Taxes & Economic Growth

January 14, 2017

Joseph Henchman
Vice President, State Projects
henchman@taxfoundation.org
www.taxfoundation.org

TAX FOUNDATION Since 1937

ABOUT THE
TAX FOUNDATION

we’ve worked for
80 years

ABOUT THE
TAX FOUNDATION

we’ve worked for

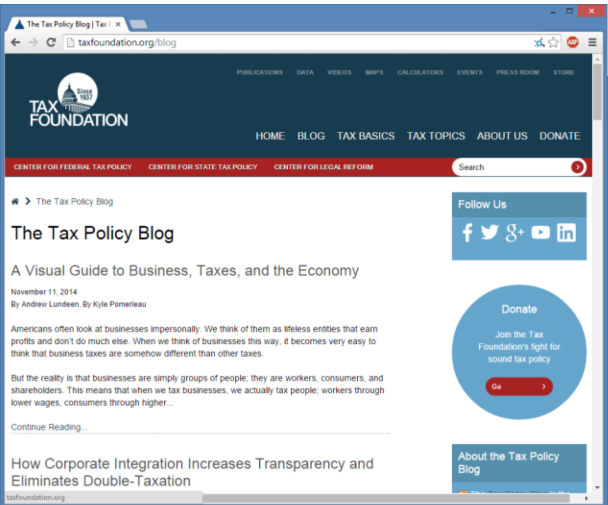
80 years

on objective
research,
data,
& analysis

ABOUT THE
TAX FOUNDATION

we've worked for
80 years
on objective
research,
data,
& analysis
at the
federal,
state,
& local levels

