

No Correlation: Economic Growth and Tax Rates on the Rich

Decades of evidence show that the tax rates of high-income households are unrelated to economic growth. Tax cuts for the rich fail to boost the economy. Higher taxes on the rich do not impede economic growth, investment or job creation. Tax rates do not determine where people choose to live.

Instead, cutting taxes on the rich increases income inequality and reduces revenue needed to support education, health and human services and public safety.

Tax cuts for rich fail to grow economy and higher top rates don't impede growth

A substantial body of evidence shows that tax rates on high-income households — be they top marginal income tax rates or capital gains income tax rates — do not correlate with economic growth, investment or job creation.

Study of 65 years of tax and economic data

A recent study by the non-partisan Congressional Research Service (CRS), Congress's policy research arm, examined tax rates and economic growth since World War II. The study concluded:

changes over the past 65 years in the top marginal tax rate and the top capital gains tax rate do not appear correlated with economic growth. The reduction in the top statutory tax rates appears to be uncorrelated with saving, investment, and productivity growth. The top tax rates appear to have little or no relation to the size of the economic pie.¹

The CRS study, however, did find that the lowering of top tax rates appears to exacerbate income inequality by concentrating income among the rich.²

Study of 60 years of capital gains tax rates

"The heated rhetoric notwithstanding, there is no obvious relationship between tax rates on capital gains and economic growth," according to Leonard Burman, the Daniel Patrick Moynihan Professor of Public Affairs at the Maxwell School of Syracuse University and one of the nation's leading experts on capital gains taxation.³ In recent testimony to a congressional committee, Burman explained the absence of any "meaningful relationship" between top tax rates on long-term capital gains and real economic growth from 1950 to 2011. The analysis, he concluded,

should dispel the notion that capital gains taxes are a very important factor in the health of the economy. Cutting capital gains taxes will not turbocharge the economy and raising them would not usher in a depression.⁴

Oregon's failed capital gains tax cut experiment

Oregon's own experience demonstrates that cutting the income tax on capital gains fails to stimulate investment. In the mid-1990s, Oregon experimented with a program allowing certain investors, primarily investors in start-up companies, to defer Oregon income taxes on capital gains if the gains were reinvested in Oregon businesses. In a joint report, the Legislative Revenue Office, the Oregon Department of Revenue and the Oregon Department of Economic and Community Development (now the Oregon Business Development Department, a.k.a. "Business Oregon") concluded that the program "has not achieved [its] goal" of increasing investment in Oregon and "created few, if any, new jobs."⁵

Analysis of 50 States' Economic Performance

History shows that cutting taxes on high-income households does not stimulate growth and that raising taxes on high-income households does not inhibit growth

A recent study by Good Jobs First and the Iowa Policy Project analyzed how the American Legislative Exchange Council's (ALEC) State Economic Competitive Index — which ranks states with low taxes as most competitive — actually correlated with state economic performance from 2007 to 2011.⁶ The study found that a higher ALEC ranking (signifying lower taxes) had no connection with state economic growth. Moreover, the higher a state ranked on the ALEC list of low tax states, the more likely that state was to experience poor job creation and lower per capita income growth.⁷

Lack of correlation: historical cases

In addition to the research, history shows that cutting taxes on high-income households does not stimulate growth and that raising taxes on high-income households does not inhibit growth.

- **Strong growth following the Oregon Measure 66 tax increase.** In January 2010, Oregon voters enacted Measure 66, which raised the top marginal tax rate on high-income households. Yet in 2010 and 2011, when the highest temporary marginal rates were in place, Oregon's gross state product increased by a total of 13.2 percent.⁸ This was nearly three times the growth of the national economy and ranked second among all states.⁹
- **Strong growth with 90 percent top marginal tax rate.** In the 1950s, when the top federal marginal tax rate exceeded 90 percent, the national economy grew by more than 4 percent per year on average, when factoring in the effects of inflation. By contrast, the economy grew at less than half that rate during the 2000s, when the top marginal tax rate stood at 35 percent for most of the period.¹⁰
- **Weak growth following the Bush-era tax cuts.** In 2001 and 2003, Congress enacted legislation lowering the top federal marginal tax rate from 39.5 percent to 35 percent and cutting the income tax on capital gains and dividends.¹¹ However, the period from the end of the 2001 recession to the start of the Great Recession at the end of 2007 constituted the weakest economic expansion since the end of World War II.¹²

- **Weak growth among non-oil producing states that made large income taxes cuts in 2000s.** Of the six states that enacted large income tax cuts in the 2000s, before the Great Recession, three states saw their economies grow more slowly than the national economy. The three that grew more quickly than the national average were major oil-producing states, which benefitted from a sharp rise in oil prices following enactment of income tax cuts.¹³
- **Weak job growth and dismal personal income growth among the five states that cut income taxes the most in 1990s.** The five states that enacted large income tax cuts in the 1990s and did not follow them with tax increases in the 2000s on average experienced slower job growth than the average rate of other states during the economic expansion of the 2000s.¹⁴ Moreover, all five states saw their personal income growth lose out to inflation during the next economic cycle.¹⁵

All five states that enacted large income tax cuts in the 1990s saw their personal income growth lose out to inflation during the next economic cycle

Tax rates do not determine where people choose to live

Taxes rates don't matter much when it comes to where people choose to live, whether it's Oregon or any other state. Researchers examining the impact of state taxes on migration conclude that taxes, at most, play a very minor role. What really drives people to move is family connections, warm weather and economic considerations such as housing costs and job availability.¹⁶

California's millionaire tax: fewer millionaires migrated

A 2012 study by Stanford University researchers found no evidence that a 2005 California tax increase on income above \$1 million caused the state's wealthy to leave.¹⁷ To the contrary, the data showed that "the highest-income Californians were less likely to leave the state after the millionaire tax was passed."¹⁸ Unlike tax policy, a factor found to strongly affect the migration of the wealthy was a particular change in family circumstances: divorce.

