



Taxes Really Do Matter: Look at the States

by Arthur B. Laffer, Ph.D.
& Stephen Moore
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For Supply-Side Economics

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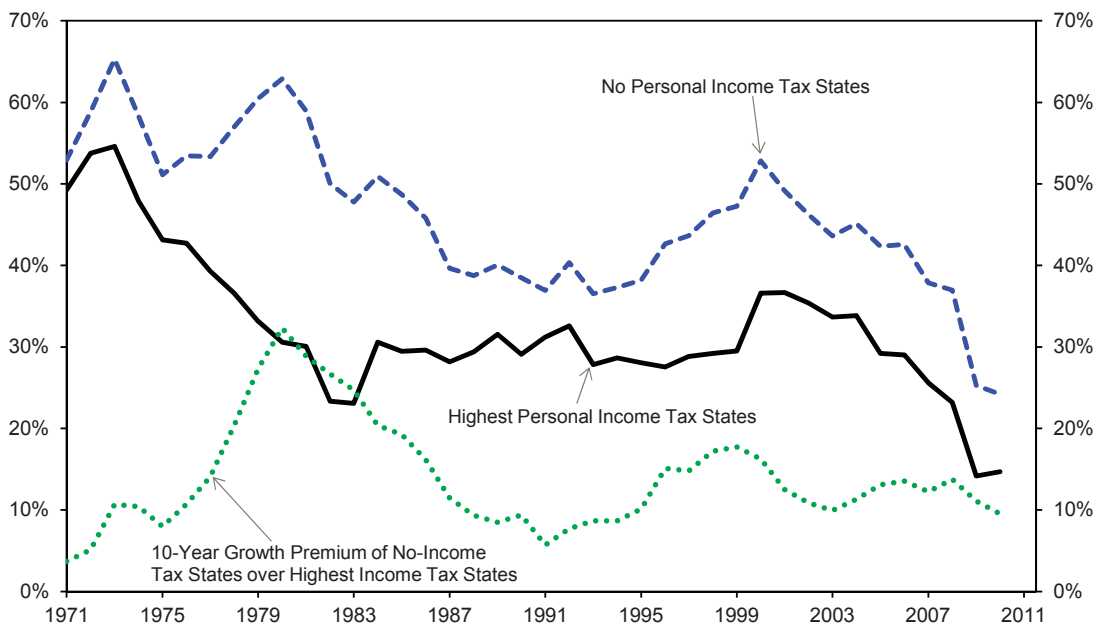
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LESSONS FOR THE ADMINISTRATION FROM HIGHEST AND LOWEST TAX STATES

Barack Obama and the Democrats in Congress are betting the future of the U.S. economy on a gamble that tax rates don't matter: so raising income taxes, dividend taxes, and capital gains taxes in 2013, won't hurt the economy. The evidence from the states, however, suggests just the opposite is true. We've looked at the evidence for more than two decades, with data dating back to 1960, and we've found that in any 10-year period you look at, the no-income tax states consistently outperform the equivalent number of the highest income tax states (*see Figure 1*).

Figure 1: 10-Year Personal Income Growth Rates for No-Income Tax States and Highest Income Tax States
(annual, percentage, period 1971-2010)



Source: Bureau of Economic Analysis, Laffer Associates

For example, over the most recent 10-year period, 2001-10, the average of the nine states without income taxes—Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming—had 14% growth in population—versus 9% for all states and only 5.5% for the nine highest income tax states—Oregon, Hawaii, New Jersey, California, New York, Vermont, Maryland, Maine, and Ohio. Job growth in the nine no-income tax states was 5.5%, versus close to zero in the average state and -1.6% in the highest tax states. On balance, no-income tax states have two and one-half times the population growth of the highest income tax states, and yes, the no-income tax states even have higher tax revenue growth than the average of all states *and* the highest income tax states.

Table 1: Nine No-Income Tax States vs. Nine Highest Income Tax States

	Growth Rates, 2001-2010			
	Population	Gross State Product	Non-farm Payroll Employment	State and Local Tax Revenue†
9 States with No-Income Tax*	13.9%	56.1%	5.5%	81.5%
U.S. Average**	8.8%	45.4%	0.6%	51.0%
9 States with Highest Personal Income Tax Rates*	5.5%	41.0%	-1.6%	44.9%

* equal-weighted average

** equal-weighted average, does not include D.C.

† 2000-09 (2010 data not yet available)

Source: Bureau of Economic Analysis, U.S. Census Bureau, Bureau of Labor Statistics, Laffer Associates

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The California/Texas comparison is especially eye-popping. California has one of the highest income tax rates at 10.3%, and Texas has no income tax. Admittedly, one swallow does not a summer make, but it is astonishing that over the 10-year period from 2001 to 2010, Texas gained nearly 870,000 net migrants from other states while California lost over 1.5 million people to other states. Texas’ gains and California’s losses are nowhere more apparent than in the Census results for the 2010 congressional reapportionment: Texas increased its congressional delegation by four seats, and California did not gain one single seat. Yet, the politicians in Sacramento are currently sponsoring a ballot initiative to be voted on this fall that would, retroactive to January 1, 2012, increase the top tax rate from more than 10% to more than 13%—the highest in the nation.

Based in part on these powerful results, which have been replicated by numerous economic studies,¹ many states like Kansas, Missouri, and Oklahoma are seriously considering abolishing their income taxes to accelerate growth. And so now the left is fighting back.

CRITIQUES OF OUR RESEARCH

Institute on Taxation and Economic Policy (ITEP)

A new study by the left-leaning Institute on Taxation and Economic Policy (ITEP) challenges our conclusion that state taxes impact population, job, and income growth.² The ITEP researchers find that from 2001 to 2010, “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.” ITEP goes on to reject our findings by writing that “the growth of states lacking an income tax is no more than coincidental.”

We wonder if our critics really believe this to be true. Clearly, there are many factors that influence economic growth. But surely if location A lowers its tax rates and location B raises its tax rates, other things being equal, businesses, capital, and people will migrate from B to A, i.e., *to* where tax rates have fallen and *from* places where tax rates have risen. Does anyone really disagree with that premise?