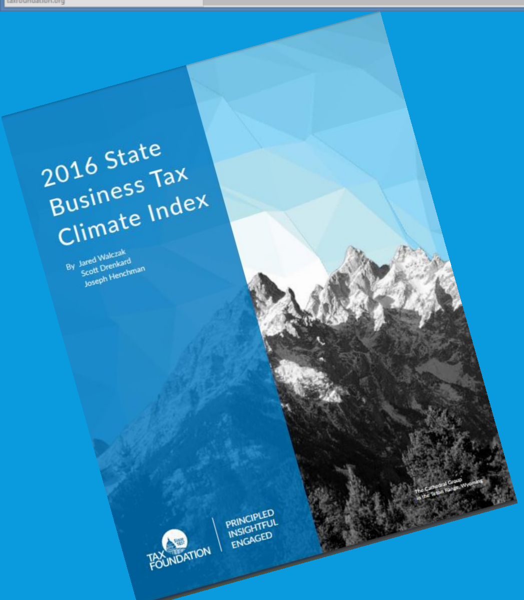
ABOUT THE TAX FOUNDATION



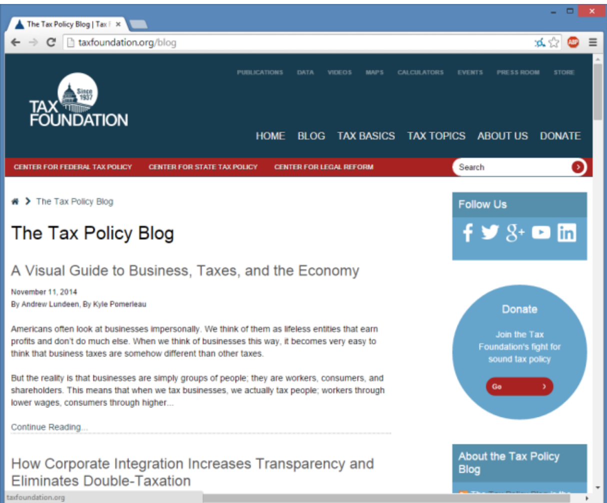
we’ve worked fo

80 years

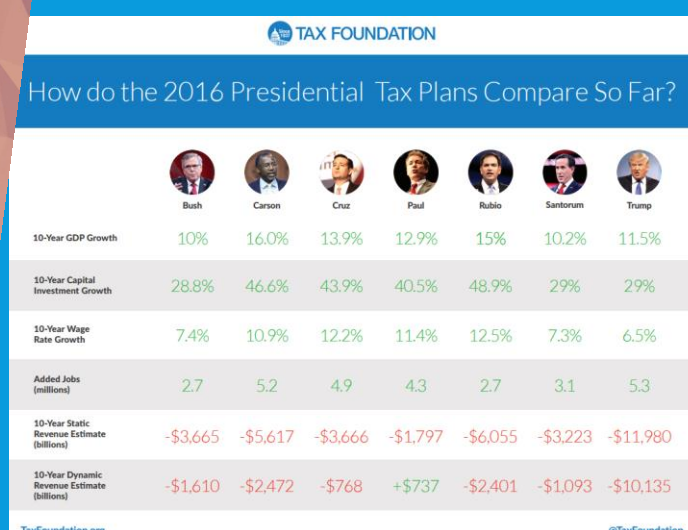
on objective
research,
data,
& analysis
at the
federal,
state,
& local levels



ABOUT THE TAX FOUNDATION

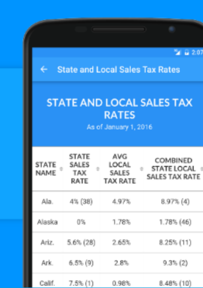


we've worked for
80 years
on objective
research,
data,
& analysis
at the
federal,
state,
& local levels



	Bush	Carson	Cruz	Paul	Rubio	Santorum	Trump
10-Year GDP Growth	10%	16.0%	13.9%	12.9%	15%	10.2%	11.5%
10-Year Capital Investment Growth	28.8%	46.6%	43.9%	40.5%	48.9%	29%	29%
10-Year Wage Rate Growth	7.4%	10.9%	12.2%	11.4%	12.5%	7.3%	6.5%
Added Jobs (millions)	2.7	5.2	4.9	4.3	2.7	3.1	5.3
10-Year Static Revenue Estimate (billions)	-$3,665	-$5,617	-$3,666	-$1,797	-$6,055	-$3,223	-$11,980
10-Year Dynamic Revenue Estimate (billions)	-$1,610	-$2,472	-$768	+$737	-$2,401	-$1,093	-$10,135

INTRODUCING
FACTS & FIGURES
FOR YOUR SMARTPHONE

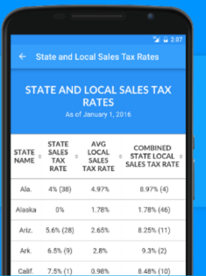


ABOUT THE
TAX FOUNDATION

	Bush	Carson	Cruz	Paul	Rubio	Santorum	Trump
10-Year GDP Growth	10%	16.0%	13.9%	12.9%	15%	10.2%	11.5%
10-Year Capital Investment Growth	28.8%	46.6%	43.9%	40.5%	48.9%	29%	29%
10-Year Wage Rate Growth	7.4%	10.9%	12.2%	11.4%	12.5%	7.3%	6.5%
Added Jobs (millions)	2.7	5.2	4.9	4.3	2.7	3.1	5.3
10-Year Static Revenue Estimate (billions)	-$3,665	-$5,617	-$3,666	-$1,797	-$6,055	-$3,223	-$11,980
10-Year Dynamic Revenue Estimate (billions)	-$1,610	-$2,472	-$768	+$737	-$2,401	-$1,093	-$10,135

we've worked for
80 years
on objective research, data, & analysis at the federal, state, & local levels

INTRODUCING
FACTS & FIGURES
FOR YOUR SMARTPHONE



PERSPECTIVES ON

TAXES & GROWTH

"[T]here is just no relationship between state personal income tax levels and the decisions of people in a state to start a business and of would-be entrepreneurs to move to the state."

PERSPECTIVES ON
TAXES & GROWTH

"[T]here is just no relationship between state personal income tax levels and the decisions of people in a state to start a business and of would-be entrepreneurs to move to the state."

Michael Mazerov, CBPP

PERSPECTIVES ON

TAXES & GROWTH

"Phasing out the state income tax will double the state's GDP growth, create hundreds of thousands of new jobs, and recapture 50% of the revenue loss from increased economic growth."

Summary of Art Laffer study of Oklahoma tax cut proposal, Nov. 2011

ADAM SMITH ON

TAXES & GROWTH

"[Taxes] may obstruct the industry of the people, and discourage them from applying to certain branches of business which might give maintenance and employment to great multitudes."

