Eliminating Louisiana's Income Taxes Will Hurt the State's Economy

By David Gray

Gov. Bobby Jindal's proposal to eliminate Louisiana's corporate and personal income taxes relies on a fundamentally flawed economic analysis and is likely to hurt the state's economy, not boost it as supporters claim. Proponents of the governor's proposal are relying on a report called "Rich States, Poor States" to sell their plan to the public. But the report contains numerous distortions and omissions:

- While it claims that 62 percent of net U.S. job growth between 2002 and 2012 occurred in nine states with no income taxes, it fails to note that just one of those states, Texas, accounted for most of that job growth. The remaining eight states did not significantly differ from the rest of the country in job creation.
- The report fails to mention that Texas' performance is largely due to factors unrelated to taxes, like its abundance of natural resources and geographic location along the trade-rich Mexican border.
- States with income taxes that are higher than Louisiana's perform better on several important economic and quality-of-life indicators than their no-income-tax counterparts. For example, those states have greater median household incomes, higher household disposable incomes and more widespread health insurance coverage – none of which should be true if taxes were a primary factor in economic activity and well-being.
- State income taxes play a negligible role in business location and hiring decisions. Doing away with them will simply drain more resources from schools, health care, public safety and the other foundations of a strong economy, which are much more important to businesses looking to expand or relocate.

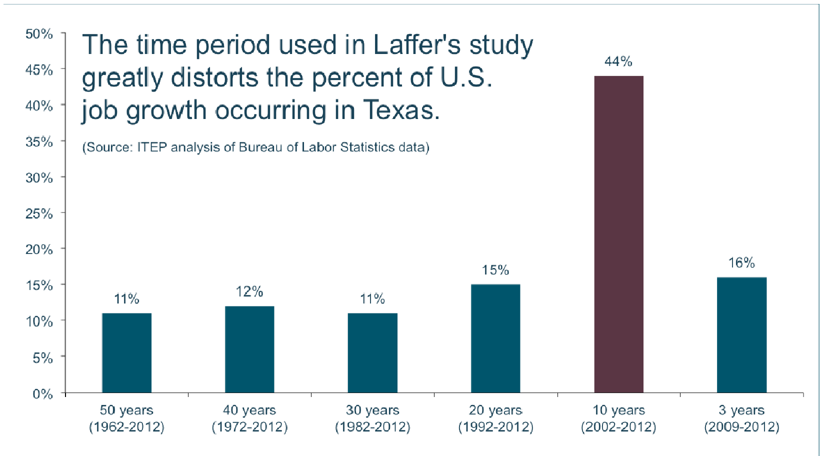
The vast majority of the governor's tax plan would benefit less than 2 percent of Louisiana's companies, according to an analysis of tax information published by the Louisiana Department of Revenue. The overwhelming majority of small businesses, start-ups and entrepreneurs are unlikely to experience any tax savings. The windfall for those that do see savings is likely to be too small to allow more hiring or investments. In any case, there is no evidence that businesses add jobs because of income tax cuts. Furthermore, substantially increased sales taxes – which the governor would use to recoup revenue losses under his plan – are likely to reduce demand for goods, which would reduce production.

Instead of eliminating income taxes and levying the highest sales taxes in the nation, the task for Louisiana's elected officials is to seek ways to raise revenues beyond current levels and invest in public services like education, health care, transportation and public safety. These investments have a far greater potential to build the state's economy and improve prosperity and well-being than the proposed income tax breaks.

A Flawed Theory

Proponents of the governor's plan propagandize an economic analysis by economist Arthur Laffer for the American Legislative Exchange Council.[i] According to Laffer's report "Rich States, Poor States," the nine states without an income tax accounted for 62 percent of the net new jobs in America between 2002 and 2012.

But Laffer's report is riddled with major flaws. First, it fails to note that Texas accounted for 44 percent of net U.S. job growth between 2002 and 2012 and 70 percent of the job growth among the nine states without income taxes.[ii] No other state without an income tax accounted for more than 7 percent of net U.S. job growth. In fact, leaving Texas out of the equation, the job growth rate in the other states without income taxes lagged behind their population growth rate, causing unemployment to rise.