ITEP researchers cherry pick from the nine states that make up the no-income tax states and the nine highest income tax states. Even with state tax rates being the enormously powerful drivers of growth that they are, it only stands to reason that some of the highest income tax states will, from time to time by chance or due to other factors—such as an energy or agricultural boom or bust, or increases in military spending which benefit states like California and Virginia—outperform some of the no-income tax states, just as some lifetime smokers will outlive some nonsmokers. But if you were a betting person, you would quickly figure out that nonsmokers, on average, are a helluva lot healthier than are smokers, and no-income tax states are far more likely to achieve prosperity than are high income tax states. It's as simple as that.

Just as a responsible parent would never encourage a child to smoke, so too a dedicated state official would never shackle the state citizenry with high income tax rates.

The six page ITEP analysis NEVER refutes the fact that the no-income tax states, on average, have higher, and, in some cases, *substantially* higher, growth rates in population, employment, tax revenues, and gross state product (GSP) over the past half century than the highest income tax states. That is because this is an indisputable fact.

Population Metric

Where we are totally at odds with ITEP is when they write that we should “control for population growth” ostensibly because they claim “population growth ... is decidedly not determined by state tax structures.” How silly can an argument be? What if one state had a 100% income tax and another state had a 0% income tax? Would they still believe that? Economist Richard Vedder of Ohio University, using a state analysis similar to ours, found that in the 1990s through early 2000s, an average of 1,000 people, each day of the year except Sundays, moved to the 10 lowest tax states.³ Do the researchers at ITEP believe this happened by chance?

Population growth differences among the states are precisely the key metrics that tax and other state policies really impact. Ignoring population growth differences among the states when analyzing state economic policies is like doing a study on the causes of lung cancer while ignoring whether people smoke or not. It just doesn't make any sense. In the exact same sense that smoking causes lung cancer, higher tax rates cause slower population growth and slower economic growth. And migration patterns between states tell a lot about where Americans think prosperity is happening and where it isn't. People aren't just moving out of Buffalo, Detroit, and Newark because it is cold.

By examining all the economic variables on a per person basis, i.e., controlling for population growth, ITEP tries to refute our findings. But this is an inappropriate statistical trick meant to fool non-experts. Both population and GSP, as ITEP points out repeatedly, grow much faster in no-income tax states. Therefore, when you look at GSP per capita, the numerator and denominator are both growing faster, and you can't know whether GSP per capita should rise or fall. Sometimes population will grow faster than the rise in GSP, and at other times it won't. Given ITEP and our other critics' obsession with per capita metrics, we are surprised they don't examine growth in population per capita. Nevertheless, whatever may happen on a per person basis, low tax rate states attract more people, jobs, and income than do high tax rate states.

One of our most vocal opponents, Professor Mickey Hepner, said, “I don't know about you, but if we have two million more people move to Oklahoma and we are poor as a result, I don't think that's progress, I don't think we're better off.”⁴ Of course, the problem with this

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statement is: why would the two million people move to Oklahoma in the first place if they became poor as a result?

But even this is a silly argument. The people in a state can all be better off even if its per capita or median income goes down. If, for example, 50,000 low income agriculture workers move into Texas, those workers' incomes almost surely go up (or else they wouldn't have moved there), the residents and business owners in Texas who benefit from their labor services are better off, and no one is worse off. But the per capita income in Texas may actually go down.

So, you may ask, what *does* account for population growth differentials according to ITEP?

Some of the explanations by the ITEP study border on the absurd. For example, the ITEP analysts say the reason that population growth is higher in no-income tax states is because: they are in the South, they are in the West, they have higher birth rates, and they have Hispanic immigration. As if Hispanics are somehow different from other Americans. And, if these reasons aren't enough for a laugh, how about "accessible suburbs?"⁵ Yikes! But, there's no mention of taxes, spending, right-to-work, or welfare generosity.

To quote ITEP, "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." Of course, we all know that taxes are not alone in explaining migration patterns among states, but let's be serious. The reasons ITEP gives for population growth are the academic equivalent of "the dog ate my homework."

Another argument used by our critics is that most of the growth we are capturing in our studies is in the southeastern region of the country (which is true), but then they go on to say that people are moving to states like Florida, Georgia, Tennessee, and Texas solely for the warm weather and "the sun," as they flee the cold northeastern states. ITEP argues that it is just a "coincidence" that the low and no-income tax states are in the South and the high income tax states are in the Northeast. Tax rates, they say, don't explain the migration patterns.

There's no doubt that a lot of people move to Florida and Georgia for the nice weather and beaches. These and other reasons are clearly factors that make these states desirable locations. We have even heard that a big factor behind the rise of the South is air conditioning, and we don't doubt there is more than a kernel of truth to that. But it's still true that those who say that people are primarily moving to the Southeast for the weather have never been to Georgia or Mississippi in the summer months.

One obvious problem with this south/west/sun explanation, however, is that it doesn't explain why New Hampshire does better than Vermont, or why Nevada does better than its cohorts, or why Washington does better than Oregon or why Tennessee does better than Kentucky. It doesn't explain why one of the states with the nicest weather year round in the nation, California, is bleeding to death. It doesn't even explain why Alaska, South Dakota, and Wyoming have seen big population gains—they are hardly warm weather southern states.

Just because people move for reasons other than taxes does not mean that they don't move for taxes as well.

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West Virginia and Nevada: Why Not to Use Per Capita Measures

The inherent problem with measuring GSP or income on a per capita basis is plainly visible when you examine two polar-opposite states: Nevada and West Virginia. First think of Nevada; a no-income tax state that, over the decade 2001 to 2010, has ranked 1st in population growth, 8th in GSP growth, 8th in personal income growth, and 9th in non-farm payroll employment growth. How's that for a rockstar state?

Nevada has been a magnet for people, jobs, and output for years, gaining another congressional seat during the 2010 congressional reapportionment. Nevada has also been extremely attractive to foreign immigrants, who usually have incomes below the average of native Nevadans.

Foreign immigration is certainly good for the immigrants, as they are likely able to enjoy higher wages and a higher standard of living. Foreign immigration is also a boon for native Nevadans, who enjoy all of the benefits from an inflow of lower-cost, high quality labor. But, according to ITEP's and others' preferred metric, Nevada ranked 48th in per capita personal income growth and 35th in median household income growth from 2001 to 2010.

