

SELLING SNAKE OIL TO THE STATES

The American Legislative Exchange Council's
Flawed Prescriptions for Prosperity

ALEC
SNAKE
OIL
FOR THE
STATES

INSTANTANEOUS CURE  FOR THE U.S. ECONOMY

MANUFACTURED BY
THE AMERICAN LEGISLATIVE EXCHANGE COUNCIL

Selling Snake Oil to the States:

The American Legislative Exchange Council's Flawed Prescriptions for Prosperity

by

Peter Fisher

with

Greg LeRoy and Philip Mattera

A Joint Publication of:

Good Jobs First

and

The Iowa Policy Project

November 2012

© Copyright 2012 Good Jobs First and Iowa Policy Project.
All Rights Reserved.

Authors & Acknowledgements

Peter S. Fisher, Research Director of the Iowa Policy Project, is a nationally recognized expert on public finance and has served as a consultant to the Iowa Department of Economic Development, the State of Ohio, and the Iowa Business Council. His reports are regularly published in State Tax Notes and refereed academic journals. He is the co-author of *Industrial Incentives: Competition Among American States and Cities* (W.E. Upjohn Institute for Employment Research, 1998) and *State Enterprise Zone Programs: Have They Worked?* (Upjohn Institute, 2002) and author of *Grading Places: What Do the Business Climate Rankings Really Tell Us?* (Economic Policy Institute, 2005). Fisher holds a Ph.D. in Economics from the University of Wisconsin-Madison, and he is professor emeritus and former chairman of Urban and Regional Planning at the University of Iowa.

This report was prepared as part of a larger research project critically examining several state economic competitiveness rankings published by national organizations. The full report will be published in early 2013. The Iowa Policy Project gratefully acknowledges the support provided for this project from Good Jobs First.

Greg LeRoy and **Philip Mattera** are the executive director and research director, respectively, of Good Jobs First. LeRoy has consulted nationally for more than 25 years for state and local governments and for other non-profits and is the author of *No More Candy Store: States and Cities Making Job Subsidies Accountable* (FIRR, 1994) and *The Great American Jobs Scam: Corporate Tax Dodging and the Myth of Job Creation* (Berrett-Koehler, 2005). Mattera has also consulted nationally for more than 20 years and is the author of four books on business, labor and economics.

Good Jobs First

Good Jobs First is a non-profit, non-partisan resource center founded in 1998 to promote accountability in economic development and smart growth for working families. It is based in Washington, DC and includes Good Jobs New York in New York City. Good Jobs First, 1616 P Street NW, Suite 210, Washington, DC 20036. 202-232-1616, www.goodjobsfirst.org and info@goodjobsfirst.org.

The Iowa Policy Project

Formed in 2001, the Iowa Policy Project is a nonpartisan, nonprofit organization promoting public policy that fosters economic opportunity while safeguarding the health and well-being of Iowa's people and the environment. By providing a foundation of fact-based, objective research and engaging the public in an informed discussion of policy alternatives, IPP advances effective, accountable and fair government.

All IPP reports are available to the public, free of charge, at www.IowaPolicyProject.org.

Iowa Policy Project, 20 E. Market Street, Iowa City, IA 52245(319) 338-0773 or email at ipp@Lcom.net

Table of Contents

Executive Summary.....	p. i
Chapter 1. ALEC’s Economic Competitiveness Index Fails to Predict Growth.....	p. 1
Chapter 2. Prosperity: Its True Sources and Consistent Measures.....	p. 9
Chapter 3. State and Local Tax Rates are Not Significant Determinants of Growth.....	p. 12
Chapter 4. Taxes Have Little to do with Migration.....	p. 18
Chapter 5. Tax Cuts Reduce Revenue.....	p. 20
Chapter 6. Wage Suppression Policies Do Not Generate Prosperity.....	p. 23
Chapter 7. Utah: ALEC’s Winner Still Pays Companies for Jobs.....	p. 26
Chapter 8. Policy Conclusion.....	p. 29
Appendix. Results of Regression Equations.....	p. 30
Notes.....	p. 31

Executive Summary

This year marks the fifth anniversary of *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index*. Written by Arthur Laffer and others and published by the American Legislative Exchange Council (ALEC), *Rich States, Poor States* embodies the policy agenda that ALEC pushes to state legislators: reduction or abolition of progressive taxes, fewer investments in education and other public services, a smaller social safety net, and weaker or non-existent unions. These are the policies, ALEC claims, that promote economic growth.

A hard look at the actual data finds that the Alec-Laffer recommendations not only fail to predict positive results for state economies—the policies they endorse actually forecast worse state outcomes for job creation and paychecks. That is, states that were rated higher on ALEC’s Economic Outlook Ranking in 2007, based on 15 “fiscal and regulatory policy variables,” have actually been doing worse economically in the years since, while the less a state conformed with ALEC policies the better off it was.

That is true whether the outcome is growth in jobs or growth in per capita or median income. There is virtually no

relationship between the ALEC ranking and state Gross Domestic Product (GDP). Further examination of the predictive power of other key components of ALEC’s rankings (income tax rates, existence of an estate tax, overall tax levels, right-to-work status) shows that none had a statistically significant effect on growth in state GDP, non-farm employment, or per capita income.

Further analysis finds that key ALEC-Laffer claims contradict longstanding peer-reviewed academic research on how state economies grow.

- ALEC-Laffer claim that lowering state and local taxes produces much greater job growth; in actuality, such taxes are such a tiny cost factor for businesses, and come with higher taxes on others or lower quality public services, that such a strategy fails (see Chapter 3).
- ALEC-Laffer claim that a low top personal income tax rate is a key to small business success; in actuality, property and sales taxes—ignored by ALEC-Laffer—are far more important issues (see Chapter 1).

- ALEC-Laffer claim that high top personal income tax rates and the presence of estate and inheritance taxes cause large-scale out-migration of high-income individuals; in reality, migration has little to do with taxes, and there is no plausible case for state estate taxes affecting job-creating investment (see Chapters 3 and 4).
- The ALEC report asserts that state tax rates in many instances approach “Laffer Curve” territory, where tax cuts would actually increase tax revenue; in reality, tax cuts reduce revenue and result in the defunding of public goods such as education and infrastructure, which really do matter for economic development (see Chapter 5).
- ALEC-Laffer claim that wage suppression policies (anti-union “right-to-work” laws and the lack of a state minimum wage law) lead to greater job creation and prosperity; in actuality, such laws reduce wages and benefits but have little to no effect on job growth (see Chapter 6).

Overall, we find that *Rich States, Poor States* consistently ignores decades of published research, making broad, unsubstantiated claims and often using anecdotes or spurious two-factor correlations that fail to control for obviously relevant factors. Indeed, our analysis

finds that the report repeatedly engages in methodologically primitive analysis that any college student taking Statistics 101 would be taught to avoid.

Using consensus academic research, we derive far more plausible explanations for recent differences in state results. For example, instead of ALEC’s extreme policy recommendations, we find that the composition of a state’s economy—whether it has large or small shares of the nation’s fastest-growing industries—is a far better predictor of job and income growth.

We conclude that the evidence cited to support *Rich States, Poor States*’ policy menu ranges from deeply flawed to non-existent. Subjected to scrutiny, these policies are revealed to explain nothing about why some states have created more jobs or enjoyed higher income growth than others over the past five years.

In actuality, *Rich States, Poor States* provides a recipe for economic inequality, wage suppression, and stagnant incomes, and for depriving state and local governments of the revenue needed to maintain the public infrastructure and education systems that are the true foundations of long term economic growth and shared prosperity.

Chapter 1. ALEC's Economic Competitiveness Index Fails to Predict Growth

ALEC has been publishing its index since 2007. The obvious question, then, is: How well do the outlook rankings predict state economic performance since 2007? Rather than focus on the best and worst eight or ten states, as *Rich States, Poor States* is wont to do, we consider all 50 states, ranked from 1 as least competitive according to the 2007 index to 50 for the most competitive.¹ We will look at scatter plots showing the state's ALEC rank versus growth on various economic performance measures so that a trend line fitted to the data shows by its steepness whether higher-ranked states do better or worse on a particular measure. The five performance measures illustrated—non-farm employment, per capita personal income, population growth, state Gross Domestic Product (GDP), and state revenue—are the principal ones relied on by ALEC in its Economic Performance Ranking and in its discussions of state performance throughout its report.²

As the charts below show, the ALEC Outlook Ranking fails to predict economic performance on four key measures of growth. On the horizontal axis, the states are arrayed according to their ALEC ranking, from the “worst” state at position 1

to the “best” state at number 50. The vertical axis shows where each state fell on some measure of economic performance. If the ALEC outlook ranking worked as advertised, the trend line shown in each graph would slope up and to the right: the better a state's ranking, the better the performance. The correlation would be positive and significantly greater than zero (the maximum possible being a value of 1.0, which would be a perfect correlation).

Let's look first at a key measure of economic growth: change in state GDP. As Figure 1 shows, there is virtually no relationship between the ranking in 2007 and a state's five-year rate of growth in GDP; the correlation is insignificant at 0.02, almost zero. The states are all over the place, and there is no tendency for better ranked states to do any better or any worse than lower ranked states.

