GRAND CANYON INSTITUTE

Policy Brief

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Voters Beware:

Arizona Chamber's Anti-Prop. 208 Study Strikes Out

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Economies are impacted by many factors: the education levels of the work force, locality to critical markets—such as Arizona's proximity to California, and to some degree taxes. Taxes, however, take many forms, and while changes in taxes can impact business decisions, business tax and business climate indices are very poor indicators of a state's overall economic performance.

That, however, does not prevent people from circulating analyses as if taxes were the pre-eminent predictor of economic outcomes, the latest illustration being the critique of Prop. 208 funded by the Arizona Chamber Foundation and authored by Arthur Laffer, Stephen Moore and Erwin Antoni.

The study's analysis when held up to scrutiny falls apart, much like a house of cards when a dog whisks past it because its underlying economics are not plausible.

The Grand Canyon Institute (GCI), an independent, centrist think tank, focuses on providing quality evidence-based analyses to help frame policy discussions. GCI has not taken a position on Prop. 208, but it has conducted the most comprehensive evaluation of the initiative.

GCI reviewed the academic literature and found the best studies available and used their findings to estimate probable impacts of Prop. 208—both in terms of educational outcome improvements and economic impact. GCI sees the educational impact as growing to eventually between $630 million and $1.3 billion annually in discounted net present value (something Laffer, Moore and Antoni ignore). GCI estimates that an estimated 30,000 wealthy households, will likely be impacted by the tax increase, including an estimated 16,000 of whom operate S-Corporations or Partnerships that employ people.

How do Laffer, Moore and Antoni's claims compare with GCI's data-driven research findings when it comes to Prop. 208's economic impact?

Laffer, Moore and Antoni's claim	GCI's research findings
220,000 less jobs over 10 years	10,000 less jobs over 10 years related to impacted small businesses
700,000 fewer people move to the state over the next 10 years	Less than 100 households leave Arizona in the next couple years
No analysis of impact on K-12 education, but do state the revenue gains will only average $450 million due to the estimated large negative economic effects	Positive educational gains that will eventually lead to annual discounted prevent value gains of between $630 million and $1.3 billion[1]

A casual observer should ask how Laffer, Moore and Antoni determine that 700,000 fewer people will move to Arizona if the tax impacts only 30,000 households? And why such a huge portion of jobs will be lost—220,000 by their estimates—when a total of 360,000 people are currently employed by small business in Arizona. **The answer is simple—they are pretending that only personal income taxes impact economic outcomes.**

Prop. 208 has been well analyzed but most of the analyses look at impacts in a silo. None of the pro-208 analyses examined the impact of taxing Arizona's wealthiest income earners and none of the anti-208 studies included education impacts. GCI's analysis is the only study that evaluated both the additional spending on education and the finance mechanism.

Laffer, Moore and Antoni not only ignore the impact of additional education spending, they do not make a plausible case that the higher taxes hurt the economy. In short, their study strikes out.

Strike 1: Laffer, Moore and Antoni Assume Only Personal Income Taxes Impact Economic Growth

The only variable that Laffer, Moore and Antoni consider in their analysis is individual income tax rates, as opposed to more common econometric analyses that seek to hold other variables constant. They begin their analysis by comparing states that adopted an income tax in the last 60 years to those that either did not have a personal income tax or had adopted one more than 60 years ago.

[1] The impact is related to the lifetime earnings of students matriculating from K-12. Because those earnings gains occur over a long period of time, the usual way to estimate its current value is through what's called discounted present value—which is smaller than the total as future gains are deemed less valuable than ones received immediately.

Laffer, Moore and Antoni show that states that adopted income taxes in the past 60 years reported lower growth in population, gross state product, and state and local tax revenue as a share of the country as a whole compared to the other states in the study. They argue that this lower performance was due to the imposition of a state personal income tax.

Their findings are driven by population changes relative to the country as a whole—so effectively they are arguing the imposition of personal income taxes are the cause of people choosing to relocate. They appear to discount other motivations such as family connections or work opportunities as well as what the taxes might pay for such as if higher taxes paid for K-12 education, for instance. **Properly conducted academic studies provide little to no evidence for their findings**.

It is helpful to consider what a properly designed study that takes into account numerous variables and seeks to control for them. For example, in its analysis, GCI cited the study "Millionaire Migration and Taxation of the Elite: Evidence from Administrative Data" by Young, Varner et al.

