BTC Brief
BUDGET & TAX CENTER
May 2013

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Empty Promises: Income Tax Cuts A Poor Strategy for Boosting the Economy

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INCOME TAX CUTS ARE A POOR STRATEGY for producing economic growth, despite the claims of North Carolina policymakers who are advocating deep cuts to the state's income taxes. This has been amply demonstrated by experience with income tax cuts at the state and federal levels and decades of careful research that has found no link between state personal income tax levels and economic growth. Instead, income tax cuts – particularly for high income households -- contribute to rising income inequality and drain resources from schools, health care, public safety and other ingredients of a strong, durable economy.

A sound tax reform plan should ensure that low- and middle-income taxpayers don't carry more of the tax load and that investments in schools, health and public safety can be sustained over time. Income tax cuts like those currently being considered would only make these goals harder to achieve.

Past income tax cuts have not produced the promised economic benefit

Past experimentation with income tax cuts by federal and state policymakers has failed to provide the kind of economic boost that supporters of the cuts promised.

The Congressional Research Service examined 65 years of federal tax and economic data and found that the top income tax rates and the top capital gains tax rate have had no discernible impact on economic growth. CRS also found that the cut in the top tax rates in recent years has not resulted in more savings, investment or productivity.[1] In fact, the cut in the top federal marginal income tax rate in 2001 and 2003 was followed by the weakest economic expansion since the end of World War II.[2]

Similar studies at the state level have reached the same conclusion. Low-tax states are more likely to have lower per capita income and employment growth than states with higher taxes.[3] The nine states with the highest income tax rates have economies as good as, or in some cases better than, the nine states without a personal income tax.[4] And the five states that enacted the largest tax cuts in the 1990s had weak job growth and personal income growth, while non-oil producing states that made large personal income tax cuts in the 2000s grew more slowly than the national economy.[5]

In fact, some economists have found that higher state personal income taxes are associated with higher state economic growth.[6] This is most likely due to the fact that states with adequate income taxes have enough resources to make considerable investments in schools, roads, health care and other services that are crucial to long-term economic growth. A study by the Federal Reserve Bank of Chicago found that the greatest driver of per capita income growth in a state is its stock of educated workers and research

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institutions, for example.[7] Tax cuts make it far less likely that a state will be able to invest in such valuable resources.

Tax cuts increase income inequality

Tax cuts targeted disproportionately to the wealthy have added to a growing gap between the earnings of those at the top of the income ladder and those on the middle and lower rungs.

Cuts in top tax rates have further concentrated income among the wealthy and deepened an increase in income disparities, according to the Congressional Research Service. The tax code in 2007 was almost one-third less effective at reducing income inequality than it was in 1979 because of cuts to the top rates, another study found.[8]

Income inequality harms the economy. It weakens the middle class, increases the distance between poverty and success, lowers demand for goods and services and discourages entrepreneurship.[9]

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