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Dispelling the Myth: State Individual Income Taxes Do Not Control Economic Growth

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As the 2011 Missouri legislative session moves forward, there is substantial interest in various proposals that would eliminate the Missouri individual income tax and replace it with a much expanded sales tax. Proponents of these measures consistently assert that eliminating the individual income tax will foster an enhanced rate of economic growth by somehow making a state that does this more "business friendly." This analysis looks objectively at data on state economic and population growth to determine if there exists any positive correlation between having no or very limited state income tax and rates of economic and population growth.

State Economic Growth

There are several statistics that may be used to measure state economic growth. The most comprehensive statistic that is currently available is "Gross State Product Per Capita" (GSP) adjusted for inflation. This is a relatively new statistic that is estimated by the U.S. Department of Commerce-Bureau of Economic Analysis. This statistic is designed to measure the value of all goods and services produced in a state, adjusted for both population changes as well as price changes. This data series runs from 1997 through 2009, the most recent year available.

The table below compares state economic growth as measured by the GSP with income tax collections in all fifty states.[1] **What becomes immediately clear is that there is no consistent relationship between state income tax and state economic growth.** In fact, between 1997 and 2009, the states that rely on an income tax, on average, obtained a state product growth rate that was substantially similar to the average growth rate seen in the non-income tax states.

Per Capita Gross State Product[2] Versus Income Tax Collections 1997 through 2009

Rank	State	1997 Real Per Capita GSP	2009 Real Per Capita GSP	Percent Change	Ind. Income Tax as % of Income, 2008	Per Capita Income Tax 2008[3]
1	WY	$42,840	$65,199	52.19	0.00	$0
2	ND	$29,765	$44,970	51.08	1.19	$495
3	SD	$29,985	$44,261	47.61	0.00	$0
4	OR	$30,986	$41,435	33.72	3.57	$1,313

[1] The table displays two measures of state income tax collections that are designed to show the degree to which the states utilize this revenue source. One measure is "Per Capita State Income Tax Collections." This measure takes total state income tax collections and divides them by state population. The second measure is "State Income Tax Collections as a Percent of State Personal Income." This takes total state income tax collections and divides them by total state personal income. Both measures show substantially similar state rankings.

[2] U.S. Department of Commerce-Bureau of Economic Analysis

[3] *State Rankings 2010,* CQ Press, Kathleen O'Leary and Scott Morgan, p. 338.

5	OK	$30,004	$39,881	32.92	2.07	$765
6	CA	$36,567	$46,992	28.51	3.46	$1,524
7	ID	$25,200	$32,082	27.31	2.86	$942
8	VT	$28,953	$36,789	27.06	2.55	$1,003
9	MD	$36,081	$44,917	24.49	2.53	$1,226
10	VA	$37,687	$46,609	23.67	2.90	$1,298
11	IA	$33,444	$41,247	23.33	2.49	$951
12	MA	$40,792	$50,023	22.63	3.74	$1,910
13	MT	$26,989	$32,859	21.75	2.55	$899
14	RI	$33,527	$40,572	21.55	2.48	$1,036
15	NY	$41,123	$49,976	21.53	3.90	$1,878
16	NH	$33,663	$40,566	20.51	0.20	$89
17	NE	$35,728	$42,605	19.25	2.41	$969
18	KS	$33,595	$39,913	18.81	2.62	$1,053
19	MN	$37,733	$44,600	18.20	3.44	$1,487
20	CO	$39,902	$46,199	17.85	2.36	$1,027
21	AZ	$29,917	$35,000	16.99	1.52	$524
22	ME	$29,596	$34,535	16.69	3.00	$1,097
23	WA	$39,377	$45,881	16.52	0.00	$0
24	AR	$27,406	$31,769	15.92	2.50	$818
25	WV	$26,011	$30,124	15.81	2.66	$837
26	AL	$27,996	$32,390	15.70	1.94	$658
27	NJ	$43,299	$49,840	15.11	2.82	$1,455
28	CT	$49,162	$56,389	14.70	3.49	$1,998
29	PA	$34,082	$39,033	14.53	2.05	$828
30	NM	$30,010	$34,360	14.50	1.82	$611
31	LA	$37,364	$42,755	14.43	1.87	$712
32	HI	$39,701	$45,308	14.12	2.83	$1,200
33	MS	$25,675	$29,225	13.83	1.72	$528
34	UT	$32,394	$36,759	13.47	2.92	$951
35	FL	$31,420	$35,653	13.47	0.00	$0
36	TX	$38,217	$43,032	12.60	0.00	$0
37	WI	$34,150	$38,140	11.68	3.11	$1,180
38	NC	$35,248	$38,437	9.05	3.35	$1,189
39	DE	$56,254	$61,248	8.88	2.82	$1,149
40	IN	$33,257	$36,168	8.75	2.17	$757
41	IL	$40,028	$43,378	8.37	1.86	$804
42	AK	$60,589	$63,846	5.38	0.00	$0
43	TN	$33,149	$34,828	5.07	0.13	$47
44	OH	$35,236	$36,421	3.36	2.37	$854
45	KY	$31,257	$32,149	2.85	2.51	$812
46	**MO**	**$34,719**	**$35,594**	**2.52**	2.34	**$859**
47	NV	$41,644	$42,319	1.62	0.00	$0
48	SC	$30,379	$30,845	1.53	2.25	$742
49	GA	$36,520	$36,252	-0.73	2.59	$912
50	MI	$34,803	$32,839	-5.64	2.03	$718

Average Growth 1997 -2009
Non-Income Tax States: 19.44%
Income Tax States: 16.59%

Two of the non-income tax states, Wyoming and South Dakota, ranked near the top of GSP growth; however, **the non-income tax (or limited income tax) states of Alaska, Nevada and Tennessee all ranked in the bottom ten states.** Over the entire period studied here (1997-2009), the states that rely on an individual income tax grew on average 16.6 percent while the non- or very limited individual income tax states grew, on average, 19.4 percent; obviously a very small difference.

Some specific state comparisons:

Oregon vs. Washington: These are two similar size states that border one another in the northwest tip of the United States. Oregon has no sales tax, but instead levies a relatively high state income tax of $1,313 per capita, the seventh highest in the nation. Conversely, Washington has no income tax, instead relying on its sales tax, which generates $1,728 per capita, the second highest in the nation. **The data show that Oregon, the income tax state, had the fourth highest economic growth rate while Washington ranked 23rd.**

Missouri vs. Tennessee: Proponents of the Mega Sales tax often cite Tennessee as a state tax system that Missouri should emulate. Tennessee combines a limited state individual income tax with the sixth highest general sales tax per capita to fund its state government. Tennessee also levies the 17th highest corporate income tax per capita at $161. From 1997 through 2009, the data show that Tennessee ranked 43rd in the nation in economic growth. To be sure, Missouri has also been a slow growth state over this period. However, Missouri ranked 46th, not far behind Tennessee. **Note also that real per capita GSP in Missouri has grown faster than Tennessee in 2007, 2008 & 2009.**

Wyoming: Wyoming is easily the nation's top coal producing state and accounts for about 40 percent of the nation's coal tonnage. The Wyoming economy has been the beneficiary of the nation's growing need for electricity along with the coal that is burned to generate electrical power. Wyoming is able to fund government services without an income tax because its severance tax (primarily on coal extraction) generates $1.2038 billion and accounts for 44.6 percent of its total state tax revenue.[4]

Summary

State economic growth is affected by a variety of factors. The data clearly indicate that there is no consistent or systematic correlation between a state's utilization of a state individual income tax and its rate of economic growth.

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[4] www.census.gov/govs/statetax/0951wystax.html