Wealth of Nations, bk. 5

REALITY ON

TAXES & GROWTH

- Taxes

REALITY ON

TAXES & GROWTH

- Taxes
- Housing prices
- Location of family and friends
- Educational opportunities
- Infrastructure such as airports and ports
- Weather
- Cost of living
- Area restaurant quality
- Where the CEO’s family wants to live

- (in no particular order)

ACADEMICS ON
TAXES & GROWTH

- In 2012, we reviewed 26 studies that examine the relationship

ACADEMICS ON

TAXES & GROWTH

- In 2012, we reviewed 26 studies that examine the relationship

TAX FOUNDATION Since 1937

December 18, 2012
No. 207

Special Report

What Is the Evidence on Taxes and Growth?

By
William McBride, PhD

Introduction

The idea that taxes affect economic growth has become politically contentious and the subject of much debate in the press and among advocacy groups. That is in part because there are competing theories about what drives economic growth. Some subscribe to Keynesian, demand-side factors, others Neo-classical, supply-side factors, while yet others subscribe to some mixture of the two or something entirely unique. The facts, historical and geographical variation in key parameters for example, should shed light on the debate. However, the economy is sufficiently complex that virtually any theory can find some support in the data.

For instance, the Congressional Research Service (CRS) has found support for the theory that taxes have no effect on economic growth by looking at the U.S. experience since World War II and the dramatic variation in the statutory top marginal rate on individual income.[1] They find the fastest economic growth occurred in the 1950s when the top rate was more than ninety percent.[2] However, their study ignores the most basic problems with this sort of statistical analysis, including: the variation in the tax base to which the individual income tax applies; the variation in other taxes, particularly the corporate tax; the short-term versus long-term effects of tax policy; and reverse causality, whereby economic growth affects tax rates. These problems are all well known in the academic literature and have been dealt with in various ways, making the CRS study unpublishable in any peer-reviewed academic journal.[3]

So what does the academic literature say about the empirical relationship between taxes and economic growth? While there are a variety of methods and data sources, the results consistently point to significant

ACADEMICS ON
TAXES & GROWTH

- Higher taxes are associated with slower growth
- All studies but three agree
- Nearly all the studies in the last fifteen years agree
- Authors include Christina Romer, Jens Arnold of the OECD, and William Easterly

ACADEMICS ON
TAXES & GROWTH

Personal income taxes are seen as more harmful to growth than consumption taxes for three reasons. First, they are generally progressive, with marginal tax rates (which discourage growth) that are higher than their average rates (which generate government revenues). This means that they discourage growth more per unit of tax revenue than consumption taxes, which are generally flat rate and not (or not very) progressive. Second, they typically tax the return to savings (interest or dividends) in addition to taxing the income from which savings are made, thus discouraging savings. While this second effect may not harm the growth of publicly quoted companies that can raise funds overseas, it may reduce the growth financing for small and medium-sized companies (especially those that rely on the funds of family and friends). Third, high income tax and social security contributions on low-wage workers can lead to people choosing to stay on social benefits rather than work (Brewer et al., 2010).

- *OECD Economists*

CBPP ON
TAXES & GROWTH

- CBPP identified several more studies on both sides
- CBPP response says we do left out some reports' emphasis on value of public spending and growth
- But see, e.g.: "[S]imulating a 1% of GDP tax increase simultaneously with a 1% productive expenditure increase suggests that this is mildly growth-retarding initially such that even after 20 years GDP remains around 0.5% lower than otherwise." *Gemmell, Kneller, and Sanz*

CBPP ON
TAXES & GROWTH

Organizations advocating lower and less progressive taxes can find some studies by reputable economists that find that above-average state and local taxes have a measurable and consistently adverse impact on state economic performance.

However, many equally reputable studies reach the opposite conclusion, and the results of many more are mixed, ambivalent, or show that any adverse impacts are small. There is simply no consensus whatsoever that cutting taxes is a good strategy to boost state economic growth and create jobs.