On the other hand, take a state like West Virginia, which ITEP ranks #1 in median household income growth from 2001 to 2010. West Virginia has gone from comprising 0.79% of the nation's total personal income in the five years before it introduced a personal income tax in 1961, to comprising only 0.48% of the nation's personal income as of 2011—we certainly wouldn't consider these metrics of West Virginia the components of a prosperous state. People, jobs, and income have been fleeing this high tax state for a very long time, though the recent development of the Marcellus Shale oil field in towns like Wheeling are bringing rapid development as we speak.

But let's really look at ITEP's measure of West Virginia's and Nevada's prosperity in the clear light of day: One point to understand about changes in median income is to recognize that a state's median income is the income of the middle worker, where half of the people earn more and half of the people earn less. Median income will rise if low income workers lose their jobs or leave the state, which is what happened in West Virginia. Median income will fall if a large number of low income workers find jobs, which is what happened in Nevada.

West Virginia has experienced the polar-opposite of Nevada. In West Virginia over the past several decades, able-bodied lower and middle class workers and their families have been unable to find work in West Virginia and have fled the state for greener pastures elsewhere. Lower or no-income people are leaving the state more rapidly than higher income people. West Virginia's growth in median income has risen. As the state becomes more and more hollowed out, the last few stubborn "wealthy" families still remaining in West Virginia cause the median household income growth to rise. Surely you wouldn't call West Virginia a prosperous place.

It seems that neither Nevadans nor foreign immigrants mind their lackluster per capita ranking given that Nevada continues to attract people, both Americans and foreign immigrants, in droves. Nevada's low median household income growth and low per capita personal income growth are a result of lots of jobs for people at the low rungs of the economic ladder.

Instead, we argue that population growth is a highly revealing metric of future prosperity. People make the decision whether or not to move, and tax rates affect those decisions. People vote with their feet and generally don't migrate to places where they will be worse off. History shows this to be true over and over. People migrated from East Germany to West Germany, North Korea to South Korea, Mexico to the United States, not in search of better weather, but because that was where they could find freedom, opportunity, and raise their living standard.

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A simple question puts the immigration issue in perspective: Which would you rather have, people lined up on your state's border trying to get into your state or trying to get out of your state? Professor Hepner seems to be saying he would prefer the latter.

And by the way, while it is true that per capita GSP is generally higher in the high income tax states—like New York, California, and New Jersey—it is NOT TRUE that per capita GSP growth is consistently higher in those states. We have found that after looking at 40 years worth of data, sometimes the no-income tax states grow faster in GSP and jobs per capita, and at other times they don't. For example, in the 2001-10 period, per capita GSP grew 37.2% in the no-income tax states, and just 33.4% in the high income tax states.

Reverse Causation and Population

An unintentionally humorous argument put forth by ITEP and other critics of our work is that people move from one place to another just for the helluvit, and, of course, they take their incomes with them as a tagalong. This is exactly what ITEP argues.⁶ And then, sensing the coming prosperity, the states' legislatures and Governors cut their states' tax rates. Thus, it really is future prosperity that causes current tax cuts, not the reverse.⁷ This, they argue, is why we find a "spurious correlation" between growth rates and taxes.

In the words of Mickey Hepner, "the relationship is presumed to be changes in taxes lead to or determine the change in income levels, but in reality what we saw in the 1980s was just the opposite ... Again, it's not the tax cuts that led to the growth, it's the growth that led to the tax cuts." Hepner goes on to say "This is why a number of state economists have looked at this study ..." (our study of Oklahoma) "... and say this is not reliable in pointing the way for Oklahoma's future. In fact, I don't know of a single state economist that has supported and endorsed this [tax cut] plan."⁸

Mickey Hepner's comments imply that during bad times government raises tax rates and during good times they cut tax rates. Not only is this contrary to the logic of any school of economics we've ever seen—you can't tax an economy into prosperity—but it's also contrary to the facts. President Reagan cut tax rates in the heart of a recession/depression. President Kennedy cut tax rates in the worst period of a recession. President Harding also cut tax rates at the bottom of an economic cycle.

And even on the state level we have seen many examples of states that cut taxes during tough times and grew their economies. The best example of the last 30 years may be Michigan. The state was in a mini-depression in the early 1990s, and even in the midst of this economic crisis then-Governor John Engler cut tax rates more than at any time in the history of Michigan. The economy of this Rust Belt state boomed as a result for most of the 1990s and even at one point had an unemployment rate *below* the national average (hard to believe today). After Mr. Engler left office, his successor Jennifer Granholm raised taxes, and the long and deep slide that Michigan is experiencing now began anew. The same was true in New Jersey. The economy was in collapse in the early 1990s after James Florio raised taxes. Governor Christine Whitman cut tax rates by more than 20%, and New Jersey went through a mini-boom and had a budget surplus.

And as far as raising tax rates? It's only Hoover and Roosevelt who raised tax rates in a Depression and President Obama who is trying his level best to follow in Hoover's and Roosevelt's footsteps. When President Clinton raised income tax rates we were well into a boom.

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To Hepner and others, passage of California’s Proposition 13 in 1978 would have to have been the direct consequence of a vision of the 1980s future prosperity by the state’s clairvoyant legislators, led by then optimistic Governor Jerry Brown. Today, California—now led by a pessimistic Governor Jerry Brown—and its cyclopean politicians foresee their own state’s demise and are thus raising taxes. The next thing they’ll tell us is that having a baby causes sex nine months earlier.