New Jersey's half-millionaire tax: close to zero effect on migration

A 2011 study by the same Stanford University researchers found that New Jersey's so-called "millionaire tax" — a tax increase on taxpayers with income above \$500,000 enacted in 2004 — had "close to zero" effect on migration.¹⁹ The group affected by the tax and a group not affected (those earning between \$200,000 and \$500,000) exhibited virtually the same levels of movement in and out of New Jersey. The researchers also calculated that the tax increase generated \$3.77 billion in new revenue for the state over a three-year period. To the extent that the tax increase might have caused some wealthy people to move out, the cost to the state in terms of lost revenue was minimal.

40 years of Census data shows taxes don't affect elderly migration

In a study published in 2012, economists Jonathan Rork of Reed College and Karen Conway of the University of New Hampshire reviewed 40-years worth of Census data to determine the impact of state tax breaks on high-income elderly

Data specific to Oregon is consistent with the findings that taxes don't really impact people's decision of where to live

households.²⁰ They found no impact. As Rork explains, “[I]t doesn’t matter what, or how much, you exempt from income taxation, the data shows no impact on elderly migration — even when we looked solely at high-income earners.”²¹

The case of Oregon: tax rates don't matter

Data specific to Oregon is consistent with the findings that taxes don't really impact people's decision of where to live. Those who wish to cut taxes for the rich, including cutting the income tax on capital gains, wrongly assert that the state's tax structure drives people away. The data shows no such impact:

- **More capital gains earners and income move in than out of Oregon.** Analysis of Oregon Department of Revenue data from 2000 to 2009 shows that among taxpayers with capital gains income who move to and from Oregon, more moved into Oregon (4,357) than moved out (3,269). Each year, on average, those moving to Oregon collectively had more capital gains income (\$144 million) than those leaving (\$120 million). Thus, over those 10 years Oregon had an average yearly net gain of \$24 million in capital gains income.²²
- **The movement to Clark County, Washington, is minimal at most.** Among taxpayers with capital gains income, migration from Oregon to Clark County Washington, which has no income tax, is minimal at most. From 2000 to 2009, Oregon averaged per year 1.7 million Oregon taxpayers, both with and without income from capital gains. Of those, just 2 of every 10,000 (0.02 percent) had income from capital gains and moved to Clark County. Looking at 2009 in particular, out of nearly 1.8 million Oregon tax returns that year, just 97,000 reported capital gains income, and only 88 taxpayers with income from capital gains moved to Clark County. Of course, those who packed their belongings and moved across the river may have done so for reasons other than taxes, such as cheaper housing, job availability and family.²³

Tax cuts for the rich increase income inequality and reduce revenue

While tax cuts for the rich don't grow the economy, they do harm Oregonians by exacerbating income inequality and reducing state revenue.

Not surprisingly, researchers have found that tax cuts for the rich are associated with increased income inequality. The non-partisan CRS study of 65 years of data found a “strong negative relationship” between the top tax rates and the income shares accruing to the wealthy, suggesting that when top tax rates are cut, “income disparities increase.”²⁴ A separate study by the CRS found that cuts to the income tax on capital gains and dividends contributed significantly to widening income inequality between 1996 and 2006.²⁵ Again, such findings are not surprising, given the extreme concentration of capital gains income among people at the top of the income scale. In 2010, for example, the wealthiest 1 percent of taxpayers collected 70 percent of capital gains income in Oregon.²⁶

Cutting taxes on the rich also results in the loss of revenue to the state. For example, the Oregon Legislative Revenue Office estimated that cutting the income tax on capital gains to 4 percent would cost the state \$526 million over

the two fiscal years 2013-15.²⁷ To put such revenue loss in perspective, that's more than the total funding (\$442 million) that Oregon will provide to all 17 Community Colleges during the current (2011-13) two-year budget cycle.²⁸

Because the law requires that Oregon maintain a balanced budget, the revenue lost to a tax cut for the rich would — in the absence of a tax hike on some other group — require cutting the state budget by the same amount. More than 90 percent of Oregon's General Fund goes to pay for three things: education, health care and human services and public safety. Thus, to pay for the tax cut for the rich, Oregonians would endure cuts in one or more of those budget areas.

Conclusion

Sound policymaking requires acknowledging decades of evidence that tax rates on high income households have no correlation to economic growth, and that tax policy is, at most, a minor factor in where people choose to live. Acknowledging this means policy makers should reject proposals to cut taxes on the rich in the name of stimulating the economy. Research and experience show that tax cuts for the rich would not spur economic growth. Rather, tax cuts for the rich would exacerbate income inequality and result in the loss of revenue necessary to adequately fund education, health care and human services and public safety.

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Endnotes

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