



## A PATHWAY TO POVERTY:

### 3 Reasons Why Tennessee is a Bad Role Model for North Carolina’s Economic Future

BY ALLAN FREYER, POLICY ANALYST

In the current debate over tax reform, legislative leaders frequently hold up Tennessee as a role model for improving North Carolina’s economic competitiveness and ensuring future prosperity. But a look beneath the surface reveals that the Volunteer State has the wrong kind of economy to emulate—Tennessee models a pathway to poverty, not a pathway to prosperity.

- Tennessee’s economy is not performing as competitively as advertised, either in job creation or economic growth.
- The jobs created in Tennessee are almost entirely in low-skill, low-wage industries that have kept poverty higher and household incomes lower than in North Carolina.
- Low- and moderate-income families in Tennessee pay a larger share of their income in taxes than the wealthiest state residents, aggravating inequality in the state.

#### 1. Tennessee’s economy is not performing as competitively as advertised.

Despite a couple years of post-recession job growth that surpassed North Carolina’s, Tennessee’s economy has not performed as competitively as advertised over the long-

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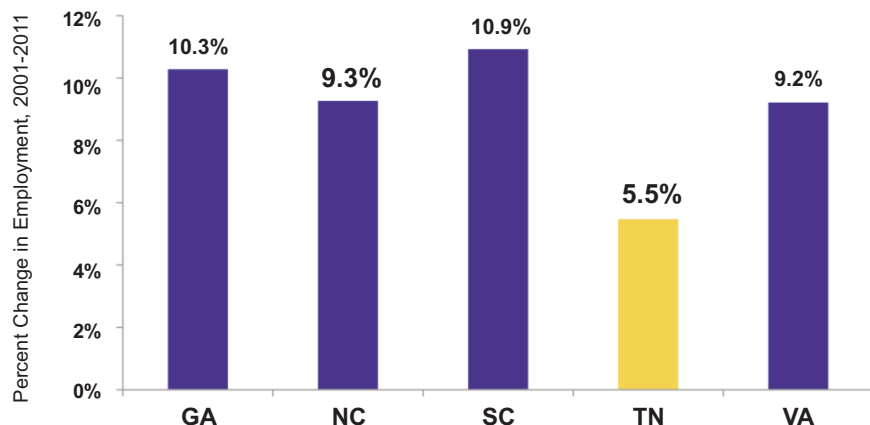
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**FIGURE 1: Tennessee lags region in job creation over last decade**



SOURCE: Bureau of Economic Analysis

term—either in job creation or overall economic growth. Certainly, the Volunteer State’s performance does not justify emulating its policies in North Carolina.

In terms of job creation, Tennessee’s competitiveness in employment growth during and after the Great Recession is highly over-rated. Although Tennessee currently has a lower unemployment rate, this is hardly a major accomplishment. North Carolina lost more jobs proportionally during the recession than did the Volunteer State, including a much greater loss of critically important manufacturing jobs, so it’s natural that the Tarheel State would take longer to recover those lost jobs and continue to have a higher unemployment rate.<sup>1</sup>

And over the long term—the last decade—Tennessee looks even less impressive. It had by far the slowest employment growth rate (4.4 percent) of any neighboring state from 2001 to 2011 (the most recent complete for which data is available), including North Carolina (which saw 8.3 percent employment growth).<sup>2</sup> In the years of recession and sluggish recovery since 2006, North Carolina has actually seen 0.2 percent nonfarm employment growth, while nonfarm employment in the Volunteer State contracted by 2 percent.<sup>3</sup> Only over the last two years has Tennessee begun to (slightly) outpace North Carolina in employment growth (2 percent to the Tarheel State’s 1.8 percent), but this does not represent a significant economic or competitive advantage.<sup>4</sup>

Similarly, Tennessee’s supposedly impressive record of economic growth is considerably less than meets the eye. Over the most recent five years for which full data are available (2006 to 2011), Tennessee’s annual rate of growth in the value of goods and services it produced (its per capita gross domestic product, or GDP) was not significantly better than North Carolina’s. In fact, North Carolina actually generated slightly higher overall growth from 2006 to 2011 (0.84 percent to Tennessee’s 0.36 percent),<sup>5</sup> but since population growth outpaced GDP growth in North Carolina, it lagged Tennessee slightly in per capita change in GDP (-0.78 to Tennessee’s -0.67).<sup>6</sup> Given that both states experienced economic contractions over this period, this difference of 0.11 percent is negligible. As with job creation, these trends are certainly not enough to claim Tennessee has some model of super-competitive economic performance.