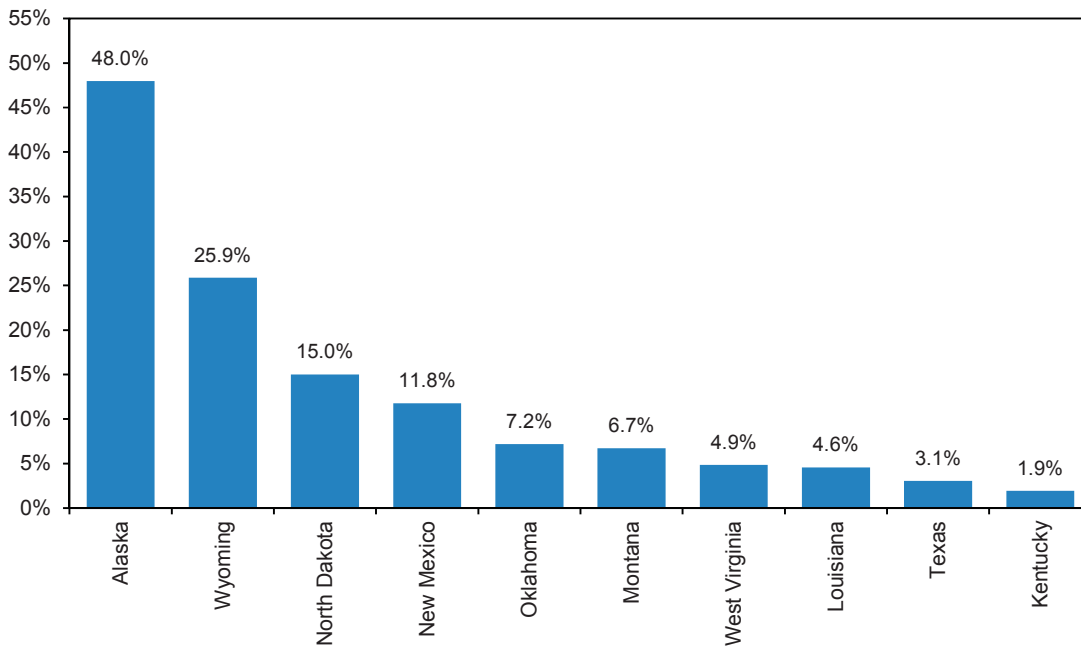
Oil, Sunshine, and Prosperity

Moore and Laffer, our critics say, don’t even take account of “oil and sunshine.” In all of our work we have specifically taken into account all sorts of other factors including “oil” and, yes, even “sunshine.” As shown in *Eureka!*,⁹ if the three highest severance tax states—Texas, Alaska, and Wyoming—are eliminated from the comparison of no-income tax states with all states and the highest tax states, the six remaining no-income tax states are still way ahead of the U.S. average and even further ahead of the highest income tax rate states in growth of income, employment, and population. And even in the past, when there was an oil bust and oil prices fell, the no-income tax states—including the oil states—outperformed the nation and the highest tax states (see *Figure 1*).

But of course oil and sunshine do matter. North Dakota’s population and economy is booming today, not because of its tax code, but because it has massive amounts of new natural gas and oil operations. Our rebuttals to our critics’ oil comments notwithstanding, our detractors still persist in arguing that no-income tax states tend to be energy rich states—like Alaska, Texas, and Wyoming—and that this is the real reason no-income tax states are doing well. If true, then our critics should explain the performances of New Mexico, Oklahoma, Montana, West Virginia, and Louisiana, all of which have more oil severance tax revenue than Texas (*Figure 2*).

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**Figure 2: Top 10 Severance Tax States:
Severance Taxes as a % of Total State and Local Tax Revenue**
(percentage, period 2000-2009)



Source: U.S. Census Bureau, Laffer Associates

The 11 States that Adopted a Progressive Income Tax

But probably our most conclusive test to account for a whole host of other factors was looking at what happened to the 11 states that introduced a progressive income tax over the past half century before and after their introduction of the progressive income tax. To be precisely clear, here we're looking at the exact same state before it had an income tax and *after* it adopted an income tax. We look at each state's share of total U.S. GSP and population for the average of the five years prior to the introduction of the state's progressive income tax and then for the most recent year, 2011.

To quote from *Eureka!*, "What we find absolutely astonishing is how the size of the economy in each one of these states has declined as a share of the total U.S. economy, compared to a time just prior to when each state introduced its income tax. Some of the declines are quite large."¹⁰ Needless to say, ITEP and our other critics never mention this result displayed prominently in our publications. It is a factual stake through their misinformed heart (*see Table 2*).

Right-to-work states far outperform closed shop or forced union states; states with high welfare payments, per eligible person, have lower growth; and estate and corporate taxes and overregulation also negatively affect growth.

Table 2: Economic Consequences from the Introduction of the State Income Tax

	Share of Total U.S. GDP	Share of Total U.S. Population	Share of Total U.S. State Tax Revenue
11 States, Average of 5 Years Prior to Income Tax Introduction*	33.0%	31.0%	27.8%
11 States in 2011 [†] *	22.5%	23.1%	24.6%
Change	-10.5%	-7.9%	-3.2%

[†] "Share of Total U.S. State Tax Revenue" is 2010 due to data limitations

* The 11 states are CT, NJ, OH, RI, PA, ME, IL, NE, MI, IN and WV. Due to gross state product data limitations, West Virginia's economic activity is measured as a share of national personal income

Source: Bureau of Economic Analysis, U.S. Census Bureau, Laffer Associates

Don't tell us Ohio, Michigan, Maine, West Virginia, Pennsylvania, Illinois, Indiana, Connecticut, New Jersey, Rhode Island, and Nebraska have all of a sudden gotten a lot cloudier and run out of oil reserves.

Other Economic Factors Our Critics Overlook

What ITEP also misses in its maniacal focus on oil, sunshine, and reverse causality are what we have found to be other important growth factors: right-to-work states way outperform closed shop or forced union states (*Table 3*); states with high welfare payments per eligible person also have lower growth (*Table 4*); estate and corporate taxes and overregulation also negatively affect growth.¹¹ These factors are about as straightforward and common sense as anything can be, and yet ITEP and our other critics never mention them even though they have been shown over and over again to be key factors in determining growth.

IRS Data, Moving Van Data and State Migration

We and lots of other people have examined Internal Revenue Service (IRS) and Census Bureau data covering at least two decades on people who move from one state to another. Looking at the past six years worth of data—from 2005 to 2010—we have the number of tax filers

Table 3: 22 Right-to-work States vs. 28 Non Right-to-work States*

	Growth Rates, 2001-2010			
	Gross State Product	Population	Non-farm Payroll Employment	Personal Income
22 Right-to-work States*	52.3%	12.1%	3.0%	48.4%
50 State Average**	45.4%	8.8%	0.6%	42.3%
28 Non Right-to-work States*	40.0%	6.2%	-1.2%	37.5%

* equal-weighted average, IN not included as a RTW state because the law had not passed during this time period
 ** equal-weighted average, does not include D.C.

