

March 1, 2024

Raising More Income Tax Revenue Can Help Pennsylvania, Other States, Pursue a Stronger Economic Future

Testimony of Wesley Tharpe, Senior Advisor for State Tax Policy, Center on Budget and Policy Priorities, Before the Pennsylvania House Finance Subcommittee on Tax Modernization

Chairman Rabb, distinguished members — good afternoon. I'm Wesley Tharpe, and I'm Senior Advisor for State Tax Policy at the Center on Budget and Policy Priorities (CBPP) in Washington, D.C. Thank you very much for the opportunity to share some brief perspective here today.

Allow me to start with a quick word about where I work and who I am. CBPP is an independent, nonpartisan research institute that since 1981 has worked to advance both federal and state policies aimed at building a nation where *everyone* has the resources they need to thrive. I've been with the Center for the past five years, and in the general line of work for more than 12 years overall, with a particular emphasis on the role that fair and adequate tax systems play in states' overall success.

I plan to spend my few minutes here today sharing some insights about the relationship between state tax policy and state economies, in particular what we know when it comes to the role of state income taxes. I will focus on two main points:

- One, that altering state income tax rates is unlikely to meaningfully impact states' *short-term* economic performance, for better or for worse, based on either the real-world track record of other states or the broad consensus of mainstream research.
- And two, that maintaining adequate tax revenues is in itself vital to a state's overall economic future, because it allows policymakers to both adequately support current public services like schools and infrastructure that undergird state economies today, and to pave the way for *new* investments that could further expand economic opportunity and enhance the state's quality of life, thereby setting states up for more durable success and growth down the road.

State Income Tax Changes Unlikely to Alter Short-term Economic Trends

Starting with my **first point**: one of the more common arguments we see come up in these sorts of state debates nationwide is that lower state income tax rates are more conducive — or even

essential — to strong economic growth. And that higher tax rates, in contrast, are likely to harm state economies or to drive people and businesses away from the state. But those claims are simply not firmly grounded in the evidence.

For one, we can look at the real-world track record of states that enacted similar measures in the recent past. Specifically, if we look at the handful of states that enacted targeted tax increases on their highest-income taxpayers (sometimes known as millionaires' taxes) during the 2000s and 2010s, we see that those states had similar economic profiles as their neighbors over the years that followed. In eight states (including the District of Columbia) that adopted these policies over that span, seven states had per capita growth in personal incomes at least as strong as nearby states; six had private-sector economic growth that met or exceeded their neighboring states; and five added jobs at least as quickly as their neighbors.¹

When we instead look at states that chose to deeply cut their income tax rates, the lack of any clear short-term economic linkage continues to shine through. Of the five states that cut personal income taxes most deeply following the Great Recession of 2007-2009, in the years after, *all five* saw weaker overall GDP growth than the nation as a whole, while four also had slower growth in personal income and job creation.² Even states that lack personal income taxes do not consistently outperform: the nine states with the highest top marginal income tax rates during the 2010s saw their economies grow slightly faster, on average, than the nine states without broad-based income taxes.³

Further on this point: the real-world track record is further supported by the bulk of mainstream expert research on the topic. Most academic experts find that while state tax rates do likely play some small role around the margins, they are highly unlikely to be a primary driver of topline economic trends. Indeed, 15 of the 20 major peer-reviewed studies published in academic journals in the 2000s and 2010s that examined the role of state personal income tax levels found little to no clear economic effects.⁴ Studies focusing on narrower issues, such as the impact of state tax levels on entrepreneurship, also find little to no impact. For instance, a rigorous 2012 study commissioned by the U.S. Small Business Administration found “no evidence of an economically significant effect of state tax portfolios on entrepreneurial activity.”⁵

¹ Wesley Tharpe, “Raising State Income Tax Rates at the Top a Sensible Way to Fund Key Investments,” CBPP, February 7, 2019, <https://www.cbpp.org/research/state-budget-and-tax/raising-state-income-tax-rates-at-the-top-a-sensible-way-to-fund-key>.

² CBPP, “Big Cuts in State Income Taxes Not Yielding Promised Benefits,” updated February 21, 2018, <https://www.cbpp.org/research/fact-sheet-big-cuts-in-state-income-taxes-not-yielding-promised-benefits>. Also see Michael Leachman and Michael Mazerov, “State Personal Income Tax Cuts: Still a Poor Strategy for Economic Growth,” CBPP, May 14, 2015, <https://www.cbpp.org/research/state-budget-and-tax/state-personal-income-tax-cuts-still-a-poor-strategy-for-economic>.

³ Carl Davis, “Another Reason to Tax the Rich? States with High Top Tax Rates Doing as Well, if Not Better, than States Without Income Taxes,” ITEP, September 23, 2020, <https://itep.org/another-reason-to-tax-the-rich-states-with-high-top-tax-rates-doing-as-well-if-not-better-than-states-without-income-taxes/>.

⁴ See Tharpe, 2019.

⁵ Donald Bruce and John Deskins, “Can State Tax Policies Be Used to Promote Entrepreneurial Activity?” *Small Business Economics*, 2012, <https://www.jstor.org/stable/41472828>.