**2. Tennessee’s economy is generating low-wage jobs that pay poverty-level wages.**

What job growth Tennessee has experienced has mostly occurred in low-skill industries that are paying workers too little to keep families out of poverty. Over the past decade, private employment growth in Volunteer State industries paying below the state’s \$30,202 median wage grew an

average of 3 percent, while dropping by almost 5 percent in industries paying above this threshold. Even more troubling, this trend appears to be accelerating. Since 2006, Tennessee’s employment in higher-wage sectors has dropped by 7 percent. These are not trends that North Carolina should import.

**FIGURE 2: Tennessee's Economy Worse than North Carolina's**

State	Poverty, 2011	Median Household Income, 2011	Median Wage, 2011
NC	17.9	\$43,916	\$31,242
TN	<b>18.3</b>	<b>\$41,700</b>	<b>\$30,202</b>

Tennessee’s workers were paid lower wages than North Carolina’s workers across all earnings groups in 2011, including the median wage, which was \$1,000 less in the Volunteer State.<sup>7</sup> Lower-skill workers in Tennessee in industries that pay below-median wages earned, on average, \$67 less in wages in 2011 than their counterparts in North Carolina. Higher-skill workers in Tennessee paid above the median wage earned about \$3,100 less than their equivalent Tarheel State workers. Even more strikingly, Tennessee lagged significantly behind North Carolina in terms of industries that pay above \$60,000 per year and require substantial education, including information, financial services, professional services, and management of companies. These industries paid between \$1,000 and \$7,200 less in Tennessee and experienced slower employment growth over the past decade, suggesting that North Carolina—not low-tax Tennessee—is the better bet for high-skill, high-wage industries.

These across-the-board lower wages go a long way toward explaining why Tennessee’s median

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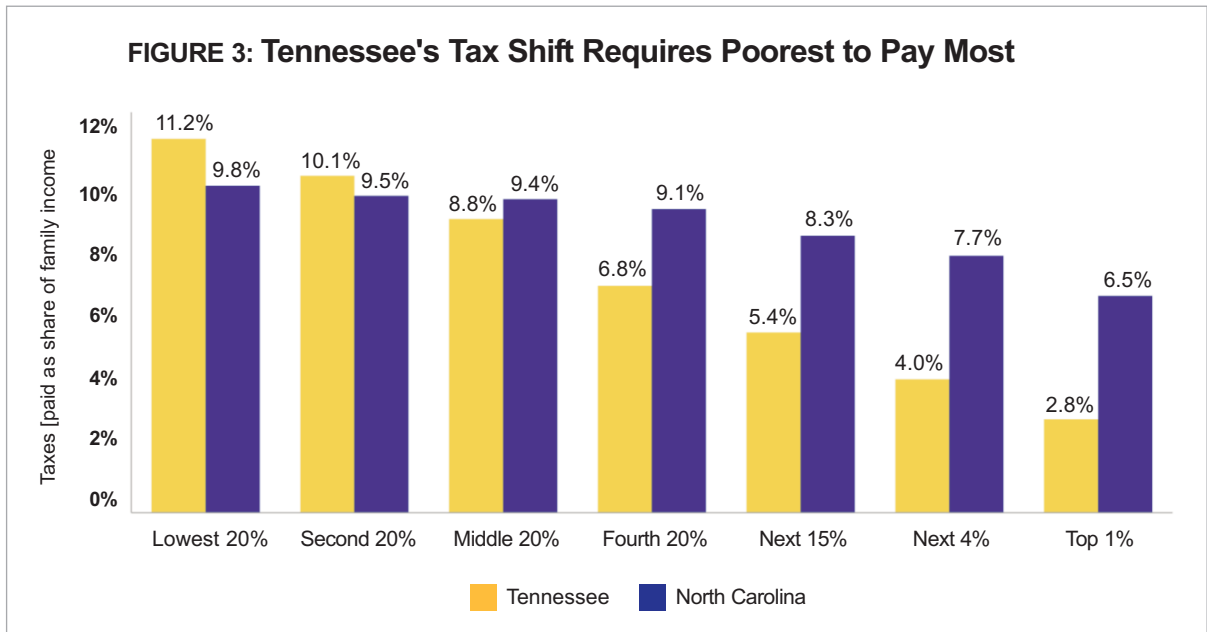
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household income (\$41,700 in 2011) is \$2,000 less than North Carolina's (\$43,916),<sup>8</sup> and its 18.3 percent poverty rate is worse than North Carolina's (17.9 percent).<sup>9</sup>