Source: Bureau of Economic Analysis, U.S. Census Bureau, Bureau of Labor Statistics, Laffer Associates

Table 4: Nine States with Lowest Welfare Generosity vs. Nine State with Highest Welfare Generosity

	2009 [†]	Growth Rates, 2001-2010			
	Welfare Spending per Person in Poverty (end of period)	Gross State Product	Population	Non-farm Payroll Employment	Personal Income
9 States with Lowest Welfare Payments per Person in Poverty*	\$ 6,558.73	45.7%	15.0%	1.3%	45.9%
50 State Average**	\$ 11,448.71	45.4%	8.8%	0.6%	42.3%
9 States with Highest Welfare Payments per Person in Poverty*	\$ 18,773.77	38.9%	4.4%	-1.2%	36.4%

[†] 2009 instead of 2010 due to data limitations
 * equal-weighted average
 ** equal-weighted average, does not include D.C.

Source: Bureau of Economic Analysis, U.S. Census Bureau, Bureau of Labor Statistics, Laffer Associates

Americans are packing up and moving into low tax states and moving away from high tax states and taking their incomes along with them.

who moved from the nine highest tax states to the nine no-income tax states, their aggregate adjusted gross income and the average income per filer. We then have these same data for filers who moved from the nine no-income tax states to the nine highest tax states.

By now it should come as no surprise that far more tax returns—416,000 more—are from people moving to the no-income tax states from the highest income tax states than people moving to the high income tax states from the no-income tax states. Not only are there more tax returns moving from the highest to the no-income tax states than the reverse, but the average adjusted gross income of those moving to the no-income tax states is far higher than is the average adjusted gross income of those moving from the no-income tax to the highest income tax states. The data show clearly that Americans are packing up and moving into low tax states and moving away from high tax states and taking their incomes along with them (*Table 5*).

Table 5: IRS State-to-state Migration Data*

	Sum, 2005-2010		2005-2010
	Aggregate Adjusted Gross Income (\$000,000s)	# of Returns Filed	Average Adjusted Gross Income Per Filer
Filers in the 9 Zero Income Tax States Who Previously Filed in the 9 Highest Income Tax States	\$ 72,857.70	1,325,374	\$ 54,971.43
Filers in the 9 Highest Income Tax States Who Previously Filed in the 9 Zero Income Tax States	\$ 39,523.11	909,176	\$ 43,471.35
Net Difference	\$ 33,334.59	416,198	\$ 11,500.08

* one year's worth of IRS migration data are created by matching individual tax returns from one year with the next year. For example, the first year in the sums above, 2005, comes from filers' 2004 returns matched with those same filers' 2005 returns.

Source: Internal Revenue Service, Laffer Associates

We've also examined the United Van Lines data on where people move from and where they move to. Low tax states are huge net destination points and high tax states are population repellers (*Tables 5 and 6*).

Table 6: United Van Lines Migration Data

	Sum, 2007-2011			
	Inbound Shipments	Inbound as a % of Total	Outbound Shipments	Outbound as a % of Total
8 Zero Income Tax States*	204,072	53.0%	180,638	47.0%
8 Highest Income Tax States**	197,155	47.7%	216,469	52.3%

* 8 states rather than 9 because United Van Lines does not ship to Alaska

** 8 states rather than 9 because United Van Lines does not ship to Hawaii

Source: United Van Lines, Laffer Associates

In fact, reflecting net migration patterns, the rates moving van companies such as U-Haul charge are sometimes far lower for the few people who move to a high tax state like California from a low tax state like Tennessee than for the large number of people who move in the opposite direction. In 2008, for example, the cost to rent a full-sized U-Haul truck to move from Los Angeles, California to Nashville, Tennessee was \$4,285—more than six times the \$557 cost of moving in the opposite direction. Similarly, it cost \$4,254 to rent a full-size truck from Los Angeles, California to Austin, Texas, yet only \$407 for the reverse trip. Today, it costs \$2,312 to rent a U-Haul truck from Trenton, New Jersey to Houston, Texas but only \$905 going the opposite way; Philadelphia, Pennsylvania to Nashville, Tennessee costs \$1,380, but Nashville, Tennessee to Philadelphia, Pennsylvania costs only \$788.¹² Price data don't lie.

Oklahoma

In his analysis of Oklahoma's recent prosperity, Professor Hepner and his academic colleagues in Oklahoma don't give any credit to Oklahoma's major income tax rate cuts from 2005 to

2009, or the adoption of right-to-work by Oklahoma in 2001.¹³ And yet they all, to a person, use Oklahoma’s recent period of economic prosperity as a reason not to cut tax rates rather than as proof of what tax rate cuts can do. To quote Mickey Hepner:

[W]e see that the Oklahoma economy is already doing pretty well. In fact, we are doing better than most of the states that don’t have a personal income tax ... Since 2000, Oklahoma’s per capita personal income has grown at the seventh fastest pace in the nation, faster than seven of the nine states that lack a personal income tax ... So, I am concerned that eliminating the income tax won’t generate the payoffs that the proponents are claiming that it will generate.¹⁴

What Mickey Hepner doesn’t say is that the Oklahoma economy underperformed the aggregate U.S. economy in the years 1998, 1999, 2000, 2002, 2003, 2004, and 2005—seven out of the eight years from 1998 through 2005. And what happened after the Oklahoma tax cuts? The Oklahoma economy outperformed the aggregate U.S. economy in 2006, 2007, 2008, and tied in 2009 and then fell behind again in 2010 and 2011.

For the whole period 1997 through 2005, prior to Oklahoma’s income tax rate cut, Oklahoma’s real GDP grew 18.9% versus U.S. growth of 28.2%. And after Oklahoma’s income tax rate cut from 2005 to the present, Oklahoma’s real GDP grew by 11.3% versus U.S. growth of 5.4%. Coincidental? We don’t think so. Tax cuts help.