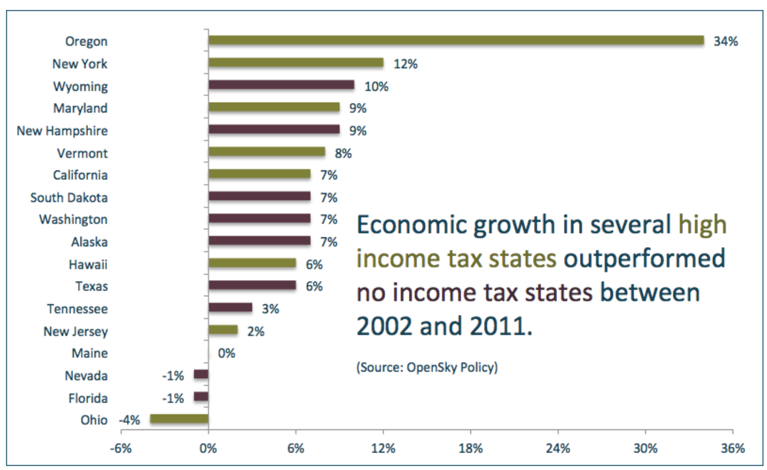
The report also fails to mention that Texas' unique characteristics had a greater impact on its job growth than the absence of income taxes.[iii] Texas' location along the Mexican border and its diverse population encourages trade and immigration, resulting in population and job growth. The availability of land for development and relatively tight lending regulations helped Texas avoid the real estate depression that continues to hurt many state economies. These factors play a much larger role in Texas' economy than taxes.

A longer-term perspective of job growth in the U.S. shows that Texas' performance during the 10-year time frame cited by Laffer is an anomaly rather than the norm. While Texas did indeed have a significant share of national job growth between 2002 and 2012, its share of U.S. job growth over the past 20, 30, 40, and 50 years was consistently between 11 and 16 percent – nowhere near the 44 percent reported by Laffer. Laffer exaggerated Texas' performance by choosing the time period that best suited his argument.

Economies of States with Income Taxes Do Better

One would expect no-income-tax states to score better on a range of indicators than states with relatively high income tax rates if income taxes were a primary factor in economic growth and family well-being. The opposite is true. A state-by-state comparison shows that sates with slightly higher income tax rates compared to others have more Fortune 500 company headquarters,[iv] greater median household incomes,[v] larger median hourly wages[vi] and more disposable income for workers.[vii] States with higher income taxes also score better than low-tax Louisiana on these indicators.

Moreover, the economies of several states with comparatively higher income taxes outperformed no-income-tax states between 2002 and 2011.[viii] For example, Oregon's economy grew by 34 percent and New York's economy grew by 12 percent – compared to Texas, which grew by 6 percent, and Florida, which declined by 1 percent.

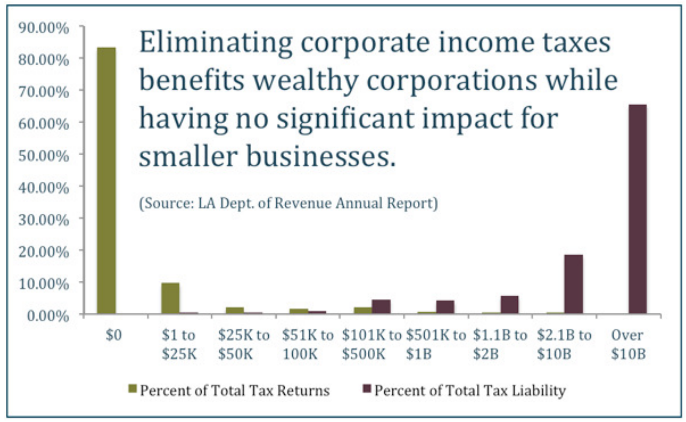


Higher income tax states also outperform their no-income-tax counterparts on two major quality-of-life measures: poverty and health insurance coverage. On average, a smaller proportion of residents in states with higher income taxes have incomes below or just slightly above the federal poverty line.[ix] In addition, the percentage of people without health insurance is much higher in states without income taxes.[x] Louisiana also lags behind states with higher income taxes on these measures.

Income Tax Cuts Won't Benefit Most Businesses

Eliminating income taxes provides very few benefits for large corporations, which consider numerous factors when deciding where to locate factories, offices and distribution centers. These include the skill and education of workers, labor costs, access to transportation and other services, and factors that are specific to that business or industry (for instance, a natural gas processing plant will locate in an area with nearby natural gas supplies).[xi] Income taxes are a small portion of overall business costs and rarely the deciding factor when corporations determine where to make major investments.