Next, consider the growth in non-farm employment, shown in Figure 2. Here the correlation is slightly stronger, but actually negative (-0.09): in other words, the higher a state was ranked on the A-L Index in 2007 the worse its job creation record over the next five years.

FIGURE 1. PERCENT CHANGE IN STATE GDP, 2007-2011

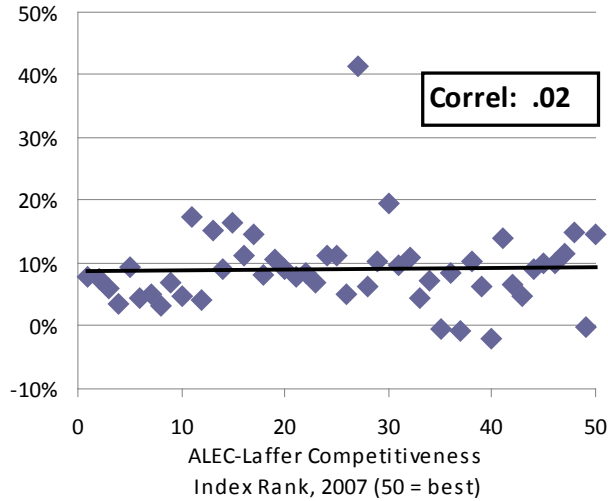
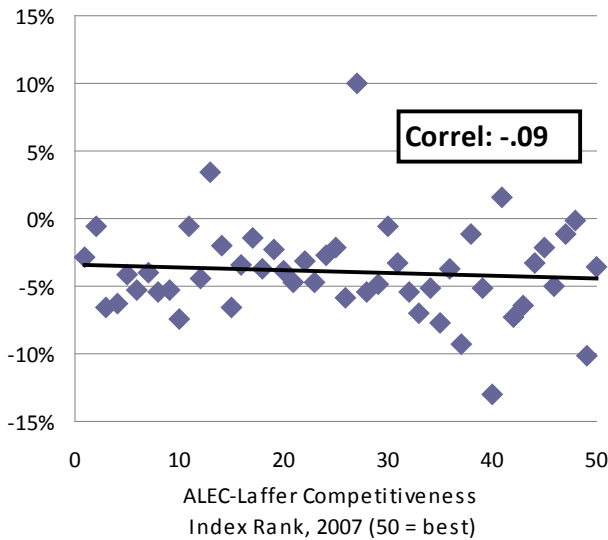


FIGURE 2. PERCENT CHANGE IN NON-FARM EMPLOYMENT, 2007-2011

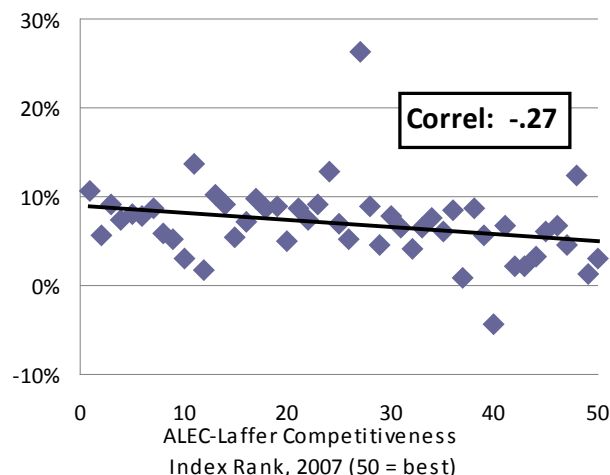


ALEC-Laffer Economic Outlook Ranking: The 15 Policy Components

1. Top personal income tax rate (lower is better)
2. Top corporate income tax rate (lower is better)
3. Personal income tax progressivity (flat rate is best)
4. Property taxes per \$1,000 of personal income (lower is better)
5. Sales taxes per \$1,000 of personal income (lower is better)
6. All other taxes per \$1,000 of personal income (lower is better)
7. Estate or inheritance tax (neither is best)
8. Recent change in total taxes per \$1,000 of personal income (cuts are better)
9. Tax or expenditure limits (the more limits the better)
10. State debt interest as a share of total revenue (lower is better)
11. Public employees per 10,000 residents (fewer is better)
12. State minimum wage (none is best)
13. Status as a “right-to-work” state (yes is best)
14. Workers’ compensation costs (lower is better)
15. Chamber of Commerce rating of state tort liability laws

Most tellingly, since the ALEC-Laffer report is about policies to enhance state prosperity, the 2007 Economic Outlook Ranking is actually a decent predictor of how state per capita income will change from 2007 to 2011—but in the opposite direction from what the report claims. The more “competitive” a state was according to ALEC, the less its per capita income grew (see Figure 3). The negative correlation of $-.27$ is statistically significant.³

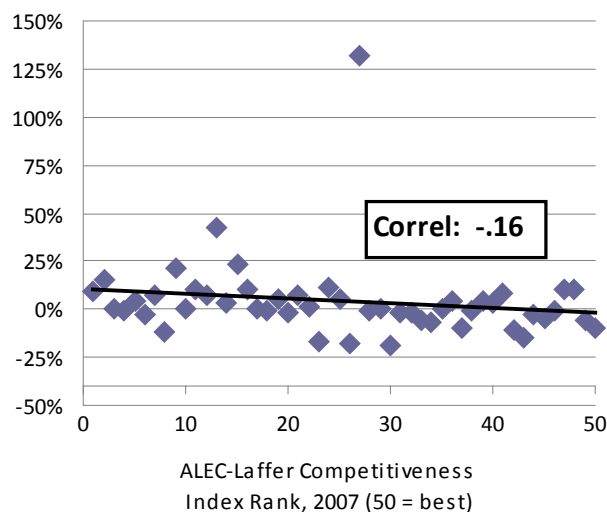
FIGURE 3. PERCENT CHANGE IN PER CAPITA INCOME, 2007-2011



Finally, Laffer et al claim that states that follow their policy prescriptions will experience more growth and higher incomes, which in turn will translate into greater government revenue. Not surprisingly, since we have already established that a high ranking on the Economic Outlook Ranking is actually associated with

lower job growth and lower incomes, the ALEC-Laffer claim about fiscal benefits is also contradicted by the evidence. As Figure 4 illustrates, the better a state was rated in the Economic Outlook Ranking, the smaller the growth in state and local revenue.

FIGURE 4. PERCENT CHANGE IN STATE & LOCAL GOVERNMENT REVENUE, 2007-2011



Population growth turns out to be the only measure on which the ALEC-Laffer Index performs as advertised: states ranked higher on the index in 2007 experienced greater population growth from 2007 to 2011. But population growth—the net effect of birth and death rates, out-migration and in-migration—is not a measure of economic performance. It may be driven in part by the economy, in that people should be drawn to states with more job growth, and better job opportunities as reflected in higher incomes. But this is

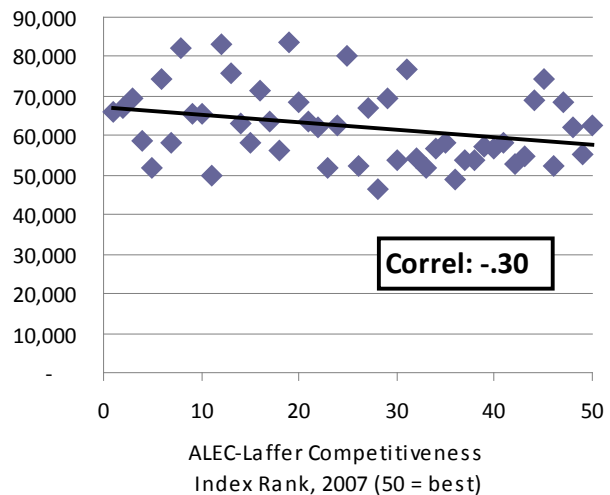
obviously not what is happening here, given that the states with better ALEC-Laffer rankings actually had worse job creation and income growth.

It makes sense as well to test the ALEC rankings against two other measures of the standard of living of the state's population: median family income and the poverty rate. The ALEC report, after all, purports to tell us what leads some states to become richer, others poorer. Here we consider both the level of income or poverty each year from 2007 to 2011 and the change in income or poverty over that period.

Once again, actual results are the opposite of the ALEC claim. The more a state's policies mirrored the ALEC low-tax/regressive taxation/limited government agenda, the lower the median family income; this is true for every year from 2007 through 2011; Figure 5 below shows the results just for 2011. The relationship is not only negative each year, it also became worse over time: the better a state did on the ALEC Outlook Ranking, the more family income declined from 2007 to 2011. The correlation, $-.30$, is statistically significant.