- *Michael Mazerov, 2013*

REAL EXAMPLES OF
TAXES & GROWTH

Predicted Economic and Revenue Effects of the Revenue Acts of 1962 and 1964		
Provision	**Long-Run Change in GDP**	**Static Change in Annual Revenue (billions of 1962 dollars)**
Create a business investment tax credit	1.35%	-$1.23
Create a minimum standard deduction	0.09%	-$0.30
Move from Bulletin F depreciation schedules to a new set of guidelines	1.15%	-$2.00
Lower individual income tax rates across the board	2.51%	-$8.44
Lower the corporate tax rate to 48% from 52%	1.09%	-$1.48
TOTAL	**6.18%**	**-$13.45**
Source: Tax Foundation *Taxes and Growth* Model		

REAL EXAMPLES OF TAXES & GROWTH

Predicted Economic and Revenue Effects of the Economic Recovery Tax Act of 1981		
Provision	**Long-Run Change in GDP**	**Static Change in Annual Revenue (billions of 1981 dollars)**
Introduce deduction for low-earning spouses	0.17%	-$0.46
Move from ADR to ACRS for depreciation schedules	2.69%	-$10.34
Increase the investment tax credit	0.52%	-$2.75
Reduce marginal individual income tax rates across the board	4.62%	-$69.50
TOTAL	**8.00%**	**-$83.06**
Source: Tax Foundation *Taxes and Growth* Model		

REAL EXAMPLES OF
TAXES & GROWTH

Predicted Economic and Revenue Effects of the Tax Reform Act of 1986		
Provision	**Long-Run Change in GDP**	**Static Change in Annual Revenue (billions of 1986 dollars)**
Tax capital gains as ordinary income	-2.59%	$10.91
Move from ACRS to MACRS	-1.81%	$8.24
Repeal the investment tax credit for businesses	-2.67%	$23.73
Expand the personal exemption and standard deduction	0.56%	-$27.35
Collapse the 16-bracket structure to a 2-bracket structure	2.97%	$3.78
Lower the corporate tax rate from 46% to 34%	3.31%	-$24.25
TOTAL	**-0.23%**	**-$4.93**

Source: Tax Foundation *Taxes and Growth* Model

REAL EXAMPLES OF

TAXES & GROWTH

Predicted Economic and Revenue Effects of the Economic Growth and Tax Relief Reconciliation Act of 2001

Provision	**Long-Run Change in GDP**	**Static Change in Annual Revenue (billions of 2001 dollars)**
Increase the AMT exempt amount	-0.01%	-$0.81
Expand the child tax credit and EITC	0.01%	-$20.70
Expand the standard deduction for joint filers	0.05%	-$6.02
Create 10% bracket and lower rates on top four brackets	1.70%	-$102.96
Eliminate phaseout of exemptions and deductions	0.52%	-$30.75
TOTAL	**2.27%**	**-$161.24**