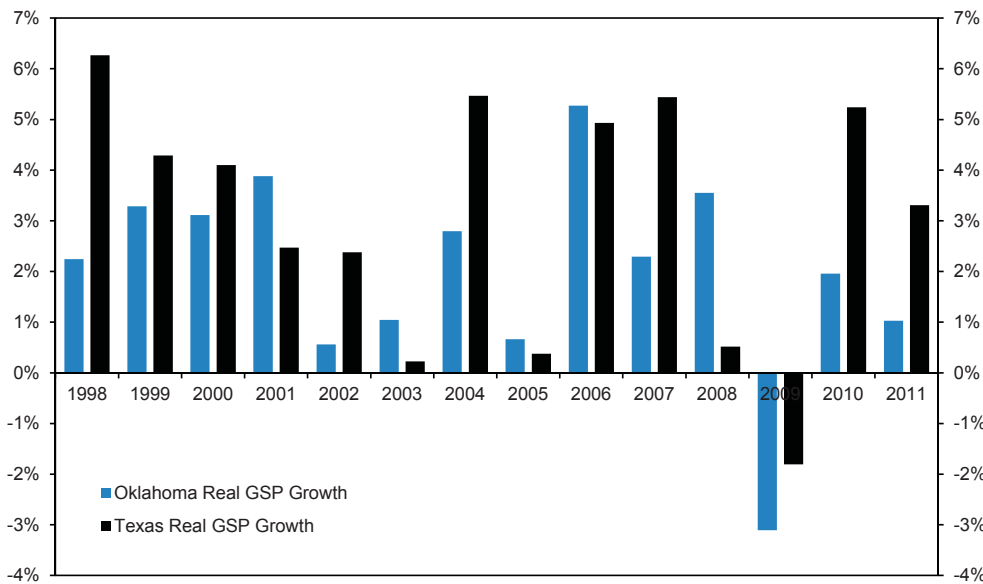
But now let’s take Hepner’s chosen mortal combatant for Oklahoma—TEXAS. Hepner states:

And I can tell you with great glee and with great joy, that by all three of those metrics, per capita growth and the state economy, per capita personal income growth, median household growth, we are thumping Texas and it’s not even close.¹⁵

Here’s the real record from 1998 through 2011:

For the whole period 1997 through 2005, prior to Oklahoma’s income tax rate cut, Oklahoma’s real GDP grew 18.9% versus U.S. growth of 28.2%. And after Oklahoma’s income tax rate cut from 2005 to the present, Oklahoma’s real GDP grew by 11.3% versus U.S. growth of 5.4%.

Figure 3: Real Gross State Product Growth: Oklahoma vs. Texas
(annual, percentage, period 1998-2011)



Source: Bureau of Economic Analysis

From Figure 3, Texas outperformed Oklahoma in the 1997-2005 period by 28.4% to 18.9%, respectively. And then in the 2005-2011 period Texas once again outperformed Oklahoma by 18.7% to 11.3%, respectively.

Using IRS data from U.S. income tax returns for the six years 2005 through 2010 (the latest data available), 2,217 more tax filers moved from Oklahoma to Texas than from Texas to Oklahoma, and the average adjusted gross income of the filers who moved from Oklahoma to Texas was \$3,455 higher than the average adjusted gross income of filers who moved from Texas to Oklahoma (*see Table 7*).

Table 7: IRS State-to-state Migration Data: Oklahoma vs. Texas*

	Sum, 2005-2010		2005-2010
	Aggregate Adjusted Gross Income (\$'000,000s)	# of Returns Filed	Average Adjusted Gross Income Per Filer
Filers in Texas Who Previously Filed in Oklahoma	\$ 2,695.29	58,302	\$ 46,229.79
Filers in Oklahoma Who Previously Filed in Texas	\$ 2,399.02	56,085	\$ 42,774.66
Net Difference	\$ 296.27	2,217	\$ 3,455.12

* one year's worth of IRS migration data are created by matching individual tax returns from one year with the next year. For example, the first year in the sums above, 2005, comes from filers' 2004 returns matched with those same filers' 2005 returns.

Source: Internal Revenue Service, Laffer Associates

Just because federal tax rates matter more than state tax rates for the whole U.S. economy, doesn't mean state rates don't matter. In fact, conceding that federal tax rates matter guarantees that state tax rates also matter. Taxes are taxes after all.

Is this really what Hepner means when he says "...we are thumping Texas and it's not even close"?¹⁶ But no. Hepner goes on to say even more. He says:

In short, we don't have to be more like Texas to beat them, we are already doing that. In fact we are doing it so badly I often wonder why they are not trying to be more like us, because the lessons are showing that we are outperforming them.¹⁷

Upon reflection we would ask Mickey Hepner, if income tax rates shouldn't be cut or eliminated, just how high should they go? Why not replace all other taxes with higher income taxes? Other than being steadfastly opposed to any reduction in either state spending or income taxes, what do Mickey Hepner and the others have to offer? So far—nothing.

Other Criticisms of Cuts in State Income Taxes

Our critics also say that federal tax rates, because they are so much higher than state tax rates, matter more than state tax rates. And, for some purposes, this may well be true. You would have to hunt far and wide to find someone more opposed to the higher tax rates Mr. Obama has proposed than we are. But just because federal tax rates matter more than state tax rates for the whole U.S. economy, doesn't mean state rates don't matter. In fact, conceding that federal tax rates matter guarantees that state tax rates also matter. Taxes are taxes after all.

The same Professor Mickey Hepner referred to earlier uses an idiosyncrasy of federal tax codes to argue that income and property taxes should be used more not less because they are deductible on federal tax returns. Maybe this is why New York, California, Vermont, and New Jersey are doing so well. It is true that federal tax policy rewards states for raising their income

taxes by allowing these state taxes to be deducted from federal taxes, but this is an argument for eliminating that deduction. How is it fair that residents in a low income tax state that is fiscally responsible and spends its money wisely (say New Hampshire), have to pay more income tax than someone of equal income from a high-income tax state (say California) that squanders resources?