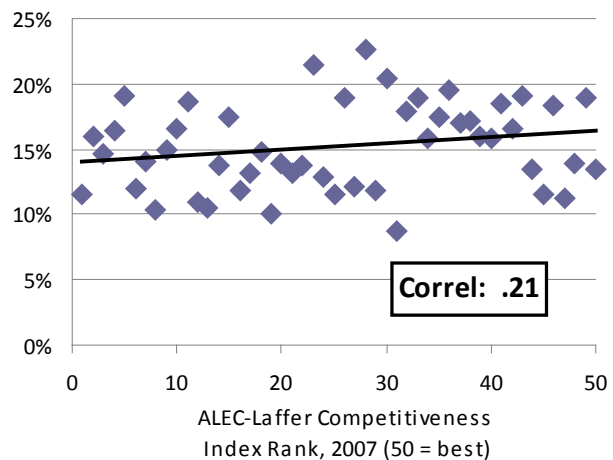
The story repeats itself when we consider state poverty rates. The more a state followed the Alec-Laffer policies, the higher its poverty rate, every year from 2007 to 2011. Figure 6 shows the relation for

FIGURE 5. MEDIAN FAMILY INCOME, 2011



2011. And again, the situation became worse over time: the more competitive a state according to the Economic Outlook Ranking, the more the poverty rate increased from 2007 to 2011. The correlation of $.21$ is marginally statistically significant.⁴

FIGURE 6. POVERTY RATE IN 2011



All of the above calculations represent a more accurate form of analysis than the methods of Laffer and company in *Rich States, Poor States*. Instead of focusing only on the top and bottom six or nine or ten states, where the cutoffs are selective and arbitrary, we consider all 50 states and compute a correlation coefficient. Still, while we demonstrate a negative relationship between ALEC's recommendations and a stronger economy, we do not pretend that such correlations establish causality. But Laffer argues that the relationship is so strong between the policies of *Rich States, Poor States* and beneficial outcomes that it will show up repeatedly in simple correlations. Clearly the evidence, when examined using a more objective and reliable approach, does not support this conclusion.

The Index Components Do No Better at Predicting Growth

The ALEC-Laffer Index fails to predict a state's success over the 2007-2011 period because it focuses on factors that matter little if at all. This becomes even clearer when we examine the individual components of the index, and compare their predictive ability to a factor that is much more relevant: state economic structure.

Consider the ALEC-Laffer component variables. In the 2011 edition, they focus particular attention on six that they say "have consistently stood out as the most important in predicting where jobs will be created and incomes will rise:" personal income taxes, corporate income taxes, the sales tax, estate and inheritance taxes, total taxes, and right-to-work laws. Do these factors actually help explain growth when the analysis controls for other possible causes through a more sophisticated statistical analysis?

Or does the overall economy matter more? State economies are thoroughly integrated within the national and international economies. One would expect that the state economies that did the best from 2007 through 2011 would be those best positioned to take advantage of high-growth national and worldwide markets, or whose economies are least exposed to declining sectors.

To test this argument, we looked at growth rates by major industry over this period and selected those that experienced the most growth and where there is substantial variation among states in terms of dependence on those industries. These sectors meet those criteria: mining; nondurable goods manufacturing; durable goods manufacturing; finance

and insurance; trade, transportation and warehousing; education and health services; and professional and scientific. If our hypothesis is valid, the share of state GDP accounted for by each sector in 2007 should predict how that state fared over the next five years. These shares were entered as variables in a multiple regression equation, and held against two variables deemed important by Laffer et al: total state and local tax revenue as a percent of state personal income over the period 2007-2009, and “right-to-work” status. This allows us to answer the question: Did the ALEC-Laffer variables reflecting state policy influence the rate at which states grew, holding constant the composition of the state economy?

They did not. Neither variable—total taxes or “right-to-work”—had a statistically significant effect on growth in state GDP, growth in non-farm employment, or growth in per capita income. The composition of the state economy, on the other hand, had a great deal to do with how fast a state grew, particularly in terms of jobs and per capita income. The share of the economy consisting of extractive industries (mining, oil) was a very significant determinant in all the statistical tests. This is consistent, of course, with many reports that as oil prices have risen, states with large oil reserves (e.g., North Dakota, Wyoming, Texas and Alaska) have experienced large increases in drilling and transmission-related jobs.

We also tested three tax components that Laffer insists are crucial determinants of how well a state economy performs: the top individual income tax rate, the top corporate income tax rate, and the existence of an inheritance or estate tax. When these components are substituted for the overall tax level, none explains why some states grew faster in terms of state GDP, non-farm employment, or per capita income from 2007 to 2011. The only variable that came close to statistical significance was the top individual income tax rate, but the effect was the opposite of the prediction by Laffer: the higher the rate, the greater the growth in per capita income (though again we would not argue causality). Neither did right-to-work status have any effect in any of the three models. Once again, the composition of the state economy was the major statistically significant factor. (For the results of all of the statistical tests described in this section, see the appendix.)

Similar results follow when the state’s overall Economic Outlook Ranking in 2007 is substituted for the tax variables and “right-to-work” status. This aggregate ranking, after all, purports to be a summary of all the policy variables contributing to growth. Once again, the composition of the state economy determined growth; the ALEC ranking had no effect.

Will the 2011 Economic Outlook Rankings perform any better in predicting economic prosperity over the next five years? There is little reason to think so. The ranking is based on the same measures,⁵ and it is still the case that the ranking is best at predicting lower incomes: the more “competitive” are state policies according to the 2011 ALEC ranking, the lower a state’s per capita income and median family income, and the higher the poverty rate, in 2011.

Small Businesses and Personal Income Tax Rates

Laffer and ALEC routinely invoke the “small businesses are hurt” argument against proposals to make the tax system less regressive. In *Rich States, Poor States*, their argument is that personal income tax increases affect many small business owners because they are organized as proprietorships or pass-through entities (partnership, S corporations, and LLCs) and therefore pay income taxes as persons, not corporations.

In fact, the personal income tax is more small-business friendly than the sales tax or the property tax. The sales tax hits the new, small, or marginally profitable businesses harder because it taxes business purchases: sales tax liabilities do not vary with profits. The property tax also can be more of a problem for the

new business; property taxes are due on business and personal property (which is often the collateral and the source of initial equity for many a new business) whether the business is in infancy and still struggling to earn a profit, or established and profitable. Income taxes, on the other hand, are low or nonexistent in the early years of a business when it is showing losses; they are payable only to the extent that a business has gotten off the ground and is generating a profit, and even then will often remain low, or nonexistent, for years as the early losses are carried forward. Clearly if a state wants to encourage entrepreneurship and help really small businesses, it should shift taxes from sales and property to income. But *Rich States, Poor States* would have us do the reverse. It’s another example of how ALEC and Laffer are fixated on progressivity (which most affects high-income individuals and larger corporations) and will employ any argument, valid or not, against it.

As evidence for the claim that “eliminating the personal income tax is good for state growth,” Laffer cites three academic studies.⁶ One, by Mark, McGuire and Papke, turns out not to be about state-level policy and growth as implied by Laffer but about local taxes and growth within a metropolitan area; furthermore, their research found no statistically significant relation between the personal income tax rate and population growth,

and did not even consider the effect of the personal income tax on job growth or business location.⁷ The second, by Timothy Bartik, estimated the effect of the corporate income tax, not the personal income tax, on new plant locations. Thus, contrary to Laffer's claim, neither of these two articles provides any support for his proposed elimination of the personal income tax. The third article, by Poulson and Kaplan, was not published in a peer-reviewed academic journal but rather in the house organ of the conservative think tank, the Cato Institute; it did not include controls for any of the major non-tax factors influencing growth (such

as wage rates and public expenditures) and cannot be considered a credible analysis of the independent effects of income tax rates.⁸

In summary, the policy prescriptions in *Rich States, Poor States* do nothing to explain why some states created more jobs than others, or why some states experienced more growth in income per person than others, over the past five years. Indeed, the policies that make up the ALEC-Laffer Economic Outlook Ranking are not a recipe for growth and prosperity, but more likely quite the opposite.

Chapter 2. Prosperity: Its True Sources and Consistent Measures

Rich States, Poor States is striking in its near-total failure to acknowledge the actual sources of state prosperity and of the role of state government in ensuring true economic development. A broad consensus holds that state economic policy should be aimed at improving the standard of living of the state's residents. But choosing the right measures of inputs and outcomes is critical before cause and effect can be debated coherently.

We agree with the ALEC-Laffer metric of rising per capita income but would also add other tests such as median family income, reduced incidence of poverty, greater stability and family economic security, and an improving quality of life as measured by public health or leisure time. On the other hand, while population growth may go along with prosperity—people naturally seek out places where their chances are better—it is not an end in itself. Also, growth in the economy, as measured by rising Gross State Product (GSP), is a crude measure of prosperity because GSP growth does not guarantee that the incomes of the average family will rise—that requires growth derived from rising wages and salaries. Similarly, more jobs will be needed if unemployment rates are to be lowered, but new jobs in themselves do not guarantee ris-

ing incomes; they must be good enough to raise the average or median wage, not lower it.

In the long run of economic history, the only way to achieve broadly shared prosperity is to increase productivity. In simple terms, more goods and services can be *consumed* per capita only if more goods and services can be *produced* per capita. Greater production per person, i.e. productivity, is achieved in four ways. First, investments in capital—buildings, equipment, infrastructure—make the economy more productive because they allow more goods to be produced with a given amount of labor and resources. For example, better highways mean goods can be shipped using less labor time and fuel. Second, technological advances increase the efficiency of production, allow new uses of existing resources, or create new products and services that directly raise the standard of living. Third, labor becomes more productive through investments in “human capital”—education and training—that increase the skills of workers. Finally, the overall productivity of the economy depends on labor and capital being used as fully as possible, and this requires full employment, and a labor force that remains healthy and on the job.