> Model 2 incorporates a basic set of state level controls, addressing winter climate, alternative tax instruments (sales and property tax rates), states' economic strength, and the price of residential land. These variables have little impact on our coefficient of interest: the effect of the top tax rate barely changes (−.08) and is still significant…
>
> Descriptive analysis suggested that evidence for tax migration is largely driven by Florida as an attractive destination for U.S. millionaires. Are elites more able to exploit geographic tax opportunities, or are they just more likely to move to Florida? We test this in Model 4 by excluding Florida migration flows from the analysis. Model 4 shows that, outside of Florida, differences in tax rates between states have no effect on elite migration. Other low-tax states, such as Texas, Tennessee, and New Hampshire, do not draw away millionaires from high-tax states.[2]

Laffer, Moore and Antoni's argument is pretty easy to debunk. It relies on the assumption that people leaving a state should be those most impacted by the imposed taxes, in this case higher earners. Therefore, per capita personal income should decrease for the states criticized in the Laffer paper and be higher for the states they applaud. After 30 to 60 years (the time lapse since imposing an income tax), such results have had a significant time to take hold. Yet that's not the pattern that emerges as shown in Table 1 below. It is pretty difficult to suggest that the personal income tax rate is the cause of West Virginia's low per capita personal incomes. As a point of reference, operational K-12 spending per pupil has been added. No clear pattern emerges.

[2] Young, C., Varner, C., Lurie, I. Z., & Prisinzano, R. (2016). 7. Millionaire Migration and Taxation of the Elite: Evidence from Administrative Data. *American Sociology Review, 81*(3), 421-446. Retrieved from https://web.stanford.edu/~cy10/public/Jun16ASRFeature.pdf., p. 431.

Table 1: Comparing New Income Tax Imposing States and No Income Tax States

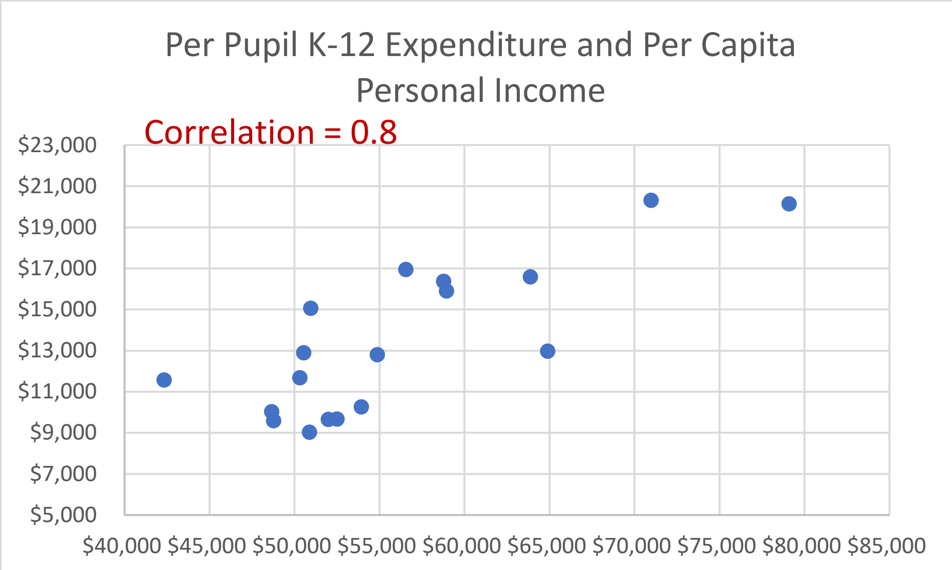
New Income Tax Imposing States			**No income Tax States**		
	Per Capita Personal Income	Per Pupil K-12 Spending		Per Capita Personal Income	Per Pupil K-12 Spending
Connecticut	$79,087	$20,147	Florida	$51,989	$9,663
New Jersey	$70,979	$20,316	Nevada	$50,883	$9,040
Ohio	$50,546	$12,893	South Dakota	$53,925	$10,263
Rhode Island	$56,542	$16,954	Texas	$52,504	$9,670
Pennsylvania	$58,775	$16,377	Washington	$64,898	$12,985
Maine	$50,950	$15,069	New Hampshire	$63,880	$16,588
Illinois	$58,935	$15,912	Tennessee	$48,761	$9,599
Nebraska	$54,871	$12,813			
Michigan	$50,320	$11,688			
Indiana	$48,657	$10,033			
West Virginia	$42,336	$11,572			
AVERAGE	**$56,545**	**$14,889**		**$55,263**	**$11,115**
Arizona	$46,233	$8,373			

Sources: 2019 Per Capita Personal Income Statistica , Expenditures for public elementary and secondary education, National Center for Educational Statistics, Table 4 FY2018.

