

January 14, 2021

Cutting State Income Taxes Counterproductive to Prosperity, Racial Justice

By Wesley Tharpe and Michael Leachman

As states enter their 2021 legislative sessions, lawmakers in several states including Arkansas, Mississippi, Montana, and West Virginia are calling for cutting personal income taxes. This would sap revenues needed for an effective response to the COVID-19 pandemic and threaten states' recovery from the recession. And, by weakening state finances, it would undermine efforts to advance racial justice — just when growing understanding of the nation's shameful history of racism, as well as white supremacist opposition to American democracy itself, demand the opposite approach.

Cutting Income Taxes Would Likely Worsen Racial Inequities

Most state tax systems already deepen racial and ethnic inequities because they ask the most, as a share of income, of lower-income households, which are disproportionately households of color.¹ In some cases, states have also used their taxing power to worsen the profound challenges facing people of color deliberately.² For example, Mississippi enacted the nation's first modern retail sales tax, during Jim Crow, in part to reduce property taxes and shift state taxes from (mostly white) property owners to consumers with little or no property to tax (many of whom were Black).³

Because most states' income taxes are progressive (meaning people pay higher rates on higher incomes), they foster at least some degree of racial equity in state tax codes; white families are three times likelier than Black and Latinx families to be in the top 1 percent, for example.⁴ In contrast, regressive taxes — especially sales taxes and fees — fall more on low- and moderate-income people. This means cutting state income taxes can worsen racial inequities by disproportionately benefiting taxpayers at the top, most of whom are white. For instance, when North Carolina slashed personal

¹ Institute on Taxation and Economic Policy, "Who Pays? 6th Edition," October 2018, <https://itep.org/whopays/>. In 45 states, lower-income households pay a larger share of their income in state and local taxes than high-income households.

² Michael Leachman *et al.*, "Advancing Racial Equity With State Tax Policy," CBPP, November 15, 2018, <https://www.cbpp.org/research/state-budget-and-tax/advancing-racial-equity-with-state-tax-policy>.

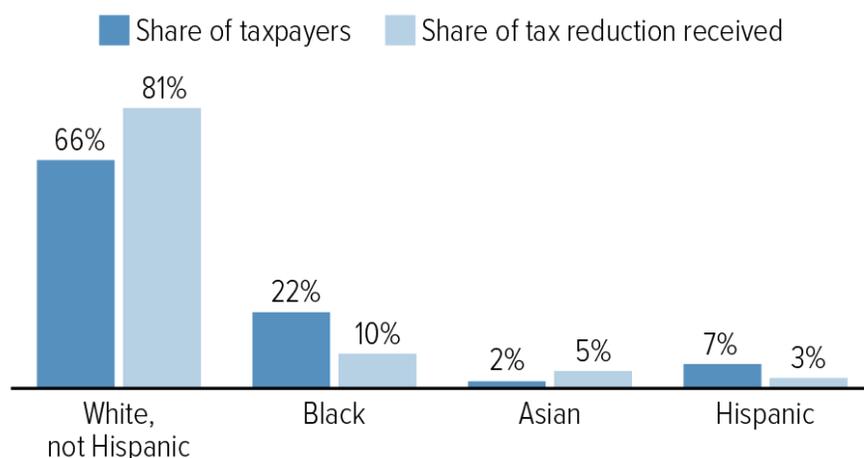
³ Michael Leachman, "Mississippi Governor Irresponsibly Proposes to Repeal State's Income Tax," CBPP, November 30, 2020, <https://www.cbpp.org/blog/mississippi-governor-irresponsibly-proposes-to-repeal-states-income-tax>.

⁴ Cortney Sanders, "State Millionaires' Taxes Can Advance Racial Justice," CBPP, March 15, 2019, <https://www.cbpp.org/blog/state-millionaires-taxes-can-advance-racial-justice>. At the other end of the income spectrum, 22 percent of the nation's households are Black or Latinx, but they make up 28 percent of the nation's poorest households.

income taxes in 2013, Black residents received only 10 percent of the tax cut, though they made up 22 percent of the state’s population.⁵ (See Figure 1.)