Based on economics, an important reason why the income tax should be eliminated rather than eliminating other taxes is that the income tax directly impacts the marginal or incremental incentive to work and innovate. No other major state tax has anything like the marginal impact an income tax has. On a dollar-for-dollar basis, the income tax is far and away the most deleterious tax to output, employment and production of the major taxes.

ITEP and others point out that the progressive state income tax takes from those who can most afford to pay taxes, and that any cut in the income tax would “shift the tax burden away from the highest earning people ... to more on the backs of the lower-income and middle class families.”¹⁸ This argument used by Professor Hepner and all opponents of income tax cuts is called the “reverse Robin Hood” effect.

But as we have tried to explain, progressive income taxes don't redistribute income, they redistribute people. The income tax literally protects the wealthiest among us and prohibits the poorest members of our society from becoming wealthy. Wealthy people don't pay taxes on their wealth. Warren Buffett, for example, may be worth \$50 billion, which is mostly in the form of unrealized capital gains which has never been and never will be taxed.¹⁹ His children and Bill and Melinda Gates own separate charitable foundations, to which Warren Buffett contributes tax free. In 2010, Warren Buffett, using the Congressional Budget Office's (CBO) definition of income, had comprehensive income of close to \$12 billion yet reported paying taxes of less than \$7 million on reported adjusted gross income of a smidgeon under \$40 million. His effective tax rate was about 6/100ths of 1 percent (0.0006). The ITEPs and Mickey Hepners of this world don't ever suggest taxing him. It goes on and on.

While federal tax codes are generally quite similar in all 50 states, state and local tax codes can be substantially different from state to state.²⁰ Therefore, if someone is going to move from one state to another for tax reasons, it seems clear that state and local taxes should be the deciding factor. It is one heckuva lot easier for a business or family to move from one state to another than from one country to another.²¹

CONCLUSION

To end this discussion on a serious note, the two of us really wonder just what type of evidence it would take to get these people to admit they just might be wrong. For us, if the nine zero income tax states consistently underperformed the nine highest tax states, the very foundation of our beliefs would be shaken. If each of the 11 states that adopted progressive income taxes increased their growth rates relative to the rest of the nation, we would be left wing converts applying to ITEP or the University of Central Oklahoma's College of Business for jobs.

By the way, we're not even sure that liberals believe their own rhetoric on the effect of state taxes on growth. One reason the left and Barack Obama want the federal government to give tens of billions of dollars to states for hiring teachers, hiring fire fighters, and for building roads rather than states raising and spending the money themselves, is that they know that

Based on economics, an important reason why the income tax should be eliminated rather than eliminating other taxes is that the income tax directly impacts the marginal or incremental incentive to work and innovate.

states are precluded economically on competitiveness grounds from raising their own taxes significantly. Some on the left derisively call this the “race to the bottom.” But why would there be a tax-cutting race to the bottom if taxes don’t affect behavior and migration?

Or consider another example: The left has been arguing for a long time—and so have retailers—that internet sales should be taxed because people will buy things on the internet if they can buy them tax free. Wait, if taxes don’t effect behavior, why should it matter? And states have tried to persuade the federal government to require *all* states to tax internet purchases so that the states that do impose those taxes are not losing firms and sales to states that do not. Why do high tax states like New York, California, Illinois, New Jersey, and others spend so much tax enforcement money trying to find out whether high income residents spend 183 days in Florida or Tennessee to avoid income taxes? If income taxes don’t matter, why would people try to pretend they live in no-income tax states? We all know people who will not set foot in California or New York for more than 182 days of the year to avoid the tax levy.

Taxes make an activity less attractive, and therefore, people will do less of that activity. If government taxes people for working and pays people not to work, don't be surprised if more people choose not to work.

But not only do the state data confirm our view of the world of the 50 states, the relationships between country growth rates and country economic policies also confirm our world view. Time series of countries and time series of states also show the same results. And then there are the studies of specific states and specific taxes, again confirming our view.

We ask ourselves, is there any amount of disconfirming data that would ever cause these people to change their minds? We’re reminded of the quote from the late logician Bertrand Russell:

Persecution is used in theology, not in arithmetic, because in arithmetic there is knowledge, but in theology there is only opinion. So whenever you find yourself getting angry about a difference of opinion, be on your guard; you will probably find, on examination, that your belief is getting beyond what the evidence warrants.²²

But changing tax rates is all about economic dynamics and incentives. People don’t like doing things they find unattractive, and they do like doing things they find attractive. Taxes make an activity less attractive, and therefore, people will do less of that activity. If government taxes people for working and pays people not to work, don’t be surprised if more people choose not to work.

And when it comes to the poor, the minorities and the disadvantaged, incentives matter as much as they do for anyone else. Taxing rich people and giving the money to poor people will increase the number of poor people and reduce the number of rich people. The dream in America has never been to make the rich poorer. It has always been to make the poor richer. The best form of welfare is a good, high-paying job, and the best tax for creating jobs is a low-rate flat tax.

To all of this Professor Hepner responded with one of the most curious arguments we had ever heard. It wasn’t more than two months after Professor Hepner made his argument that President Obama took Mickey Hepner’s words almost verbatim for his own. Here’s what Hepner said:

[T]he wealthy don’t become wealthy on their own. They became wealthy as part of a system, as a part of a country that supported and educates its populous, that provides roads, that allows commerce to take place, that supports the infrastructure of the city, the state and this nation.²³

And then Professor Hepner and President Obama go on to say that the wealthy owe their success to government and should pay higher tax rates.

The first logical fallacy with Hepner's and Obama's inference from an obviously correct observation is that government didn't provide the "system" of resources, the taxpayers and the private sector did. The second fallacy is that everyone had an equal chance to use all of the resources our society provided. Those resources were provided for everyone, not just for those people who used them well. As a result, there is no reason why those who used our publicly available resources well should be required to pay proportionally more than those people who didn't use our publicly available resources as well. And this then leads to the third fallacy of making those who use our publicly available resources well pay disproportionately more. Taxing the people who use our publicly available resources more will only assure less aggregate wealth and progress for future generations, i.e. less publicly available resources in the future.