As a result, workers in Tennessee are suffering from a poverty-wage economy that limits opportunity and upward mobility—low-skill, low-wage industries are booming, while high-skill, high-wage industries are lagging. An economy that provides greater opportunities to prosper would see stronger job growth in industries that require high skill levels and also pay above the state's median wage, yet Tennessee saw the reverse.

**3. Tennessee's tax policies make poverty worse by shifting tax load to working families**

Tennessee's regressive tax policies have exacerbated the challenges faced by workers in the state's poverty-wage economy by requiring low-income families to pay more in taxes as a share of their income than the wealthiest state residents. Tennessee has no personal income tax, and as a result, the state is much more reliant on sales taxes to fund schools, health care, and other services that form the foundation of a strong economy. In fact, Tennesseans pay higher sales



SOURCE: Institute for Taxation and Economic Policy, 2012

taxes as a proportion of their income than residents of any surrounding state—\$46.42 for every \$1,000 of personal income, compared to North Carolina's \$35.58, which is right at the national average.<sup>10</sup> Since lower-income families spend a greater portion of their total income on food, rent, health care and other basics than high-income families, sales taxes have a disproportionate impact on those least able to pay them.

The poorest 20 percent of Tennessee taxpayers—those making less than \$17,000 per year—pay 11.2 percent of their income in taxes, while the wealthiest 1 percent—those making an average of \$945,900 per year—pay just 2.8 percent of their income in taxes. The majority of Tennesseans, who earn an average of \$57,000 or less, end up paying at least three times more, in percentage terms, than what the wealthiest pay in taxes.<sup>11</sup> In contrast, the bottom 20 percent of North Carolina taxpayers pay 8.9 percent of their income in taxes, while the top 1 percent pay 6.5 percent of their income in taxes. While that's still an unfair situation, the disparity is much worse in Tennessee.

Although proponents of Tennessee's tax system claim that the lack of a personal income tax means lower taxes for all taxpayers, this is clearly not the case. The lowest income taxpayers in

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Tennessee end up paying more as a share of their income than the richest taxpayers. Combined with the boom in low-wage employment, the tax shift that results from no personal income tax ensures that low- and moderate-income families don't have enough to get by. Clearly, Tennessee's economy is a bad role model for North Carolina. It provides a pathway to poverty, not a pathway to prosperity.

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- 1 Freyer, Allan. (2013). North Carolina's Economy is Competitive with Neighboring States: Declining manufacturing, not tax policy, cause for higher unemployment
  - 2 Bureau of Economic Analysis, Total full-time and part-time employment by NAICS industry
  - 3 Ibid.
  - 4 BTC Analysis of Bureau of Economic Analysis data
  - 5 BTC Analysis of Bureau of Economic Analysis data
  - 6 Freyer, Allan. (2013). North Carolina's Economy is Competitive with Neighboring States: Declining manufacturing, not tax policy, cause for higher unemployment
  - 7 Current Population Survey, in 2011 dollars
  - 8 American Community Survey
  - 9 American Community Survey
  - 10 U.S. Census, State Government Tax Collections Data
  - 11 Institute for Taxation and Economic Policy. (2013). Who Pays? A Distributional Analysis of the Tax Systems in All 50 States.

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