The public sector has important roles to play in creating the foundations for rising productivity and incomes. State and local governments play a crucial role in expanding capital investment as they have the major responsibility for maintaining and improving the transportation network. Streets and highways and transit are part of the capital that an economy needs, as are water and sewer systems, sea ports and airports, and other elements of infrastructure. State and local governments are also the primary providers of K-12 and community college education, and play an important role in worker training. Finally, states and counties are significant players in providing public health services and health insurance through insurance regulation and the funding of Medicaid and children's health insurance.

The importance of educational attainment in raising incomes has long been well documented. A recent study by a Federal Reserve Bank economist found that the education level of the workforce in a state was the primary determinant, along with the rate of patent applications, of growth in incomes from 1939 to 2004.⁹ Another research article studying differences among states in the rate of growth in personal income from 1967 to 1993 found that the more a state spent on education the greater the growth in personal income.¹⁰

While increasing economic productivity is a prerequisite for increasing prosperity, it does not guarantee that prosperity will be broadly shared. In fact, the period from 1979 to 2007 was characterized by growing productivity but also rising inequality: 40 percent of the gains in real income during this period were captured by the richest 1 percent of the population, and almost two-thirds of the gain in income went to the top 10 percent.¹¹ The logic of an unregulated market economy is that the gains go to those with the most leverage or bargaining power in the market. Thus again it is public institutions, including regulations aimed at mitigating monopoly power, laws strengthening the bargaining power of labor, or a tax system based on ability-to-pay, that help ensure that the gains from greater productivity are spread more broadly and not captured entirely by those at the top.

Despite the long-established body of evidence regarding the sources of growth, *Rich States, Poor States* consistently fails to acknowledge where state prosperity comes from and the vital role of state government investments in ensuring effective economic development. Its focus instead is on measures that would produce growth without development, or would merely facilitate the greater accumulation of wealth by those already the richest. By "growth without development," we mean an increase in GSP or jobs, where the gains are captured in higher profits rather than higher wages,

or where job gains are at the low end of the wage scale and displace better paying jobs. The ALEC-Laffer strategies are exclusively those that would lower taxes on corporations and the wealthy, reduce public sector revenues (and hence public investments in education, health and infrastructure), and lower wages by eliminating minimum wages and weakening the bargaining power of workers. Yet the book claims that all of these measures would make states, and their populations, richer.

The centerpiece of *Rich States, Poor States*, in fact the subtitle of the report itself, is the ALEC-Laffer State Economic Competitiveness Index, which consists of two separate state rankings, one based on past performance, the other allegedly portraying the outlook for future growth. (Despite the subtitle of the report, there is actually no Competitiveness Index that combines the two; there are simply the two rankings.) The Economic Outlook Ranking (EOR) combines state rankings on 15 “fiscal and regulatory policy variables” that the report claims have been shown to be significantly related to the ability of a state to compete successfully for business activity and growth. Each state’s overall ranking is based simply on the sum of its 15 rankings.

The Economic Performance Ranking (EPR) is based similarly on the sum of rankings on separate measures, in this case just three: absolute domestic mi-

gration, per capita income growth, and non-farm payroll growth between 2000 and 2010. It is not clear why the authors narrow the ranking to just these three measures since elsewhere in the report they focus considerable attention as well on other performance measures, notably growth in state Gross Domestic Product (GDP), overall population growth, and state and local government tax revenue.

To attain the highest EOR would require a state to have no individual or corporate income tax, no estate or inheritance tax, no state minimum wage, severe tax and expenditure limits and very limited public services. To attain high EOR it also would have to be a so-called “right-to-work state”—that is, it would deny employees the right to negotiate a union contract that requires all workers who benefit from the contract to share the costs of negotiating and enforcing it. We conclude that the actual purpose of *Rich States, Poor States* is to sell the ALEC-Laffer package of policies—fiscal austerity, regressive taxation and wage suppression—in the sheep’s clothing of economic growth.

In the following chapters we take a critical look at each of the core ALEC-Laffer policy claims and the research that allegedly supports them.

Chapter 3. State and Local Tax Rates are Not Significant Determinants of Growth

A report aimed at generating prosperity should focus on how to increase investment, public and private, how to strengthen labor productivity through education, or how to maintain an economy at full employment with a healthy labor force. And it would address how that prosperity is shared. Instead, the cumulative thrust put forth in *Rich States, Poor States* is to use the power of state government to lower the costs of doing business in the hopes that this will entice firms to move to or expand in one state at the expense of another. This beggar-thy-neighbor strategy is captured most completely in the authors' index of policies they claim produce growth, the EOR, a recipe for how to compete with your neighboring states for business. Foremost among the measures in this index are tax cuts. Lowering income and inheritance taxes, they assert, is the best way to lower the costs of doing business, and will lead to growth and prosperity. Will this strategy even work? Will tax cutting and wage suppression policies cause a state to grow more rapidly, at the expense of its neighbors? Here we look at what the research tells us about such a strategy.

A state strategy of tax cuts to lower the costs of doing business is focusing on a very small component of business costs.

Businesses take many factors into account when making an investment location decision: access to markets and to suppliers; transportation costs; access to a pool of labor with appropriate education and skills; wage rates; energy costs; occupancy costs (to buy or lease space); access to supporting business services; the quality of local schools, recreational amenities, climate and other amenities important in attracting and keeping skilled labor; proximity to university research facilities; quality of state and local government services and fiscal stability of government.

For service-sector companies, labor costs are the biggest cost; for sectors such as manufacturing or warehousing, the costs of physical plant space are also major expenses. By comparison, all state and local taxes on businesses combined (corporate and individual income taxes, sales taxes, local property taxes) represent only about 1.8 percent of total business costs on average for all states.¹² Corporate income taxes, in turn, are only about 9.5 percent of that 1.8 percent, or 0.17 percent, according to one estimate.¹³ Put another way, a large corporate tax break that reduces a company's corporate income tax bill by half represents a cost savings to the average firm of just 0.09

percent.¹⁴ By contrast, tiny differences in big-ticket cost items such labor, occupancy, energy, or raw materials, would dwarf anything a company could gain via tax breaks.

Such a small change in the cost calculus facing a business cannot be expected to change any significant share of site location choices. The tax differences will be overwhelmed by differences in other costs. As a result, all or nearly all of any tax cut will be wasted on corporations that would have chosen that location anyway.

If taxes do affect business location decisions to any degree, then states with lower taxes should experience more rapid growth, other things equal. The last phrase, “other things equal,” is crucial. If a state lowers corporate taxes, it must deal with the loss of revenue by raising taxes on individuals and/or other businesses or by lowering the quality of public services, or some of both. Either action could make a state less attractive for private investment. Anyone can make a list of states with higher tax rates and another list of states with lower tax rates, and then see which set grew faster over some time period. Many people (including Laffer) have done just that, but such an exercise provides no useful evidence about causality.

As stated above, many factors influence business location decisions and state

economic growth rates. To discern the separate effect of tax levels, researchers must use statistical techniques to hold all other relevant factors constant. The question is-- If two states are similar in terms of labor skills and wages, access to markets and materials, occupancy and energy costs, will a difference in taxes on business produce a difference in the rate at which the state grows? Statistical techniques have become increasingly sophisticated over the past 25 years, enabling better ways to control for other location determinants and more reliable answers to this question. While even the most sophisticated analysis cannot *prove* causality, the more carefully a study controls for the whole range of factors reasonably thought to affect business decisions, and the more such studies are replicated by others, the more confidence one has that the study results are indeed evidence of the strength of a causal relation.

Laffer et al acknowledge, after a fashion, that this is how research on the determinants of state growth should be conducted. On page 13, they point out correctly that “correlation is not the same thing as causation.” They also state correctly that it is necessary to isolate the effect of the factor of interest (say taxes) from all other factors that influence growth. This is the reason serious research relies on multiple regression analysis—to control for other factors and isolate the effect of taxes. However, Laffer et al spend the rest of *Rich States, Poor States* citing

simple correlations as support for their position.

In fact, their admonition regarding causal inferences on page 13 is violated just two paragraphs later. A report by the Institute on Taxation and Economic Policy (ITEP),¹⁵ concludes that income taxes are not a significant cause of population growth or decline, a conclusion supported by a number of academic studies relying on the kinds of research principles just outlined on page 13 of *Rich States, Poor States*.¹⁶ Laffer's response to this refutation of the *Rich States, Poor States* argument is to employ his favorite "research" technique, which is even more simplistic than calculating a correlation: he compares the average population growth of the nine states with no income tax to growth in the nine states with the highest top personal income tax rates. Such a comparison is meaningless because it assumes that nothing else going on in these states could explain why some grew and some did not: not birth rates, housing prices, wage rates, job availability, public education quality, climate, or recreational and cultural opportunities. None of these factors, it seems, was worth considering; it all must have come down to income taxes.

