



## No Income Tax: The Key to Economic Growth

by Amy K. Frantz

Seven states in our nation collect no state income tax from their citizens: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. Two other states, New Hampshire and Tennessee, tax only dividend and interest income. Is there an economic advantage for states that do not collect an income tax from their citizens?

Studies show that no-income-tax states are more prosperous than states with an income tax. Dr. Richard Vedder published a study comparing the ten states with the highest increase in income tax burden over a forty-year period to the ten states with the lowest increase in income tax burden (or no increase, in the case of states that did not have an income tax).<sup>1</sup> Real total income growth for the top ten income-tax-raising states was 191%, while real total income growth for the states with the lowest or no increases in the state income tax was 455% over the forty-year period.<sup>2</sup>

Another study by Dr. Vedder looks at net domestic migration for the 50 states and the District of Columbia, or the number of native-born Americans moving into a state minus the number moving out of a state.<sup>3</sup> Vedder's analysis shows that nearly 3 million persons moved from states with an income tax to states without an income tax between 1990 and 1999.

Curtis Dubay and Chris Atkins authored the Tax Foundation's most recent *State Business Tax Climate Index*, looking at tax policies and how they impact business decisions.<sup>4</sup> Seven of the Index's top ten states for best business tax climate are states that do not have an income tax.

Iowa's personal income tax has nine tax brackets, with a top rate of 8.98%. Our neighboring state, South Dakota, has no income tax. How do the two states compare? What is the impact of having or not having an income tax on economic indicators such as income, population, and employment? How do the states match up on quality of life issues such as housing, crime, and education?

Looking at the most recent forty-year period for which data is available, 1967 to 2007, a comparison of the two states shows that South Dakota has experienced greater growth in total personal income over each of the four decades, as well as over the entire forty-year period. From 1967 to 2007, total personal income, adjusted for inflation, grew 96.3% in Iowa, while growing 151.9% in South Dakota. The same trend holds for per capita personal income growth. From 1967 to 2007, per capita personal income, adjusted for inflation, grew only 83.5% in Iowa, but grew 112.3% in South Dakota.<sup>5</sup>

A growing population is another measure of a state's economic success. While South Dakota has a smaller overall population than Iowa, the growth rate of South Dakota's population over the last forty years was greater than the growth rate of Iowa's population. Iowa's population grew only 7.0% from 1967 to 2007, while South Dakota's population grew 18.7% in that same time period.<sup>6</sup>

Jobs are another important indicator of the economic health of a state. South Dakota has consistently experienced greater growth in total non-farm employment in each of the last four decades. The overall

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growth in non-farm employment from 1967 to 2007 was 148% in South Dakota, while non-farm job growth in Iowa was only 82.1% over the same time period.<sup>7</sup>

It is important to look at each state's overall state and local tax burden when making a comparison. South Dakota has no income tax, but how does the complete tax burden picture compare with Iowa? Iowa's per capita tax burden is \$4,085; South Dakota's per capita tax burden is \$3,435.<sup>8</sup> Without an income tax, South Dakota simply has a lower overall tax burden than Iowa.

While the tax burden in South Dakota is lower than in Iowa, South Dakota's tax revenue has experienced faster growth. From 1992 to 2000, Iowa's tax revenue grew by 44%, while South Dakota's tax revenue increased by 64.1% over the same time period.<sup>9</sup> Low taxes combined with more dynamic economic growth can lead to faster-growing tax revenues.

Quality of life issues go hand in hand with economic growth and low taxes in making states attractive places to live and work. South Dakota has seen greater growth in the number of housing units than in Iowa and has a lower crime rate than in Iowa. Education is one area in which Iowa does manage to rank ahead of South Dakota. Iowa spent \$8,360 per pupil for public elementary and secondary school systems for the 2005-06 school year, while South Dakota's per-pupil spending was \$7,651.<sup>10</sup> As for results, Iowa's ACT scores and college readiness results are somewhat higher than in South Dakota, although both states are above the national average.<sup>11</sup>

Studies show that states without an income tax have greater economic growth rates than states with an income tax, including greater rates of income growth, population growth, and job growth, and are more attractive to businesses looking for locations to build or expand. Looking at economic statistics and quality of life markers for Iowa, which has an income tax, and South Dakota, which does not, reinforces the findings of those studies — that states without an income tax experience greater levels of economic success.

*Public Interest Institute's POLICY STUDY, "No Income Tax: The Key to Economic Growth" can be viewed at [www.limitedgovernment.org](http://www.limitedgovernment.org)*

#### **Endnotes:**

<sup>1</sup>Dr. Richard K. Vedder, "Taxes and Economic Growth," The Taxpayers Network, September 2001. Dr. Vedder is a distinguished Professor of Economics at Ohio University and a member of the Public Interest Institute Academic Advisory Board.

<sup>2</sup>Ibid, p. 14.

<sup>3</sup>Dr. Richard K. Vedder, "Taxation and Migration," The Taxpayers Network, March 2003.

<sup>4</sup>Curtis S. Dubay and Chris Atkins, "2008 State Business Tax Climate Index," Tax Foundation *Background Paper*, October 2007, Number 57, p. 4.

<sup>5</sup>"State economic profiles," U.S. Bureau of Economic Analysis, <[www.bea.gov/regional/spi/action.cfm](http://www.bea.gov/regional/spi/action.cfm)> (May 20, 2008).

<sup>6</sup>Ibid, and "American FactFinder," U.S. Census Bureau, <<http://factfinder.census.gov>> (May 21, 2008).

<sup>7</sup>"State and Area Employment, Hours, and Earnings," U.S. Department of Labor, Bureau of Labor Statistics, <<http://data.bls.gov>> (May 21, 2008).

<sup>8</sup>Curtis S. Dubay, "State and Local Tax Burdens Hit 25-Year High," Tax Foundation *Special Report*, April 2007, Number 153, p. 3.

<sup>9</sup>Dr. Arthur B. Laffer and Stephen Moore, "Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index," American Legislative Exchange Council, 2007, p. 50.

<sup>10</sup>"Per Pupil Amounts for Current Spending of Public Elementary-Secondary School Systems by State: 2005-06," *Public Education Finances 2006*, U.S. Census Bureau, Annual Survey of Local Government Finances, April 2008, p. 8, <<http://ftp2.census.gov/govs/school/06f33pub.pdf>> (May 20, 2008).

<sup>11</sup>"2007 ACT National and State Scores," ACT, <<http://www.act.org/news/data/07/index.html>> (May 21, 2008).

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