Income tax cuts have even fewer benefits for small businesses, start-ups and entrepreneurs. Four of every five Louisiana businesses make profits too low to owe corporate income taxes.[xii] In fact, the wealthiest 1.5 percent of businesses is responsible for 94 percent of the tax. Eliminating corporate income taxes would benefit wealthy corporations while having no significant impact on virtually every small business.



While small business owners and entrepreneurs often choose to pay individual income tax rather than corporate tax, personal income tax cuts are equally as inconsequential for these individuals. Very few would see enough savings from an individual income tax cut to hire an additional employee or make significant economic investments in their communities.[xiii]

Indeed, businesses overwhelmingly make hiring decisions based on the demand for their products, not the taxes they pay. Generally, the more they sell, the more workers they need to keep up with demand.[xiv] Increased sales taxes under the governor's plan could mean decreased demand for products, leading to less job growth.

The Evidence Is Clear: Income Tax Breaks Don't Grow State Economies

It is clear that eliminating income taxes will not grow Louisiana's economy or improve the quality of life of Louisianans. The Laffer report is severely flawed, the majority of business owners in Louisiana would not gain any benefit, and those that do would not receive enough extra revenue to hire additional employees.

The economies of states without income taxes perform worse on average than states with income tax rates that are relatively higher than others. The latter have more Fortune 500 companies, and workers in these states earn greater median hourly wages and have more disposable income. Higher income tax states also have lower proportions of their population in poverty and higher proportions with health insurance.

Eliminating income taxes and levying the highest sales taxes in the nation is not going to improve Louisiana's economy. A better way to create jobs and promote widespread prosperity is to raise new revenues and invest in public services that have potential to build the state's economy - like education, health-care, transportation and public safety.

APPENDIX A: HIGH AND LOW TAX STATE COMPARISONS

Appendix A, Table 1

States with high corporate income taxes perform better on economic indicators than states with no income taxes.

State	Corporate Income Tax Rate	Number of Fortune 500s	Median Household Income	Per Capita Disposable Income	Median Hourly Wage
Louisiana	4%-8%	3	$41,734	$35,308	$14.77
States with High Corporate Income Tax Rates					
Iowa	6%-12%	3	$49,427	$37,406	$14.99
Pennsylvania	9.99%	23	$50,228	$37,647	$16.71
Minnesota	9.80%	19	$56,954	$39,257	$17.54
Illinois	9.50%	32	$53,234	$38,797	$16.95
Alaska	1.4%-9.4%	0	$67,825	$41,420	$20.65
Average		**15.4**	**$55,534**	**$38,905**	**$17.37**
States with No Corporate Income Tax Rates					
Nevada	None	4	$48,927	$33,536	$15.70
South Dakota	None	0	$48,321	$41,133	$13.78
Texas	None	52	$49,392	$36,631	$15.44
Washington	None	8	$56,835	$39,960	$19.30
Wyoming	None	0	$56,322	$43,194	$17.37
Average		**12.8**	**$51,959**	**$38,891**	**$16.32**

Appendix A, Table 2

States with high individual income taxes perform better on economic indicators than states with no income taxes.

State	Individual Income Tax Rate	Number of Fortune 500s	Median Household Income	Per Capita Disposable Income	Median Hourly Wage
Louisiana	2%-6%	3	$41,734	$35,308	$14.77
States with High Individual Income Tax Rates					
Hawaii	1.4%-11%	0	$61,821	$39,073	$17.44
California	1%-10.3%	53	$57,287	$38,308	$18.52
Oregon	5%-9.9%	2	$46,816	$33,361	$16.90
New York	4%-8.97%	50	$55,246	$43,524	$19.02
New Jersey	1.4%-8.97%	21	$67,458	$45,850	$19.01
Iowa	0.36%-8.98%	3	$49,427	$37,406	$14.99
Vermont	3.55%-8.95%	0	$52,776	$37,714	$16.36
Average		**18.42857143**	**$55,833**	**$39,319**	**$17.46**
States with No Individual Income Tax Rates					
Alaska	None	0	$67,825	$41,420	$20.65
Florida	None	16	$44,229	$36,173	$14.79
Washington	None	8	$56,835	$39,960	$19.30
Wyoming	None	0	$56,322	$43,194	$17.37
Nevada	None	4	$48,927	$33,536	$15.70
South Dakota	None	0	$48,321	$41,133	$13.78
Texas	None	52	$49,392	$36,631	$15.44
Average		**11.42857143**	**$53,122**	**$38,864**	**$16.72**

Appendix A, Table 3

States with high corporate income taxes perform better on quality of life indicators than states with no income taxes.