Let us say loud and clear: Of course, Americans want to live in states with good schools, clean parks, safe neighborhoods, good roads, prisons that keep the criminals off the streets and all the vital services that state and local governments provide. But that doesn't mean that the level of taxes and the way taxes are imposed doesn't matter too. There's no guarantee that high taxes mean good schools. Just consider New Jersey, California, Washington, D.C., or Chicago with rotten schools but very high expenditures. Utah and Iowa have good schools spending much less. Moreover, our research finds that states with no income taxes raise revenues at a faster pace than states with high income taxes—a point that our critics have never refuted, because they can't.

In any case, our state analysis is intended to help advise lawmakers on the best pro-growth policies to help their citizens. They cannot, alas, change the weather or where their state is located, or have much of an impact on how much oil they have in the ground, but they certainly can change their taxes, how much state and local governments spend, whether their state is a right-to-work state and how generous their state's welfare system is. The quality of schools also matters as does the state's highway system, but it takes years for those policies to pay dividends, while cutting taxes can have a near immediate and permanent impact, which is why we have advised Oklahoma, Kansas, and other states to cut their income tax rates if they want the most effective immediate and lasting boost to their states' economies.

ITEP inadvertently seems to concede the broader point that we have made for years that the Northeast is becoming like Europe and the economic gazelles in the U.S. are in the South. We have always argued that it isn't just tax rates that matter. Government spending matters, the level of regulation matters, whether the state has a right-to-work law matters a lot too. The Northeast is losing ground to the South because it has much more statist control of the economy than do the southern states. It's not an accident that the auto industry has left the Midwest for the South and that Airbus is opening up its new plant in the South.

The Northeast is falling further and further behind, and the South is booming. One of the biggest factors behind that phenomenon is that the South, on a whole variety of economic policy variables we have examined, is a region much more receptive to business and worker rights than the high tax, heavily unionized Northeast. The future is happening in the low-tax South while high-tax California, New York, and Illinois are increasingly looking like the Greece of North America. The wonder is why Mr. Obama wants the country to adopt the tax policies of the loser states, and not the winners.

The future is happening in the low-tax South while high-tax California, New York, and Illinois are increasingly looking like the Greece of North America.

And then there's always government spending. In his defense of the status quo on government spending we turn once again to Professor Mickey Hepner:

But we could also cut government spending, and this is a concern to me. As an educator, I know that what really matters for business vocation is the ability of us to train the workforce, the ability of us to provide the necessary services that the companies need. It's hard for me to imagine a successful economy that's populated with unhealthy, uneducated individuals who often have to travel down dirt roads populated with criminals.²⁴ **LC**

ENDNOTES

- ¹ For a partial bibliography, see “Arthur B. Laffer and Wayne Winegarden, “State Economics: Who Has the Facts?” Laffer Associates (21 Feb. 2012).
- ² “‘High Rate’ Income Tax States Are Outperforming No-Tax States,” Institute on Taxation and Economic Policy (Feb. 2012). <http://www.itepnet.org/pdf/junkeconomics.pdf>
- ³ Richard Vedder, Ph.D. “Taxing Texans: A Six-Part Series Examining Taxes in the Lone Star State, Part 3,” Texas Public Policy Foundation (12 Apr. 2002). <http://www.texaspolicy.com/sites/default/files/documents/2002-04-12-tax-taxingtexans3.pdf>
- ⁴ Mickey Hepner is a University of Central Oklahoma faculty member and dean of the College of Business. Hepner’s remarks are from the State Chamber of Oklahoma’s “Tax Policy Forum” (9 May 2012). Watch the debate here. <http://youtu.be/uMnKdMHxYTU>
- ⁵ “‘High Rate’ Income Tax States Are Outperforming No-Tax States,” ITEP.
- ⁶ Here’s what they wrote: “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.”
- ⁷ In academic circles, this phenomenon of a future event causing a current event is called the fallacy of “post hoc ergo propter hoc.”
- ⁸ Mickey Hepner, State Chamber of Oklahoma’s “Tax Policy Forum” (9 May 2012).
- ⁹ Arthur B. Laffer and Wayne Winegarden, *Eureka!*, Pacific Research Institute (Mar. 2012).
- ¹⁰ *Ibid.*
- ¹¹ Arthur B. Laffer and Wayne H. Winegarden, “The Economic Consequences of Tennessee’s Gift and Estate Tax,” The Laffer Center for Supply-Side Economics and Beacon Center of Tennessee (Mar. 2012). <http://www.laffercenter.com/2012/03/economic-consequences-tennessees-gift-estate-tax/>
- ¹² U-Haul price data were collected from www.uhaul.com.
- ¹³ Oklahoma cut tax rates starting in 2005 from a high of 7% in 2004 to today’s 5.5% rate.
- ¹⁴ Mickey Hepner, State Chamber of Oklahoma’s “Tax Policy Forum” (9 May 2012).
- ¹⁵ *Ibid.*
- ¹⁶ *Ibid.*
- ¹⁷ *Ibid.*
- ¹⁸ *Ibid.*
- ¹⁹ For more on Warren Buffett and taxation, see: Arthur B. Laffer, “Warren Buffett’s Call for Higher Taxes on the Rich,” Laffer Associates (3 Jan. 2012). Summarized in: Arthur B. Laffer, “Class Warfare and the Buffett Rule,” *The Wall Street Journal* (11 Jan. 2012).
- ²⁰ Not surprisingly, federal taxes can vary across states even when the federal tax codes don’t change. The Alternative Minimum Tax (AMT) is much more impactful in high tax states because state tax payments are a “preferred deduction” and therefore not allowed in the calculation of the AMT tax base. There is at least one state that allows federal taxes as a state deduction, and federal taxes allow state tax deductions if the filer itemizes.
- ²¹ For some people, federal taxes have become so onerous that they have renounced their citizenship specifically for tax reasons. It has become an issue of national concern of late of wealthy Americans who are renouncing their citizenship and moving abroad for tax reasons. In this light, ITEP’s contention that no one moves from one state to another for tax reasons is a stretch, to say the least.
- ²² Bertrand Russell, *Unpopular Essays*, 1950.
- ²³ Mickey Hepner, State Chamber of Oklahoma’s “Tax Policy Forum” (9 May 2012).
- ²⁴ *Ibid.*



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