Fortunately for those seriously interested in learning how important taxes are to economic growth, there has been a large volume of research investigating this question over the past 40 years. Three

summaries of the research, in 1988 (by Newman and Sullivan), 1991 (by Bartik), and in 1998 (by Wasylenko) produced something of a consensus on the independent effect of state taxes on state growth.¹⁷ The research conclusions were expressed in terms of "elasticity," a measure of how sensitive growth is to taxes. The elasticity of state GDP with respect to state taxes, for example, is the percentage change in GDP divided by the percentage change in taxes. Bartik's review of 59 studies completed prior to 1991, including 34 studies that attempted to measure the effects of business taxes on state output, led him to conclude that the bulk of the credible research indicated an elasticity somewhere between -.1 and -.6, and probably about -.3. What does this mean? It means that a 10 percent reduction in taxes will lead eventually to an increase in the state GDP of 3 percent (+3 percent divided by -10 percent is equal to the elasticity of -.3). Reviews of the literature since then indicate that research continues to produce mixed results, with several studies finding no significant effect of business taxes on state growth, and others finding statistically significant but small effects (almost all within the range of -1. to -.6).¹⁸

The preponderance of the evidence from many dozens of studies over a period of 30 years or more is that business tax cuts, *if they could be enacted without cutting public spending*, have some positive effect on state economic growth, but that

this effect is quite small. These statistically-controlled policy experiments are in effect *holding all else equal*. It is important to understand what this means. The research does not imply that a 10 percent cut in taxes on business that is paid for by cutting 10 percent of the state budget would produce 3 percent growth. Such a balanced budget policy (and states of course must balance their budgets) might well produce no growth at all, especially in the long run, because budget cuts necessarily mean cuts in state and local services essential to the functioning of the economy. As Bartik himself has said: “[A]n economic development policy of business tax cuts may fail to increase jobs in a state or metropolitan area if it leads to a deterioration of public services to business. An economic development policy of tax increases may succeed in increasing jobs if it significantly improves public services to business.”¹⁹

Business tax breaks could be financed, alternatively, by increases in taxes on households. However, such a strategy is likely to result in a net *decrease* in consumer spending within the state, with resultant harm to local retailers and other in-state businesses, and to the state economy.²⁰ This is the case because a greater share of household income than of business profits is spent locally.

It is also important to understand why these effects are correctly characterized as small. They suggest that a 10 percent

cut in *total state and local taxes on business*—not a 10 percent cut in any one business tax—might lead to a 3 percent increase in growth. While a 10 percent cut in a state’s corporate income tax is quite achievable, that would reduce the *total* state and local taxes on all businesses in the average state by only about 1 percent. It is this 1 percent reduction that matters if we are to apply the results of previous research to estimate the effects of the cut in corporate income taxes; a 1 percent cut in total taxes would lead to a meager 0.3 percent increase in growth. And, again, much or even all of that small gain is likely to be offset by the effects of spending cuts or other tax increases.

Instead of relying on serious, peer-reviewed research, *Rich States, Poor States* proceeds to argue for the powerful effect of taxes on business location on the basis of two kinds of claims: (1) unequivocal assertions with no evidence or research whatever cited in support of them, and (2) simple correlations of the kind that Laffer acknowledges are inadequate and often misleading.

Laffer would also have us believe that government has no useful role to play in the economy, so that reductions in state revenue, no matter how drastic, have no consequences. The fervent anti-government bias in this report is evident throughout, in statements such as this: “The bottom line is governments don’t create resources; they redistribute re-

sources...Every resource given to someone by the government represents a resource being taken away from someone else by the government.”²¹ Apparently the interstate highway system is not a resource; public school buildings are not resources; an educated workforce is not a resource; state employment offices, public hospitals, fire trucks, water and sewer systems, libraries, national parks, the court system – none of these things are resources. Or perhaps Laffer is just arguing that the taxes and other revenues used to create these resources should be abolished and people should buy their own schools, parks, libraries, fire departments, district courts, and water treatment plants on the private market. The absurdity of either position is self-evident.

Laffer and company do not even concede a role for government in economic stabilization. They claim that all transfer payments—unemployment compensation, welfare, food stamps, Social Security—provide no economic stimulus because they are entirely offset by tax increases necessary to fund them. The fact that safety-net spending automatically increases during a recession leads to a “sharper drop in output,” they claim, and “an increase in unemployment benefits is expected to lead to a rise in unemployment.” Any principles of economics text will explain how these programs function as automatic stabilizers, sustaining consumer demand at a time when

the private market economy is failing to produce full employment, and thereby reducing the severity of the business cycle.²² And analyses show that an increase in taxes on upper income households to finance an increase in any of these transfer programs would have a net positive effect on the economy. Increased spending from transfer payments is so much higher than the reduction in spending from taxing high incomes of the rich. Increases in food stamps or unemployment compensation in fact have five times the stimulus effects of cuts in taxes on high-income households.²³ Progressivity is good for the economy, a truth quite inconvenient for ALEC.

Any doubts that the main objective of *Rich States, Poor States* is political—cutting taxes on the wealthiest segments of society in order to redistribute income upwards—are put to rest by the fact that the report devotes an entire chapter (one of only four) to a condemnation of the most progressive tax of all: the estate tax. The federal estate tax currently exempts the first \$5 million of an estate (\$10 million for a couple); as a result of this large exemption, only about 0.13 percent of U.S. adults dying in 2011 had a taxable estate.²⁴ It is a tax on the extremely wealthy.

Nowhere are logic and evidence stretched farther than in this chapter’s attempts to tag estate and inheritance taxes as “job killers” that “strangle economic growth.”

Once again the authors cite a simplistic correlation: states without estate taxes had higher growth – and then go on to claim that this proves that abolishing the estate tax will produce growth. They then devote considerable time to the state of Tennessee, a state that scores very well on most aspects of their own economic outlook ranking but has had lackluster economic performance, which they then deduce must be due entirely to the fact that it has an estate tax. They then conclude, with no evidence provided whatsoever, that if Tennessee had abolished its estate tax it would have grown at the same rate as the average no-income tax state and would therefore have had 200,000 to 220,000 more jobs. This claim has been thoroughly debunked by the Institute on Taxation and Economic Policy, which notes that Laffer is “asserting that no other differences between Tennessee and the other no-income tax states can possibly explain Tennessee’s slower economic and employment growth,” ignoring many more plausible explanations, including the fact that four of the no-income tax states have substantial extractive sectors (Alaska, Wyoming, Nevada and Texas).²⁵

How does it help a state economy to have rich people die within its borders instead of somewhere else? Here Laffer and company are quite vague, asserting that states with an estate tax are losing “enormous amounts of accumulated wealth,”

and that this wealth would have created jobs, alleviated poverty, and increased tax revenue. How this happens remains a mystery. The wealth that leads to economic prosperity, as we pointed out earlier in this report, consists of the stock of real assets: natural resources, plant and equipment, public infrastructure, human capital, technological knowledge. The wealth of large estates consists of real estate, stocks and bonds, mutual funds, and the whole range of financial assets that represent ownership of the real assets of society, assets that could be located anywhere in the world. The future use of those assets is unaffected by where the person owning some share of them dies.

Finally, dead people are not entrepreneurial, though the heirs of the estate might be. But the decision as to if, where and how those heirs invest the assets is likewise unaffected by the location of the estate. How exactly would a decision of a wealthy household to move to Florida in the closing years of life affect how much the household’s heirs, who could be located anywhere in the world, invest in businesses in Tennessee? It would not, nor would the decision to remain in Tennessee increase the heirs’ investments in that state. But for every estate that remained in Tennessee despite an estate tax, the additional tax revenue would indeed be invested in Tennessee—in schools, in roads, in the real public assets that are essential for economic growth.

Chapter 4. Taxes Have Little to do with Migration

Over their lifetimes, the majority of Americans do not move far: most remain in the state they grew up in.²⁶ Of those who do move, many move to a neighboring state. Those who move farther away do so for many reasons: job availability, climate, marriage or proximity to family, housing costs, and other factors. We know this because researchers for many years have been studying migration patterns and what determines where people move. What this research shows, consistently, is that taxes have little to do with migration decisions.²⁷ This should not be surprising; people are averse to moving because it is costly—finding a new job, selling and buying a home, leaving family and friends.

Ignoring the large body of careful research about the causes of migration, Laffer and his co-authors again resort to unsupported assertions and spurious correlations. They claim, predictably, that high personal income taxes and estate or inheritance taxes are major causes of out-migration and state population loss (or lagging growth). They also make the astounding claim that “taxes never redistribute wealth, but they do redistribute people,” which could happen, strictly speaking, only if *all* of those with

incomes above the median fled a state in response to progressive taxation, thwarting the state’s attempt at redistribution. The regressive taxation that they favor, meanwhile, would redistribute income upwards—giving the rich a larger share of after-tax income.

Countering these claims by Laffer et al is a substantial body of serious research. A study published in 2011 of the New Jersey 2.6 percent income tax surcharge on those with incomes over \$500,000 found that “exposure to the new tax did not affect migration rates.”²⁸ Furthermore, the surcharge generated nearly \$1 billion in additional annual revenue (so much for the Laffer Curve effect) and had a modest effect in reducing income inequality. In other words, the tax did redistribute income, but did not redistribute people.

Similarly, Maryland’s imposition of a new higher tax rate on those with incomes above \$1 million did not cause the massive flight of wealth that was predicted by many. The decline in the number of millionaire filers after the new tax rate went into effect was largely the result of the Great Recession: there were simply fewer people with million-dollar-plus incomes, in Maryland and everywhere else.