FIGURE 1

2013 Tax Cuts Worsened Racial Wealth Inequities in North Carolina



Source: Institute on Taxation and Economic Policy, 2013-2016

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Cutting Income Taxes Hasn’t Boosted State Economies in the Past

States that sharply cut income taxes in the past have reaped sharply lower state revenues, as common sense would predict, and the tax cuts have consistently failed to produce an economic boom. In the early 2010s, Kansas, Maine, North Carolina, Ohio, and Wisconsin cut personal income taxes by large amounts in hopes of boosting their economies. But all five saw *slower* growth in private-sector gross domestic product than the United States as a whole over the next few years, and four of the five saw slower growth in private-sector jobs.⁶ (See Figure 2.) Kansas’ massive income tax cuts wreaked so much havoc on the state’s ability to pay its bills and save for the future, let alone invest in people and infrastructure, that lawmakers voted on an overwhelming, bipartisan basis to reverse them in 2017.⁷ States that cut income taxes in the 2000s and 1990s didn’t see much economic gain either.⁸

⁵ The 2013 tax cuts reduced the taxes of the highest-income state residents by 1.5 percent of their income, on average, but by just 0.1 percent of income for the lowest-income North Carolinians, according to the Institute on Taxation and Economic Policy. See Leachman *et al.*, *op. cit.*

⁶ CBPP, “Big Cuts in State Income Taxes Not Yielding Promised Benefits,” updated February 21, 2018, <https://www.cbpp.org/research/big-cuts-in-state-income-taxes-not-yielding-promised-benefits>.

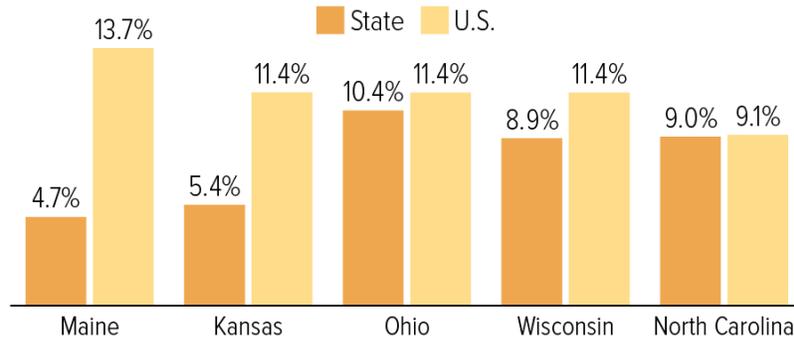
⁷ Michael Leachman, “A Kansas Wake-Up Call for Other States Considering Big Income Tax Cuts,” CBPP, February 23, 2017, <https://www.cbpp.org/blog/a-kansas-wake-up-call-for-other-states-considering-big-income-tax-cuts>.

⁸ Four of the six states that cut personal income taxes significantly in the 2000s saw their share of national employment decline after enacting the cuts. And, in the 1990s, states with the biggest tax cuts grew jobs during the next economic cycle at an average rate only one-third as large as more cautious states. Michael Leachman and Michael Mazerov, “State

FIGURE 2

Biggest Tax-Cutting States Didn't See Economies Take Off

Growth in private state and national gross domestic product during period the tax cuts have been in effect



Note: Effective dates for tax cuts are Jan. 2012 for Maine, Jan. 2013 for Kansas, June 2013 for Ohio and Wisconsin (retroactive to Jan. 2013), and Jan. 2014 for North Carolina. In June 2017, Kansas restored some but not all of its tax cuts; the figures above for Kansas reflect the period between enactment and repeal of the majority of the January 2013 tax cuts.

Source: Chained, quarterly private GDP from Bureau of Economic Analysis, February 2018

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Other evidence indicates that *raising* income tax rates — in particular through targeted tax hikes on high incomes — doesn't harm states' ability to compete economically with their neighbors.⁹ It's also worth noting that states *without* broad-based income taxes have higher sales and property taxes¹⁰ and haven't enjoyed especially strong economic performance. The nine states with the highest top marginal income tax rates over the last decade saw their economies grow slightly faster, on average, than the nine states without income taxes, for example.¹¹

More broadly, mainstream research finds that tax differences among states aren't the main driver of states' relative economic performance. Fifteen of 20 major studies published in academic journals from 2000 to 2018 that examined the broad economic effect of state personal income tax levels

Personal Income Tax Cuts: Still a Poor Strategy for Economic Growth," CBPP, updated May 14, 2015, <https://www.cbpp.org/research/state-budget-and-tax/state-personal-income-tax-cuts-still-a-poor-strategy-for-economic>.

⁹ Of the eight states (including the District of Columbia) that enacted lasting "millionaires' taxes" from 2000 to 2018, seven had per capita personal income growth at least as strong as their neighbors after raising taxes; six had growth in private-sector gross domestic product about as good as or better than their neighbors; and five added jobs at least as quickly as their neighbors. Wesley Tharpe, "Millionaires' Taxes a Smart Way for States to Invest in Their Future," CBPP, February 7, 2019, <https://www.cbpp.org/blog/millionaires-taxes-a-smart-way-for-states-to-invest-in-their-future>.

