongest economic performers,” while Oklahoma Governor Mary Fallin **cited** an Arthur Laffer analysis in attempting to make the case for income tax repeal.

² “High rate” states include California, Hawaii, Maine, Maryland, New Jersey, New York, Ohio, Oregon, and Vermont. States without a broad-based personal income tax include Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming. See OCPA and ALME, “Eliminating the State Income Tax in Oklahoma: An Economic Assessment,” November 2011, pp. 4.

³ This report focuses on states with the highest marginal income tax rates as of January 2011 in order to be consistent with the relevant Laffer analysis, though we should note that this measure provides only a very partial snapshot of what are in reality much more complicated personal income tax codes.

⁴ “The Heartland Tax Rebellion,” *The Wall Street Journal*, February 8, 2012.

- Six of nine non-tax states are doing worse than the average state when it comes to economic growth per capita: New Hampshire, Washington, Texas, Florida, Tennessee, and Nevada.
- Five of nine non-tax states are doing worse than average in terms of median income growth: Texas, South Dakota, Nevada, Tennessee, and Alaska.
- Six of nine non-tax states have higher than average annual unemployment rates: Florida, Texas, Tennessee, Washington, Nevada, and Alaska.

The Economic Boom Myth

The Laffer analysis distorts reality by focusing on a number of variables that are very closely related, including population growth, total employment growth, and total growth in economic output (GSP). Since a larger population brings with it more demand, it's only natural that states experiencing the fastest population growth would also experience more growth in the total number of jobs and total amount of economic output.

Simply put, the Laffer analysis is hugely distorted by its failure to acknowledge the importance of population changes to the variables it presents. A more sophisticated way of examining how each state's residents are actually faring is to control for population growth by looking at **households' median income**, the **unemployment rate**, and **economic output per capita**. Figure 1 and the charts in the Appendix do precisely this, and show that residents of states levying a "high rate" income tax are faring at least as well, and in many cases better, than their non-income tax neighbors. More people, jobs, and economic activity certainly aren't bad things, but income levels and unemployment rates matter a lot more to the typical family, and neither of these are areas in which non-income tax states excel.

Population Growth is Not Determined by Income Tax Laws

The usefulness of the statistics being pushed by Laffer is further limited by the fact that population growth – the driver of the alleged economic success in non-income tax states – is decidedly not determined by state tax structures.

According to the U.S. Census, eighteen of the top twenty states in terms of population growth between 2001 and 2010 are located in the south or western part of the country, and seven of these states are located in the so-called Sunbelt. Demographers have identified a large number of reasons for the population growth occurring in the south and west that are completely unrelated to these states' tax structures. Lower population density and more accessible suburbs are important factors, as are higher birth rates, Hispanic immigration, and even warmer weather.

With this in mind, the growth of states lacking an income tax is no more than coincidental. Six of the nine states not levying a personal income tax are located in the south or western parts of the country (eight of nine if you count Alaska and South Dakota), and are therefore benefiting from the same regional trends also bolstering growth in states with higher income taxes like Oregon, Hawaii, Idaho, and North Carolina. In this light, it should come as little surprise that the state without an income tax that experienced the lowest rate of population growth was New Hampshire – the only non-income tax state located in the northeastern part of the country.

Many Non-Income Tax States Enjoy Economic Advantages Not Available to Others

Figure 1 showed that states with a "high rate" income tax are performing at least as well, if not better, than their no-tax counterparts. What makes this finding particularly remarkable is that states choosing not to levy an income tax often do so because they possess some unique economic advantage that allows them to generate tax revenue through non-traditional means. According to the Bureau of Economic Analysis, three of the top six states with the largest mining sectors, relative to their economies, also lack an income tax (Alaska, Wyoming, and Texas).

Unsurprisingly, serious state-based analysts in non-income tax states frequently point to natural resources as the cause of their economic success. For example, in January Alaska's Department of Labor explained that:

*Recently, Alaska's dependence on oil revenue has been a boon. When most states were coping with budget shortfalls stemming from reduced state income and state sales tax collections, Alaska's oil revenue reached an all-time high in 2008 and has remained well above historical averages for the last three years. ... During a bleak economic period for much of the nation and world, Alaska benefitted from large budget surpluses, replenished rainy-day savings accounts, and a stable public-sector workforce. Those same relative advantages are expected to persist into 2012 and help generate stronger-than average growth compared to other states, whose state governments will be digging themselves out of debt for years to come.*⁵

confuses population growth with economic performance, and fails to acknowledge the natural resource advantages enjoyed by a number of the most successful non-income tax states. There is no reason for states to expect that reducing or repealing their income taxes will improve the performance of their economies. 🚫

Analysts in Wyoming point to very similar economic drivers.