Furthermore, a few hundred wealthy taxpayers had been leaving the Maryland tax rolls every year (because they died or left the state) prior to the tax increase, for any number of reasons; even if all of the slight increase in out-migration in 2008 and 2009 were induced by the tax increase and not any of the other possible causes, it would represent merely two percent of the high-earner tax filers.²⁹

Another recent study focused on the elderly, a group that one might think would be more likely to migrate in response to tax differences because they are not tied to a location by a job. This analysis of data from four decennial censuses (1970 to 2000), over a period when a number of states enacted or expanded tax preferences for the elderly (such as exempting income from private pensions or Social Security) led the authors to conclude: “Across all of these samples, specifications and tax measures, our results are overwhelming in their failure to reveal any consistent effect of state income tax breaks on elderly migration.”³⁰

Even in metropolitan areas split by a state line, where tax differences could most easily tip the balance and cause in-migrants to pick a city in the lower-tax part of a metro area, research has shown that location choices are affected very little by the tax differences.³¹

In sum, those who have conducted serious studies that actually test Laffer’s assertions—with large samples over long time frames, and generally in the peer-reviewed literature—consistently find that taxes have little to do with rates of migration into and out of states. This is probably why Laffer falls back on anecdotes (including why he himself moved from California to Tennessee), spurious correlations (California and Hawaii, with nice weather but high taxes, lost population, while Alaska, with bad weather but low taxes, gained population), and unsupported claims.

Chapter 5. Tax Cuts Reduce Revenue

Arthur Laffer's claim to fame is the invention of the Laffer Curve, supposedly sketched out on a napkin for the benefit of Dick Cheney in a Washington, D.C. bar in 1974, and reproduced in the ALEC report not once but twice. The curve is based on an alleged truism: If you tax a particular thing at 100 percent, you will generate zero revenue (e.g., if wages were taxed at 100 percent, no one would work). Therefore, at some point, as the tax rate approaches 100 percent, increasing the rate will decrease revenue. This is called the "prohibitive range;" a state with tax rates in this range could increase revenue by cutting taxes, which is the effect Laffer wants to claim. The curve invariably is drawn so that it appears that this point is reached at about a 50 percent tax rate.

There are so many things wrong with this depiction and the conclusions drawn from it that it is difficult to know where to begin. Laffer provides no empirical evidence showing at what tax rate the curve starts to bend back, though he implies that we are already at the point where increasing rates further will reduce revenue for many state taxes.

Laffer's curve also lacks any nuance or complexity: The point at which a rate

increase leads to a reduction instead of an increase in revenue—if there is such a point at all—will vary dramatically depending on which commodity or activity is taxed, and by which jurisdictions. Finally, there is no guarantee that the fundamental premise is even true; a tax equal to 100 percent of the price of, say, cigarettes, is quite feasible, and would generate a great deal of revenue. Those addicted to cigarettes would still buy them, even if the tax effectively doubles the price.

This does not deter Laffer and company from making this statement on page xi of the 2011 edition: "Economists have observed a clear Laffer Curve effect with respect to cigarette taxes." Their evidence? States with higher cigarette taxes sell fewer cigarettes than neighboring states with lower taxes. Laffer apparently is counting on the reader not remembering what the Laffer Curve, which he just explained, actually predicts. A reduction in number of units sold is not a demonstration of the Laffer effect at all; the Laffer effect is a *reduction in total revenue*.

All competent research on the effect of taxes on cigarette consumption shows that cigarettes are well within what Laf-

fer calls the “normal range,” where an increase in the state tax rate *increases* revenue. Yes, fewer cigarettes are sold in Illinois (Laffer’s example) than would be the case with a lower tax. This is due both to reduced purchases by residents near the borders who buy their cigarettes in a lower tax state, and to some reduction in cigarette use by others. But the overall loss in sales is nowhere near enough to offset the gain in tax revenues from the purchases that are still made. If state cigarette taxes are the best example of the Laffer effect ALEC could come up with, its argument is in serious trouble. (Not to mention research that finds higher cigarette prices reduce the number of teenagers who start smoking, thereby reducing long-term state costs for Medicaid.)

Since the focus of *Rich States, Poor States* is on state policies that affect economic growth, let’s examine how the Laffer Curve relates to state taxation of business. Are state taxes in the “normal range,” so that increased tax rates will increase revenue? Or are effective tax rates so high in some states that they fall in the “prohibitive range,” where tax increases would reduce revenue? The latter is certainly what Laffer and company would like us to believe, though they present no credible evidence that this is the case. Keep in mind that states tax corporate and personal income at single-digit rates. The Institute on Taxation and Economic Policy has documented that the most profitable

Fortune 500 corporations pay an average of just 3.0 percent of their profits in income tax to the states.³² (It has also documented that the same companies pay actual federal income taxes of about half the statutory rate of 35 percent.)

In fact, we need only look at the large accumulation of empirical evidence, cited earlier, on the effect of taxes on state economic growth, to realize that states are well within the normal range. As we saw, state economic growth is clearly inelastic with respect to state and local taxes: a 10 percent tax cut leads to perhaps a 3 percent increase in growth. But a 3 percent increase in the tax base is obviously not enough to make up for a 10 percent cut in taxes per unit of tax base. Moreover, the revenue loss begs the issue of how to keep the budget balanced and sustain the same level of public services. To use a simple example of how a tax cut reduces revenue when demand is inelastic, consider that a tax of \$1 on 100 packs of cigarettes raises \$100; a tax of 90 cents (a 10 percent cut) applied to 103 packs (a 3 percent increase in sales) produces \$93.

Most importantly, the effect of tax rate increases on revenue depends crucially on what government does with the revenue.³³ In the Laffer model, the implicit assumption is that revenue is simply frittered away on waste and abuse. In fact, of course, it is spent, and government spending can have a substantial positive

effect on economic activity and hence on the tax base if used to fund education, job training, or infrastructure improvements that stimulate economic growth and a larger business tax base. Therefore tax increases will increase revenue, and increase it even more to the extent that the revenue is devoted to programs and

investments that enhance the prospects for long term growth. And tax cuts reduce revenue, and reduce it even more to the extent that the revenue loss results in cuts to programs and investments needed for long-term growth. Tax cuts and windfall incentives have a real and substantial cost.

Chapter 6. Wage Suppression Policies Do Not Generate Prosperity

One could reasonably assume that a report about “policies that lead to prosperity” would tell you what states can do to increase wages and incomes, since for most Americans work is the principal route to anything approaching prosperity. Instead, *Rich States, Poor States* is full of advice on measures to lower wages. According to ALEC, state minimum wage laws are a bad thing and unions are to be avoided.

The path to prosperity is paved with so-called “right-to-work” (RTW) laws, according to Laffer and company. Such laws do not create a right to a job, of course. Instead they take away the right of labor unions to negotiate a contract provision requiring all workers covered by and benefiting from a union contract with a private company to contribute to the cost of negotiating and maintaining that contract. While Laffer and company insist on referring to states without a “right-to-work” law as “forced union” states, they must know that this is not true: no one is forced to join a union (which would be counter to federal law). In fact, federal law requires a union to provide its services, including resolution of grievances, to all workers in a workplace; the effect of RTW is thus to force union members to

pay for and to provide such services for free to non-union members. RTW states would more accurately be dubbed “Right to Freeload” states. The real intent of such laws, of course, is to weaken unions, which in turn weakens their ability to win higher wages and better benefits. The real objective is to suppress wages.

It has been demonstrated conclusively that wages are lower and benefits more meager in RTW states. In a study that examined the effect of a state’s RTW status, controlling for differences in the cost of living, demographics, job characteristics, education of the workforce, and other factors, it was found that in RTW states, compared to free-bargaining (non-RTW) states, wages are 3.2 percent lower; a smaller percentage of workers (by 2.6 percentage points) have employer-sponsored health insurance, and the percent of workers with employer-sponsored pensions is 4.8 percentage points lower.³⁴ These effects would be larger, of course, if we considered only the sectors with substantial unionization rates. That they are small reflects the fact that only seven percent of private-sector jobs in the U.S. are unionized (RTW does not pertain to public employees) and many sectors of the economy have virtually no union-

ization, making RTW wholly irrelevant for employers choosing locations in, for example, high technology, financial services, information technology, and most of the service sector. It is important to note also that these are the effects for all workers in the state, union and non-union. Stronger unions result in higher wages and benefits not just for those covered by a union contract, but also for non-union workers in the same or similar sectors, because non-union employers must compete in the same labor market. The study also found that the RTW wage penalty is higher for women, blacks and Hispanics.