State	Corporate Income Tax Rate	Percent Without Health Insurance	Percent of Population Below 100% FPL	Percent of Population Below 125% FPL
Louisiana	4%-8%	17.5%	20.4%	25.8%
States with High Corporate Income Tax Rates				
Iowa	6%-12%	8.9%	12.8%	17.0%
Pennsylvania	9.99%	10.1%	13.8%	18.0%
Minnesota	9.80%	8.8%	11.9%	15.7%
Illinois	9.50%	13.1%	15.0%	19.7%
Alaska	1.4%-9.4%	20.1%	10.4%	14.5%
Average		**12.2%**	**12.8%**	**17.0%**
States with No Corporate Income Tax Rates				
Nevada	None	21.9%	15.9%	20.9%
South Dakota	None	11.9%	13.9%	18.7%
Texas	None	23.0%	18.4%	24.1%
Washington	None	14.2%	13.9%	18.2%
Wyoming	None	15.4%	11.3%	14.9%
Average		**17.3%**	**14.7%**	**19.4%**

Appendix A, Table 4

States with high individual income taxes perform better on quality of life indicators than states with no income taxes.

State	Individual Income Tax Rate	Percent Without Health Insurance	Percent of Population Below 100% FPL	Percent of Population Below 125% FPL
Louisiana	2%-6%	17.5%	20.4%	25.8%
States with High Individual Income Tax Rates				
Hawaii	1.4%-11%	7.1%	12.1%	15.5%
California	1%-10.3%	18.1%	16.6%	22.0%
Oregon	5%-9.9%	15.7%	17.5%	22.5%
New York	4%-8.97%	11.4%	15.9%	20.4%
New Jersey	1.4%-8.97%	13.1%	10.4%	13.8%
Iowa	0.36%-8.98%	8.9%	12.8%	17.0%
Vermont	3.55%-8.95%	6.6%	11.5%	16.1%
Average		**11.6%**	**13.8%**	**18.2%**
States with Low Individual Income Tax Rates				
Alaska	None	20.1%	10.4%	14.5%
Florida	None	20.9%	17.0%	22.6%
Washington	None	14.2%	13.9%	18.2%
Wyoming	None	15.4%	11.3%	14.9%
Nevada	None	21.9%	15.9%	20.9%
South Dakota	None	11.9%	13.9%	18.7%
Texas	None	23.0%	18.4%	24.1%
Average		**18.2%**	**14.4%**	**19.1%**

[i] Arthur Laffer (American Legislative Exchange Council): Rich States, Poor States.

[ii] Institute on Taxation and Economic Policy: Laffer's new Job Growth Factoid is All Rhetoric and No Substance.

[iii] For more information, see Elizabeth McNichol and Nicholas Johnson (Center on Budget and Policy Priorities): The Texas Economic Model: Hard for Other States to Follow and Not All It Seems.

[iv] CNN Money: Annual Ranking of America's Largest Companies, 2012.

[v] U.S. Department of Commerce, U.S. Census Bureau: 2011 American Community Survey 1-Year Estimates (DP03).

[vi] U.S. Department of Labor, Bureau of Labor Statistics: May 2011 State Occupational Employment and Wages.

[vii] U.S. Department of Commerce, Bureau of Economic Analysis: Personal Income, Per Capita Personal Income, Disposable Personal Income, and Population (SA1-3, SA51-53).

[viii] OpenSky Policy Institute: Personal Income Tax Cuts Don't Spur Economic Growth. The data represents growth in real GDP per capita between 2002 and 2011 (Source: US Bureau of Economic Analysis Data)

[ix] U.S. Department of Commerce, U.S. Census Bureau: Poverty Status by State (POV46).

[x] U.S. Department of Commerce, U.S. Census Bureau: 2011 American Community Survey 1-Year Estimates (DP03).

[xi] Missouri Budget Project: Corporate Tax Rates do not Drive Business Decisions, Rate Cuts Could Impede Economic Growth.

[xii] Louisiana Department of Revenue: 2011-2012 Annual Tax Collection Report.

[xiii] Michael Mazerov (Center on Budget and Policy Priorities): Cutting State Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies.

[xiv] Douglas Elmendorf (Congressional Budget Office): Policies for Increasing Economic Growth and Employment in 2012 and 2013.