According to the Wyoming Economic Analysis Division:

*After a short, but severe recession, Wyoming's economy has turned around since the beginning of 2010, thanks to the robust rebound of the energy industries. The State's gradual recovery continued to be faster than the U.S. average. For the third quarter of 2011, Wyoming's recovery was still on track, and may have picked up speed.*⁶

It's also worth noting that North Dakota – a state that levies an income tax *and* is endowed with significant natural resources – is consistently at the top of the list of strongest economic performers. North Dakota ranks first in the nation under two of the three measures of economic success presented in this report: lowest average unemployment rate between 2001 and 2010, and strongest per capita GSP growth during that same period. In terms of the remaining measure, median income growth, North Dakota ranks second behind only West Virginia, another state that levies an income tax.

Conclusion

Whether looking at income levels, unemployment rates, or economic output per person, states with “high rate” income taxes have economies that equal or surpass those in states lacking an income tax. The most commonly cited analysis purporting to show the opposite

⁵Alaska Department of Labor and Workforce Development, “Alaska Economic Trends,” January 2012, pp. 4.

⁶Wyoming Economic Analysis Division, “Economic Summary: 3Q2011,” December 2011, pp. 1.

Appendix: Nine Non-Income Tax vs. Nine "High Rate" States

Figure 2: Growth in Per Capita Real GSP, 2001-2010

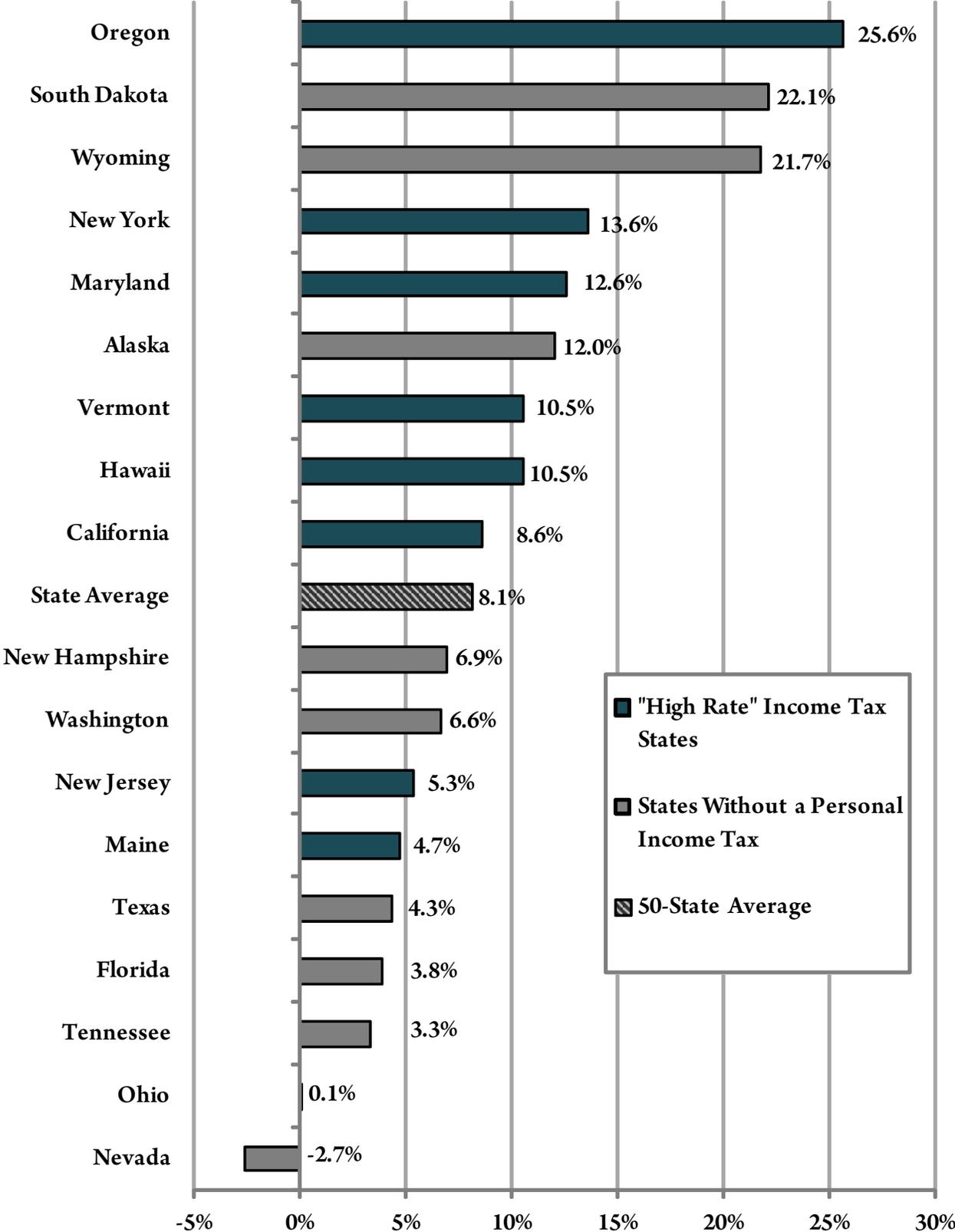
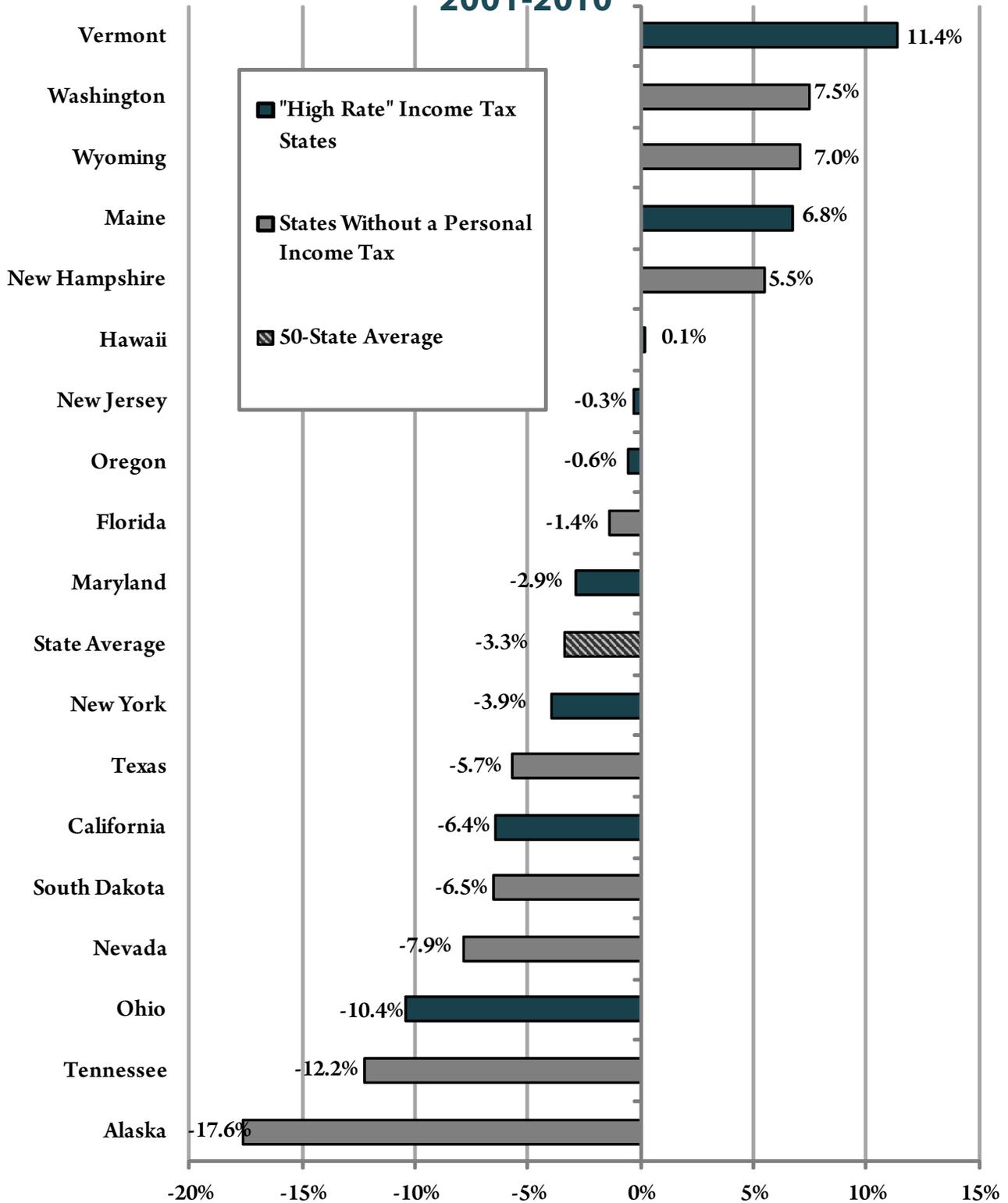


Figure 3: Change in Real Median Household Income, 2001-2010



**Figure 4: Average Annual Unemployment Rate,
2001-2010**