What about economic growth? Perhaps, as Laffer would have us believe, employers prefer RTW states and weak unions to such a degree that those states experience greater growth in GDP and employment. This turns out not to be the case. As Gordon Lafer has documented, a 50-state examination of growth rates in per capita income from 1977 to 2008 reveals no pattern with respect to RTW status. Even using Arthur Laffer's method of focusing on outliers: the fastest-growing and the slowest-growing states were both free bargaining states, while RTW states claimed both the third-highest and the third-lowest growth rates. Gordon Lafer puts it this way: "If states with right-to-work laws can experience either dramatic employment growth or steep declines, and if both right-to-work and free-bar-

gaining states can foster booming job markets, then it is clear that something in these states' economies, demographics, or policies other than right-to-work laws must be driving their job growth."³⁵

A serious attempt to research the impact of RTW status on state growth would have to control for these other factors—state economic structure, climate, workforce demographics, and others—in order to isolate the RTW effect. Two recent studies have done just that. One concluded: "...right to work laws ... seem to have no effect on economic activity."³⁶ The other found that right-to-work laws have no significant impact on job growth or the rate of new business formation, but do result in lower wages and lower per capita income.³⁷

Most states (45) have minimum wage laws that establish a state minimum wage for groups of workers not covered by the federal minimum and/or establish a state minimum for federally-covered workers that is higher than the federal rate (currently 17 states). In the ALEC-Laffer State Economic Outlook Ranking, states are penalized for having a state minimum wage higher than the federal. How could raising wages for thousands of workers *reduce* prosperity? Laffer provides no rationale whatsoever for this claim. Presumably he would reiterate the old argument that minimum wages cost jobs. But research conducted in the 1990s and

more recently has demonstrated that the employment effects of a modest increase in the minimum wage are very small or nonexistent; as a result, the minimum wage clearly raises incomes overall.³⁸ Second, minimum-wage jobs are overwhelmingly in local market sectors: leisure and hospitality (especially food ser-

vice occupations) and retail trade.³⁹ By that we mean these are not “footloose” industries with capital mobility to seek out the best production location among many states and then export to national or world markets; these kinds of services must locate where the market is.

Chapter 7. Utah: ALEC's Winner Still Pays Companies for Jobs

In every one of the five editions of *Rich States, Poor States*, the state that wins top ranking in the Economic Outlook is Utah. If the methodology employed by Laffer and his co-authors were legitimate, one would expect to see the Beehive State enjoying a steady stream of job-creating investment without having to take any special steps to lure business. Utah's adherence to the costly, regressive fiscal and labor-market policies promoted in *Rich States, Poor States* should be enough to keep the corporate dollars flowing in.

In reality, Utah employs the same economic development subsidies as other states to attract big-dollar investments: special tax credits, cash grants, tax-exempt bonds, subsidized training, etc. The most expensive of these efforts is the Economic Development Tax Increment Financing (EDTIF) program, a refundable corporate tax credit worth up to 30 percent of the new sales, corporate income and employee withholding tax revenue generated by a subsidized project.

During the past five years, Utah has given lucrative EDTIF deals to some of the country's largest and most prosperous corporations. The biggest payday was

enjoyed by Procter & Gamble, which in 2008 was awarded \$85 million in EDTIF credits over 20 years for a paper-towel and toilet-tissue plant that employed only 200 workers when it opened in 2011.

In 2007 controversial Wall Street giant Goldman Sachs was awarded a \$20 million EDTIF deal; two years later, the amount was boosted to \$47 million. Another EDTIF double-dipper is eBay, which got a \$27 million award in 2008 to build a data center; in 2011 the potential subsidy was hiked to \$38 million. Other tech companies receiving big EDTIF awards include Adobe Systems (\$40 million in 2010) and Oracle (\$15 million in 2008).

The fact that Utah feels it must provide these packages—and sometimes sweeten those already granted—suggests that the state is not quite the corporate nirvana depicted by Laffer & Co. When the increased Goldman Sachs EDTIF award was announced, the *Salt Lake Tribune* reported that the company had told state officials it might expand elsewhere if it didn't get the sweetener. Apparently, the bank's executives had not read *Rich States, Poor States*.

Unaccountable Harm to Utah's Budget

Although Utah's population grew seven percent between 2007 and 2012, and its personal income rose 17 percent, total state revenue remained nine percent below its 2007 level, according to a May 2012 report by Voices for Utah Children.⁴⁰ And yet there is no way to accurately tally the cost of the state's economic development efforts.

First, Utah taxpayers lack company-specific disclosure about credits provided through the EDTIF program. The Governor's Office of Economic Development (GOED), which cuts the checks for companies that have lived up to their job creation targets, provides no annual public accounting of these amounts.

GOED reports only the "incentive amount" of multi-year agreements as they are signed, not the amount actually paid out for deals made in prior years. The best current estimate of these obligations comes from the state's 2011 *Comprehensive Annual Financial Report*, which finds that EDTIF had "long-term contract commitments" for cash rebates and credits of up to \$310 million. These payouts are presumably spread over periods ranging from five to twenty years, depending on the details in each deal.

Second, more revenue has been lost due to efforts by the state legislature to minimize the amount of sales and use taxes paid on "business inputs." Voices for Utah Children points to these sales tax breaks as one cause of the state's revenue shortfall, though inadequate accounting rules make it impossible to measure their true cost:

Of particular concern is the removal of reporting requirements for sales tax exemptions on the purchase of manufacturing machinery and equipment. These requirements were whittled away beginning in 1995, when legislation dramatically lowered the penalty for inaccurate reporting of this information. Then, in 1999, the Tax Commission was given discretion on whether or not to impose penalties for non-compliance, paving the way for a new law in 2009 that dropped the reporting requirement entirely.

And the benefits? Voices for Utah Children notes that the state's Tax Commission admitted in its 2011 *Review of the Sales and Use Tax Exemption for Manufacturing Machinery and Equipment* that it cannot "explicitly establish a cause and effect relationship" between sales tax exemptions and growth in Utah's manufacturing sector.

Despite Utah's top ALEC-Laffer ranking, its subsidies for development deals and its relaxed reporting requirements for sales tax exemptions, the state's performance has been anything but stellar. From 2007, when Utah was first ranked number one, to 2011, the state averaged a lowly 44th among the states in the level of per capita income, and 24th in median

family income. While the state ranked 7th in the growth of state GDP from 2007 to 2011, employment growth was just 21st among the states, the growth in median family income ranked 34th, and the growth in per capita income was 43rd. The state did stand out on one measure: its 39 percent increase in the poverty rate was fourth highest among the states.

Chapter 8. Policy Conclusion

Rich States, Poor States purports to provide a recipe of state policies to achieve economic growth and prosperity. These policies entail cutting or eliminating progressive taxes, suppressing wages, and cutting public services. The evidence and arguments cited to support the beneficial effects of these policies range from deeply flawed to nonexistent. In actuality, the

book provides a recipe for economic inequality and declining incomes for most citizens and for depriving state and local governments of the revenue needed to maintain public infrastructure and education systems that are the underpinnings of long-term economic growth. ALEC's policy prescriptions don't work.

Results of Regression Equations: Value of Coefficients and Statistical Significance

Explanatory Variables	Dependent Variables: Growth Rates, 2007-2011								
	State GDP	Non-farm Employment	Per Capita Income	State GDP	Non-farm Employment	Per Capita Income	State GDP	Non-farm Employment	Per Capita Income
Intercept	-.217	-.319	-.217	-.263	-.311	-.250	-.210	-.304	-.214
Taxes: Percent of personal income (average 2007-09)	-.001	.002	.001	.297	.065	.360			
Top personal income tax rate				-.311	-.065	-.237			
Top corporate income tax rate				-.006	.003	-.009			
Estate/ inheritance tax (1=yes)				.017	.006	.002			
Right-to-work status (1=yes))	.019	.009	.005						
A-L 2007 Economic Outlook Ranking							-.0002	.0001	.0003
Share of 2006 state GDP:									
Nondurable goods manufacturing	.322	.242*	.168	.350	.237*	.177	.364	.251**	.167
Durable goods manufacturing	.152	.031	.072	.223	.015	.125	.125	.011	.077
Finance and insurance	.380	.283**	.211	.448	.305**	.284*	.381	.299**	.230*
Trade, transportation & warehousing	.681	.550*	.598*	.736	.598**	.678**	.798	.634**	.684**
Education and health services	.950	.797***	1.336***	1.123*	.803**	1.479***	.800	.706**	1.180***
Professional & scientific	.193	.451*	-.031	.326	.458	.063	.125	.424	-.025
Mining	.473**	.359***	.243*	.536**	.409***	.345***	.439**	.388***	.269**
Adjusted R ²	0.04	0.28	0.32	0.01	0.24	0.34	0.05	0.29	0.35

*Significant at the 10% level

**Significant at the 5% level

***Significant at the 1% level

Notes.

- ¹ While the ALEC report gives a value of 1 for most competitive, we reverse the values so that the charts appear in the normal fashion with the lowest value on the left and the highest value on the right – i.e., so that 1 is at the zero point and indicates a low competitiveness and 50 is at the far right and indicates a high competitiveness.
- ² We use net growth in population rather than “absolute domestic migration,” (the measure used in their performance ranking) because the latter term is not defined by ALEC and because much is made of population growth throughout the report.
- ³ It is statistically significant at the 5 percent level.
- ⁴ It is statistically significant at the 10 percent level.
- ⁵ The only change from the first to the fifth edition is that the 16th measure in 2007, “Education Freedom Index Score,” was omitted in 2011.
- ⁶ *Rich States, Poor States*, 5th edition, p. 24.
- ⁷ Stephen Mark, Therese McGuire, and Leslie Papke, “The Influence of Taxes on Employment and Population Growth: Evidence from the Washington, D.C. Metropolitan Area,” *National Tax Journal*, v. 53, no. 1, March 2000, pp. 105-123.
- ⁸ A number of research studies published in peer-reviewed academic journals have investigated the question of the role of state personal income taxes in state economic growth; most have found little or no effect, or inconsistent effects, but one did find a statistically significant negative effect (Randall Holcombe and Donald Lacombe, “The Effect of State Income Taxation on Per Capita Income Growth,” *Public Finance Review*, May, 2004). The preponderance of evidence from all of these studies taken together is that higher personal income taxes have little effect or no measurable effect on business location decisions or state economic growth.
- ⁹ Paul W. Bauer, Mark E. Schweitzer and Scott Shane. “State Growth Empirics: The Long-Run Determinants of State Income Growth.” Federal Reserve Bank of Cleveland Working Paper. May 2006.
- ¹⁰ Michelle Bensi, David Black and Michael Dowd. “The Education/Growth Relationship: Evidence from Real State Panel Data.” *Contemporary Economic Policy*, April 2004.
- ¹¹ Josh Bivens, *Failure by Design: The Story behind America’s Broken Economy*. Washington, D.C., Ithaca, N.Y.: Cornell University Press, 2011, p. 67.
- ¹² This is based on data averaged over three years 2005-2007 from two sources: U.S. Internal Revenue Service, Statistics of Income, Integrated Business Data for all U.S. Corporations, partnerships, and non-farm proprietorships, showing total deductions for business costs on tax returns, at <http://www.irs.gov/taxstats/bustaxstats/article/0,,id=152029,00.html> ; and a 2009 report by the Council on State Taxation, which estimates total state and local taxes paid by businesses, available at <http://www.cost.org/Page.aspx?id=69654> .
- ¹³ Council on State Taxation (see note 3). This is the average proportion over the three years 2005 to 2007; the fraction is lower in recession years.