Revisiting data with comparisons to Per Capita Personal Income and Per Pupil K-12 Expenditures

A clear pattern emerges when the data is reconfigured, so it looks at Per Capita Personal Income and Per Pupil K-12 expenditures. Per Pupil K-12 expenditures highly correlate with per capita personal income. Figure 1 certainly does not support Laffer's argument that all that matters is personal income tax rates.

Figure 1 Comparing Per Pupil K-12 Expenditure and Per Capita Personal Income

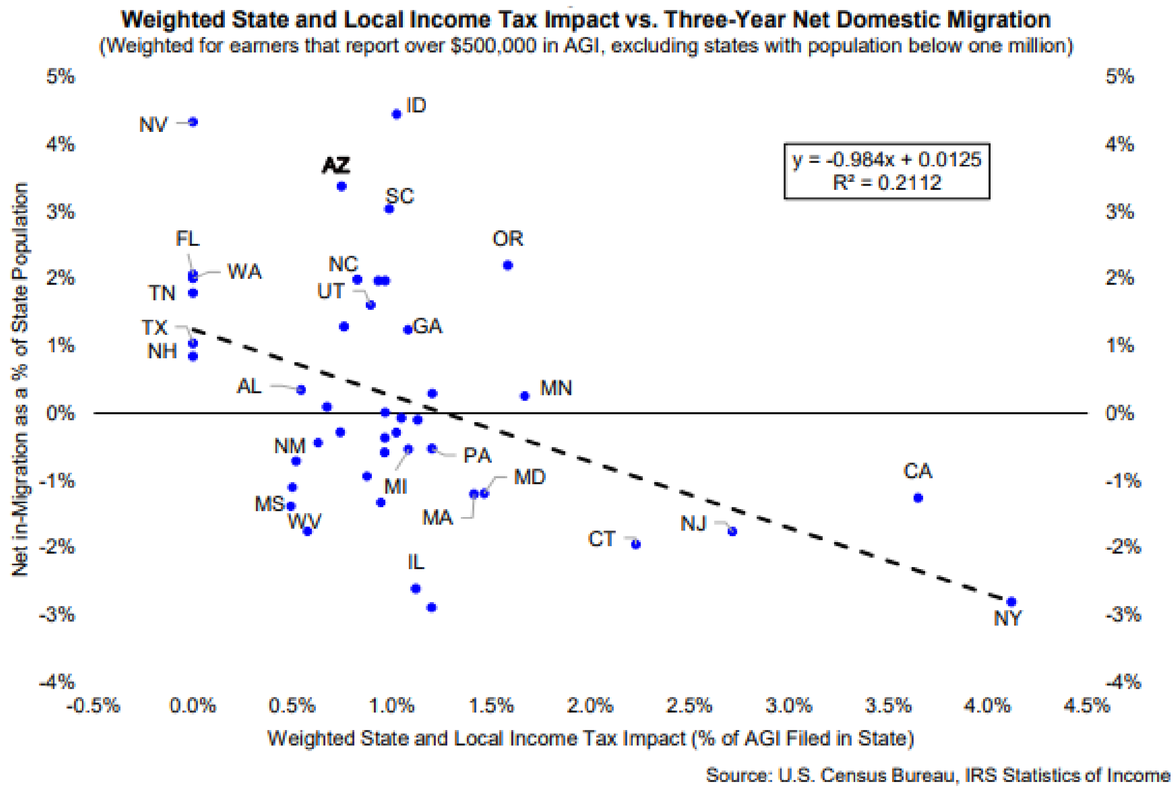


Strike 2—Poorly Grounded Estimate on Out Migration

Laffer, Moore and Antoni offer a poorly grounded claim that Arizona will suffer a significant loss in in-migration over the next 10 years if Prop. 208 passes.