Source: Tax Foundation *Taxes and Growth* Model

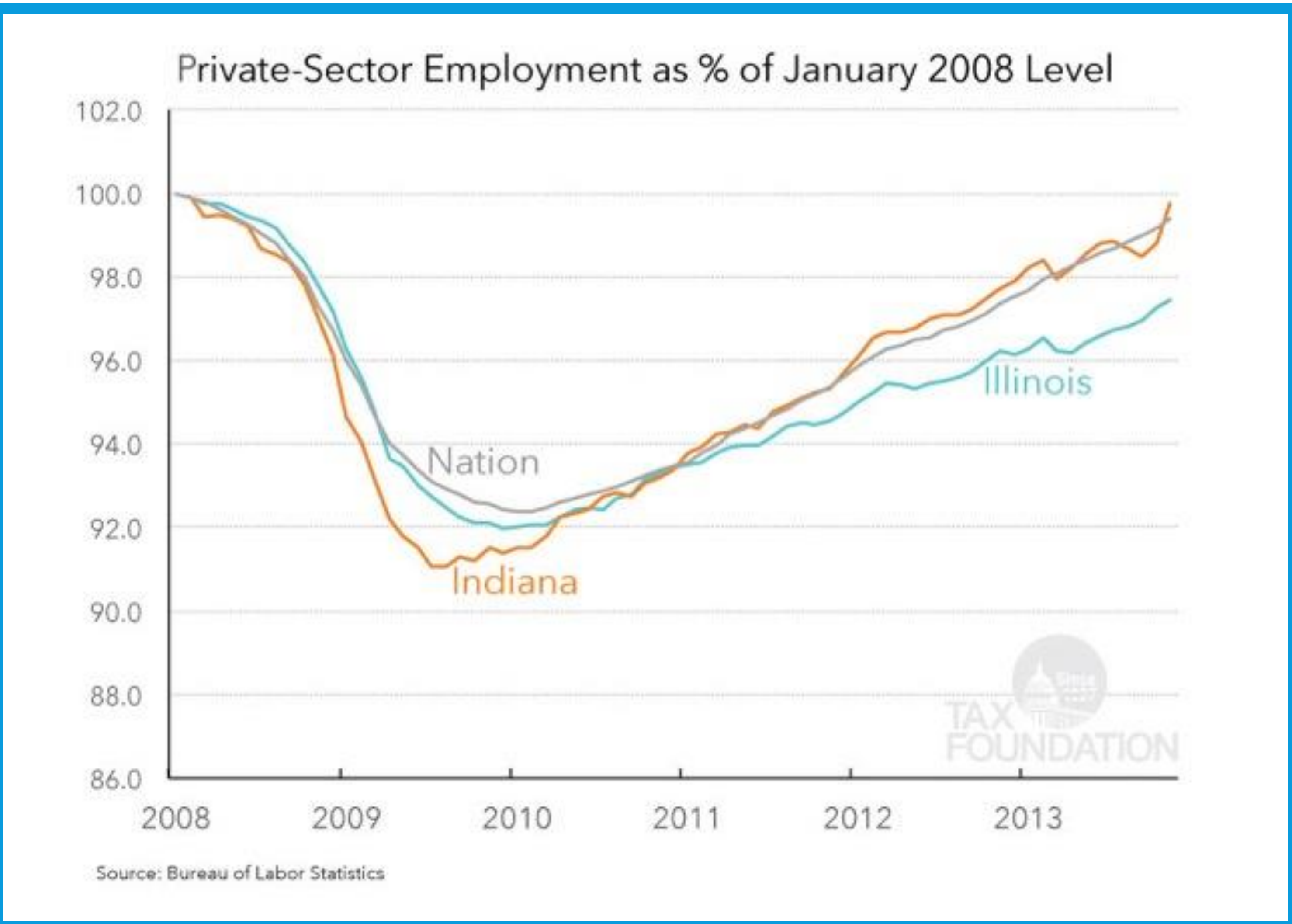
REAL EXAMPLES OF

TAXES & GROWTH

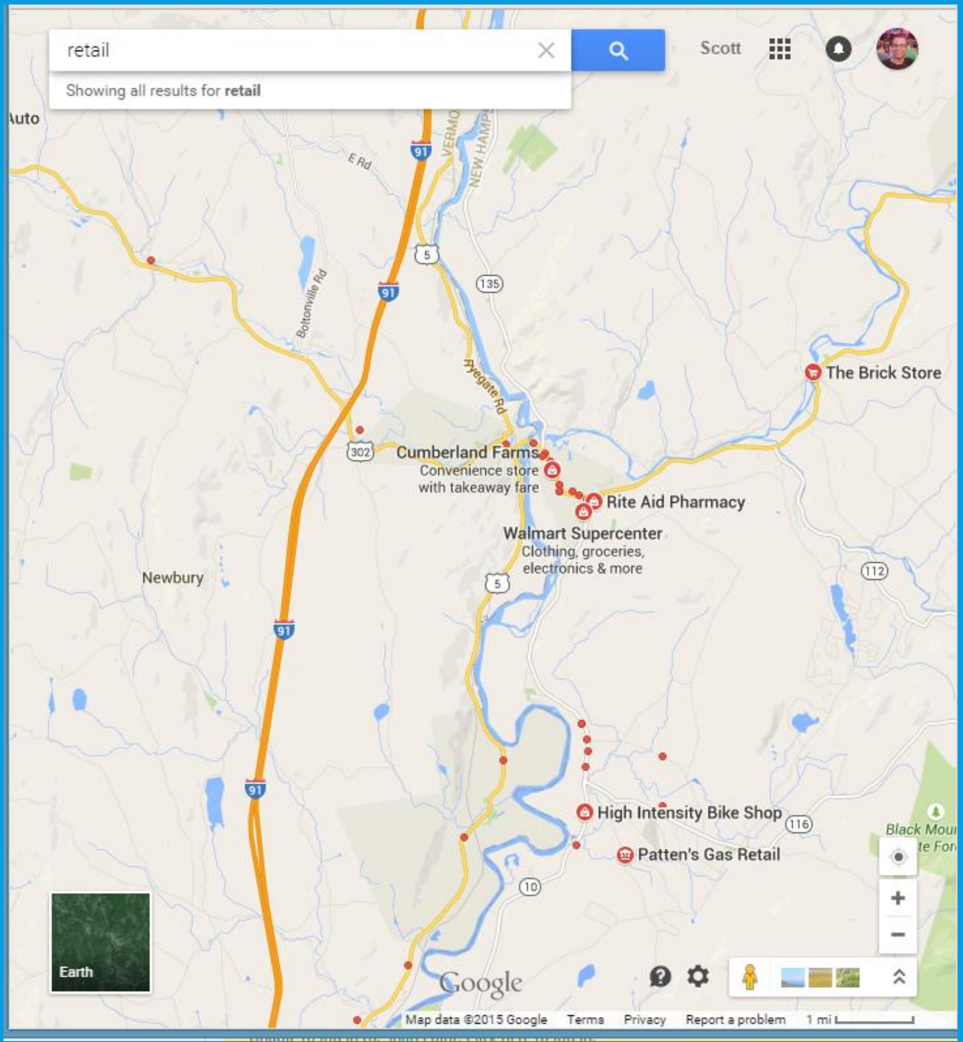
- Phil Mickelson
- Tiger Woods
- Gerard Depardieu
- Tom Golisano
- Eduardo Saverin

REAL EXAMPLES OF

TAXES & GROWTH

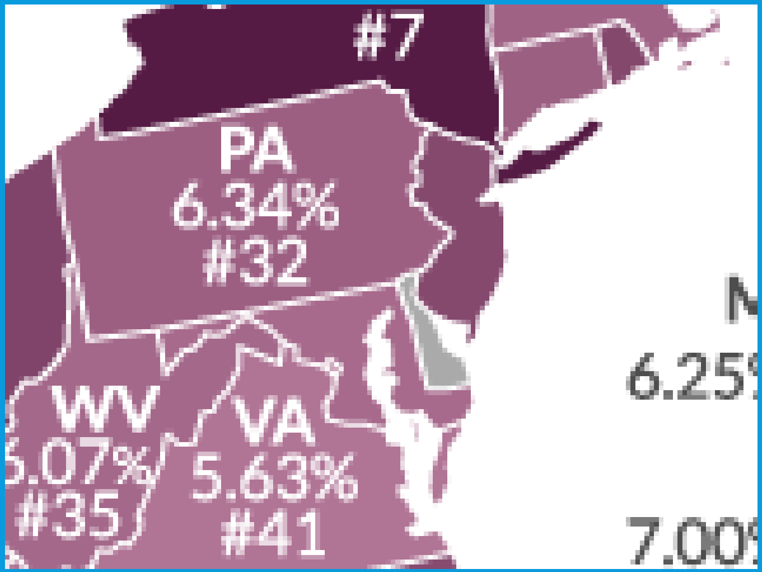


REAL EXAMPLES OF
TAXES & GROWTH



REAL EXAMPLES OF

TAXES & GROWTH



CONCLUSIONS ON TAXES & GROWTH

- Larger tax changes do not always lead to larger economic effects
- Although recent [federal] tax changes have had little economic effect, this does not imply that taxes do not affect the economy.
- The top individual tax rate isn't everything.
- Changes to depreciation schedules are particularly significant.
- The tax plans under consideration would create historically unprecedented economic effects.

Taxes & Economic Growth

January 14, 2017

Joseph Henchman
Vice President, State Projects
henchman@taxfoundation.org
www.taxfoundation.org

TAX FOUNDATION Since 1937