- ¹⁴ 50 percent times 9.5 percent times 1.8 percent equals .09 percent. This is the average over all types of business, which is the relevant figure for considering the impact of a particular tax cut on overall business activity. The impact of a corporate income tax cut on corporations only would be somewhat larger; however, considering corporations only, state and local taxes are only 2.3 percent of total corporate business expenses at most (see Michael Mazerov and Mark Enriques, "Vast Majority of Large Maryland Corporations Are Already Subject to Combined Reporting in Other States," Center on Budget and Policy Priorities, November 9, 2010, Note 4), while the state and local corporate income tax represents about 19 percent of corporate state and local tax payments, according to IRS data, so the impact of a 50 percent corporate income tax cut is still very small: 50 percent times 19 percent times 2.3 percent equals 0.22 percent.
- ¹⁵ Institute on Taxation and Economic Policy, "'High Rate' Income Tax States Are Outperforming No-Tax States," Washington, D.C., February, 2012. <http://www.itep.org/pdf/junkeconomics.pdf>
- ¹⁶ W. Robert Reed and Cynthia L. Rogers, "Tax Cuts and Employment Growth in New Jersey: Lessons from a Regional Analysis," *Public Finance Review*, May 2004. Andrew Leigh, "Do Redistributive State Taxes Reduce Inequality?" *National Tax Journal*, March 2008. Cristobal Young and Charles Varner, "Millionaire Migration and State Taxation of Top Incomes: Evidence from a Natural Experiment," *National Tax Journal*, June 2011. Stephen T. Mark, Therese J. McGuire, and Leslie E. Papke, "The Influence of Taxes on Employment and Population Growth: Evidence from the Washington, D.C. Metropolitan Area," *National Tax Journal*, March 2000. Jeffrey Thompson, "The Impact of Taxes on Migration in New England," Political Economy Research Institute, University of Massachusetts, Amherst, April 2011.
- ¹⁷ Robert Newman and Dennis Sullivan, "Econometric Analysis of Business Tax Impacts on Industrial Location: What Do We Know, and How Do We Know it?" *Journal of Urban Economics*, vol. 23, 1988, pp. 215-34; Timothy Bartik, *Who Benefits from State and Local Economic Development Policy?* Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 1991; Michael Wasylenko, "Taxation and Economic Development: The State of the Economic Literature," *New England Economic Review*, March/April 1997, pp. 37-52.
- ¹⁸ See, among others, Alan Peters and Peter Fisher. "The Failures of Economic Development Incentives." *Journal of the American Planning Association*, vol. 70, no. 1: Winter 2004, pp. 27-38; J. William Harden and William H. Hoyt, "Do States Choose Their Mix of Taxes to Minimize Employment Losses?" *National Tax Journal*, March 2003, pp. 7-26; James Alm and Janet Rogers, "Do State Fiscal Policies Affect State Economic Growth?" *Public Finance Review*, July 2011; Daphne Kenyon, Adam Langley, and Bethany Paquin. *Rethinking Property Tax Incentives for Business*. Cambridge, MA: Lincoln Institute for Land Policy, 2012.
- ¹⁹ Timothy Bartik, *Who Benefits from State and Local Economic Development Policy?* Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 1991, p. 8.
- ²⁰ See Michael Mazerov, "Cutting State Corporate Income Taxes is Unlikely to Create More Jobs," Center on Budget and Policy Priorities, Sept. 14, 2010, at <http://www.cbpp.org/cms/index.cfm?fa=view&id=3290>.
- ²¹ *Rich States, Poor States*, 5th edition, p. 16.

- ²² Even Social Security plays this role to an extent because it provides an alternative source of income for those age 62 to 69 who hadn't planned to retire but find themselves without work due to a recession.
- ²³ Alan S. Blinder and Mark Zandi, "How the Great Recession Was Brought to an End." Moody's Economy.com, July 27, 2010. At <http://www.economy.com/mark-zandi/documents/End-of-Great-Recession.pdf>
- ²⁴ Urban-Brookings Tax Policy Center, "Taxable Estate Tax Returns as a Percentage of Adult Deaths, Selected Years of Death, 1934-2011," Nov. 30, 2011, at <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=52&Topic2id=60>
- ²⁵ Institute on Taxation and Economic Policy, "Repealing Estate Tax Will Not Create an Economic Boom," Washington, D.C., April, 2012.
- ²⁶ Jeffrey Thompson, *The Impact of Taxes on Migration in New England*. Political Economy Research Institute, University of Massachusetts, Amherst. April 2011. http://www.peri.umass.edu/fileadmin/pdf/published_study/Migration_PERI_April13.pdf
- ²⁷ For a review of this research, see Robert Tannenwald, Jon Shure, and Nicholas Johnson, "Tax Flight is a Myth: Higher State Taxes Bring More Revenue, Not More Migration." Washington, D.C.: Center on Budget and Policy Priorities, August 4, 2011, at <http://www.cbpp.org/files/8-4-11sfp.pdf>.
- ²⁸ Cristobal Young and Charles Varner. "Millionaire Migration and State Taxation of Top Incomes: Evidence from a Natural Experiment." *National Tax Journal*, vol. 64, no. 2, pt. 1, June 2011, p. 221.
- ²⁹ See Institute on Taxation and Economic Policy, "Five Reasons to Reinstate Maryland's 'Millionaire Tax,'" Washington, D.C., March 9, 2011; and Tannenwald et al, "Tax Flight is a Myth."
- ³⁰ Karen Conway and Jonathan Rork, "No Country for Old Men (or Women) – Do State Tax Policies Drive Away the Elderly?" *National Tax Journal*, vol. 65, no. 2, June 2012, p. 244.
- ³¹ Paul Coomes and William Hoyt. "Income Taxes and the Destination of Movers to Multistate MSAs." *Journal of Urban Economics*, vol. 63, no. 3, pp. 920-937.
- ³² "Corporate Tax Dodging in the 50 States, 2008-2010." Institute on Taxation and Economic Policy, December 2011. <http://www.itep.org/pdf/CorporateTaxDodgers50StatesReport.pdf>
- ³³ See Zsolt Becsi, "The Shifty Laffer Curve." *Economic Review*, vol. 85, no. 3, 2000.
- ³⁴ Elise Gould and Heidi Shierholz, "The Compensation Penalty of 'Right-to-Work' Laws," Briefing Paper, the Economic Policy Institute, Washington, D.C., February 17, 2011.
- ³⁵ Gordon Lafer, "'Right to Work': The Wrong Answer for Michigan's Economy," EPI Briefing Paper, Washington, D.C.: The Economic Policy Institute, September 15, 2011. <http://www.epi.org/files/2011/BriefingPaper326.pdf>

- ³⁶ Dale Belman, Richard Block and Karen Roberts, "Economic Impact of State Differences in Labor Standards in the United States, 1998-2000," East Lansing, Michigan, Michigan State University, Jan. 21, 2011, posted on the Employment Policy Research Network blog.
- ³⁷ Lonnie Stevans, "The Effect of Endogenous Right-to-Work Laws on Business and Economic Conditions in the United States: A Multivariate Approach," *Review of Law and Economics*, vol. 5, no. 1, 2009, pp. 595-612.
- ³⁸ For a review of the research on the employment effects of increases in the minimum wage, see Liana Fox, "Minimum Wage Trends: Understanding Past and Contemporary Research," Briefing Paper#178, Washington, D.C. Economic Policy Institute. October 24, 2006. <http://www.epi.org/publication/bp178/>
- ³⁹ U.S. Bureau of Labor Statistics, Characteristics of Minimum Wage Workers: 2011 <http://www.bls.gov/cps/minwage2011tbls.htm#4>
- ⁴⁰ "What's Eating Utah's General Fund? How Tax Expenditures and Earmarks Undermine the Budget Process," by Allison Rowland and Tracy Gruber, Utah Voices for Children, revised May 17, 2012, pp. 4-8. <http://www.utahchildren.org/publications/category/5-tax-and-budget-reports>.