Now, part of the reason why income tax rates are not reliably linked to economic performance is that one common claim for how they might be so — namely that they are a major factor in states’ ability to attract and retain residents — tends to be significantly overblown. While evidence indicates that taxes do matter to interstate tax migration around the margins, most rigorous analysis finds any real-world impact to be small. For example, in a landmark 2011 study of New Jersey’s top tax bracket on high incomes adopted in 2004, researchers found that the tax increase resulted in a net loss of 1 out of every 2,000 millionaires present in that state at that time.⁶

Meanwhile, other evidence on interstate tax migration indicates that non-tax factors — such as housing costs, proximity to jobs and family, and climate rank as more important. Indeed, when households that have moved across states are asked by the U.S. Census why they chose to do so, more than two-thirds report their reason was either job- or family-related.⁷

Those non-tax factors come especially clearly into light when thinking about migration differences between the so-called Rust Belt and Sun Belt, which is a decades-long trend. As just one case in point: for the last 30 years, Pennsylvania consistently had the *lowest* top income tax rate among all the states levying that tax, yet the state experienced net out-migration in all of those years. Meanwhile, North and South Carolina, which had graduated rate structures with top income tax rates more than twice as high for almost the entire period, had substantial net in-migration every single year.⁸

Adequate Revenues Help Protect and Enhance State Economies Over Time

That brings me to my **second and final point**: something that often gets lost in these sorts of debates of whether tinkering with tax rates will help or harm a state’s economy is the fact that states’ ability and willingness to raise adequate taxes revenues is — in and of itself — an essential component of whether or not a state’s economy and its people can reliably thrive.

This is true for two reasons: one, adequate revenues allow states to protect the pillars of economic growth and opportunity that they already have, such as by preventing or minimizing harmful budget cuts to schools or child care, shoring up Rainy Day Funds to protect against the next recession, or striving to fill structural budget deficits⁹—such as the one this state’s Independent Fiscal Office recently reported Pennsylvania has now had for nine consecutive years.¹⁰

⁶ Cristobal Young and Charles Varner, “Millionaire Migration and State Taxation of Top Incomes: Evidence from a Natural Experiment,” *National Tax Journal*, June 2011.

⁷ Michael Mazerov, “State Taxes Have a Minimal Impact on People’s Interstate Moves,” CBPP, August 9, 2023, <https://www.cbpp.org/research/state-budget-and-tax/state-taxes-have-a-minimal-impact-on-peoples-interstate-moves>.

⁸ *Ibid.*

⁹ The importance of state policymakers prioritizing revenue in order to protect the economic foundations they have already built was perhaps most clearly evidenced by what happened in the wake of the Great Recession of a decade-plus ago — when crashing revenues across the states led to actions like sharp increases in college tuition, cuts in school funding, widespread public sector layoffs, and other cutbacks that both harmed workers and families and contributed to a slower economic recovery. Michael Leachman and Erica Williams, “States Can Learn From Great Recession, Adopt Forward-Looking, Antiracist Policies,” CBPP, February 11, 2021, <https://www.cbpp.org/research/state-budget-and-tax/states-can-learn-from-great-recession-adopt-forward-looking>.

¹⁰ Josh Goodman, “State Budget Problems Spread,” Pew, January 9, 2024, <https://www.pewtrusts.org/en/research-and-analysis/articles/2024/01/09/state-budget-problems-spread>.

The second reason is that adequate revenues, and in particular sizable revenue expansions such as those contemplated by the Fair Share plan, can allow states to take a strategic leap forward by boosting public investment in emerging or unmet areas of need, such as child poverty, maternal well-being, climate resiliency, or affordable housing — all of which are vital to protecting state prosperity and well-being in the short-run, and to further bolstering it over time. For example, in Massachusetts, a new levy on incomes above \$1 million is already allowing policymakers to do things like expand public transit service, bolster free community college programs and university scholarships, and retrofit K-12 schools to be more energy efficient and environmentally healthy.¹¹ That state's not alone, as several others have also raised new revenues for various new investments in workers and families — and to strengthen their long-term economic promise.¹²

To close: these sorts of shared public commitments are as essential to states' short-term economic health as any narrower questions around income tax rates. And they are likely to be even more important to it over the long run. By embracing tax policies that raise sufficient revenue, and ideally doing so in sound, targeted ways that make the state's tax system fairer for low- and middle-income people in the process, Pennsylvania would be taking an important step toward protecting and enhancing its own economic future.

Thank you once more for the opportunity to speak and I look forward to any discussion.

¹¹ Jason Wright, "Your Fair Share Dollars at Work: Critical Investments and Hard Choices," MassBudget, August 15, 2023, <https://massbudget.org/2023/08/15/your-fair-share-dollars-at-work-critical-investments-and-hard-choices/>.

¹² Wesley Tharpe, "States Should Reverse Tax-Cut Spree, Take Brighter Path in 2024," CBPP, January 24, 2024, <https://www.cbpp.org/blog/states-should-reverse-tax-cut-spree-take-brighter-path-in-2024>.