Take a look at his simple Net Migration and Tax Model as shown in Figure 2. Two things are readily apparent. The R^2 indicates that just using income tax data explains only 20% of the migration variation—meaning it fails to explain 80% of the variation in why people choose to move somewhere. Worse yet, Arizona is one of the states that the model is particularly inaccurate at explaining given that it has significantly more in-migration than this simple model would predict. In other words, a lot more people come to Arizona than you would estimate if you only looked at taxes. A statistically accurate analysis would control for other factors such as region, climate, job growth and overall cost of living. Importantly, robust studies repeatedly find there is very little to no impact on migration levels due to taxes—especially if migration to Florida is removed.

Figure 2: Laffer, Moore and Antoni Model on Net Migration

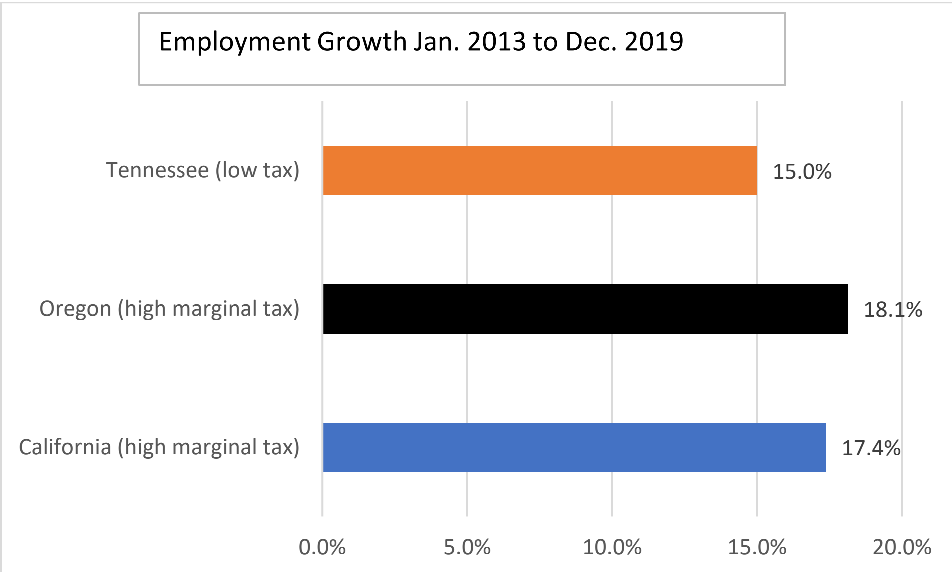


Strike 3—Misrepresentative Case Studies

North Carolina — Laffer, Moore and Antoni offer the miracle of North Carolina as a case study in wise public policy. The state cut taxes and got immediate great results. The 2013 to 2015 timeframe referenced by the Laffer paper recognizes North Carolina's miracle policies as instigating a decline in unemployment from 7.8% to 5.7%. That appears noteworthy until North Carolina's economy is compared to the national economy—the national unemployment rate dropped from 7.7% to 5.0% from Jan. 2013 to Dec. 2015. This national context was left out of the Laffer paper's analysis.

Tennessee—They also herald low-tax Tennessee as having the third lowest taxes in the country. For Tennessee they tout a variety of statistics from 2013, 2015 and 2016, such as 18th in highways up form 37th in 1986. But their best statistic is perhaps 55,600 more people employed from November 2015 to November 2016, which they indicate was the best in the nation relative to a state's population. One year seems a bit narrow of a stretch to reach broad conclusions, so GCI looked at employment growth from the Current Employment Statistics—the employer survey that is the primary measurement stick for employment growth (excludes the self-employed) from Jan. 2013 until Dec. 2019. Laffer, Moore and Antoni malign high marginal tax states, so GCI added California and Oregon which have high marginal personal income taxes. The data reviewed showed that despite the incidental Tennessee growth, the states considered in the Laffer paper as having high marginal tax rates had higher job growth numbers than Tennessee.

Figure 3 Employment Growth Comparison



Summary

Any proposition put before Arizona's voters warrants rigorous analysis before votes are cast. The Grand Canyon Institute has not taken a position on Prop. 208. It has committed itself to providing data-driven research to ensure that voters are well-informed before casting their ballots on propositions. The Laffer study, released since GCI put out its evaluation, warranted scrutiny due to the risk that voters will be misinformed when considering their vote on Prop. 208.

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