¹⁰ Nicholas Johnson and Erica Williams, "Without A State Income Tax, Other Taxes Are Higher," CBPP, March 22, 2012, <https://www.cbpp.org/sites/default/files/atoms/files/3-22-12sfp.pdf>.

¹¹ 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," Institute on Taxation and Economic Policy, 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/>.

found no significant effects, and one of the others produced internally inconsistent results.¹² As a pair of university researchers described in a comprehensive literature review in 2018, “The vast majority of the academic studies that examined the relationship between state and local taxes and economic growth found little or no effect.”¹³

Cutting Personal Income Taxes Doesn’t Promote Small Businesses or Jobs

One reason state income tax cuts don’t unleash economic growth is that they don’t help small businesses to the degree often advertised. The vast majority of taxpayers are in no position to create a job, with or without a tax cut: only 2.1 percent of personal income taxpayers own a small business with any employees other than the owners. Also, most small businesses don’t earn enough for tax cuts to make a crucial difference. More than 8 in 10 small businesses have less than \$50,000 in annual taxable income, so even *eliminating* the tax wouldn’t come close to paying one full-time worker’s salary.¹⁴

For entrepreneurs considering where to launch a company and create jobs, states’ education systems, workforce talent, and general quality of life are much more important factors than tax differences, evidence suggests.¹⁵

Cutting Income Taxes Hinders Investments to Create Thriving, More Equitable Economies

Another reason income tax cuts don’t unleash economic growth is that, since states must balance their budgets, they must offset the lost revenue by cutting support for schools, infrastructure, social services, and other building blocks of a strong economy.

States need adequate revenues in good times to pay for investments that promote long-term growth, such as by knocking down long-standing barriers to opportunity. States also need adequate revenues in bad times such as the COVID-19 recession, to help families and small businesses stay afloat and limit short-term harm, especially for people of color and struggling communities. Without adequate revenues, states will be hard pressed to advance antiracist policies needed in the wake of the pandemic to address structural barriers that limit states’ economic potential, such as the massive disparities in wealth and incomes and persistent racial discrimination.¹⁶

¹² 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>

¹³ Dan S. Rickman and Hongbo Wang, “U.S. State and Local Fiscal Policy and Economic Activity: Do We Know More Now?” August 7, 2018, https://mpra.ub.uni-muenchen.de/88422/1/MPRA_paper_88422.pdf.

¹⁴ CBPP, “Tax Cuts Don’t Boost Small Business Employment,” https://www.cbpp.org/sites/default/files/atoms/files/5-11-15sfp-fact_4.pdf.

¹⁵ In a survey of the founders of many of the country’s fastest-growing firms, only 5 percent cited low tax rates as a factor in deciding where to launch their company. Endeavor Insight, “What Do the Best Entrepreneurs Want in a City? Lessons from the Founders of America’s Fastest Growing Companies,” February 2014, p. 6, https://issuu.com/endeavorglobal1/docs/what_do_the_best_entrepreneurs_want.

¹⁶ Erica Williams and Cortney Sanders, “3 Principles for an Antiracist, Equitable State Response to COVID-19 — and a Stronger Recovery,” CBPP, May 21, 2020, <https://www.cbpp.org/research/state-budget-and-tax/3-principles-for-an-antiracist-equitable-state-response-to-covid-19>.

Instead of cutting income taxes, states can help create stronger, more equitable economies by *raising* taxes on high incomes. This can generate substantial revenue, disproportionately from white taxpayers,¹⁷ for public investments that improve schools in communities of color, repair often-neglected water systems and other public infrastructure in these communities, increase family incomes, dismantle racist and sexist barriers to innovation and opportunity,¹⁸ and otherwise help build an economy whose benefits are widely shared.

¹⁷ Cortney Sanders, “State Millionaires’ Taxes Can Advance Racial Justice,” CBPP, March 15, 2019, <https://www.cbpp.org/blog/state-millionaires-taxes-can-advance-racial-justice>.

¹⁸ Wesley Tharpe, Michael Leachman, and Matt Saenz, “Tapping More People’s Capacity to Innovate Can Help States Thrive,” CBPP, December 9, 2020, <https://www.cbpp.org/research/state-budget-and-tax/tapping-more-peoples-capacity-to-innovate-can-help-states-thrive>.