House Finance testimony on H5751 and H5805, to increase the top income tax rate to 7.99% and 10.00%, respectively

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The mission of the RI Center for Freedom & Prosperity is, in part, to research public policy in terms of economic freedom and principles of limited government, and to educate the public and government officials to make better decisions in the course of their civic activities. In the case of legislation to increase taxes on higher-income households, education is in particular need.

Simply put, the arguments in favor of such policies are emotionally driven, not intellectual. The value of fairness is not an economic variable, but a goal. If it means that every Rhode Islander should have the opportunity to realize his or her full potential in every sense, it is a goal that we share.

We do not agree, however, that this goal can be achieved by taking more money from prosperous families, processing it through government, and using it for the benefit of others. That approach uses the state's resources inefficiently, creates opportunities for waste, fraud, and abuse, and prevents the economy from directing resources where they will do the most people the most good.

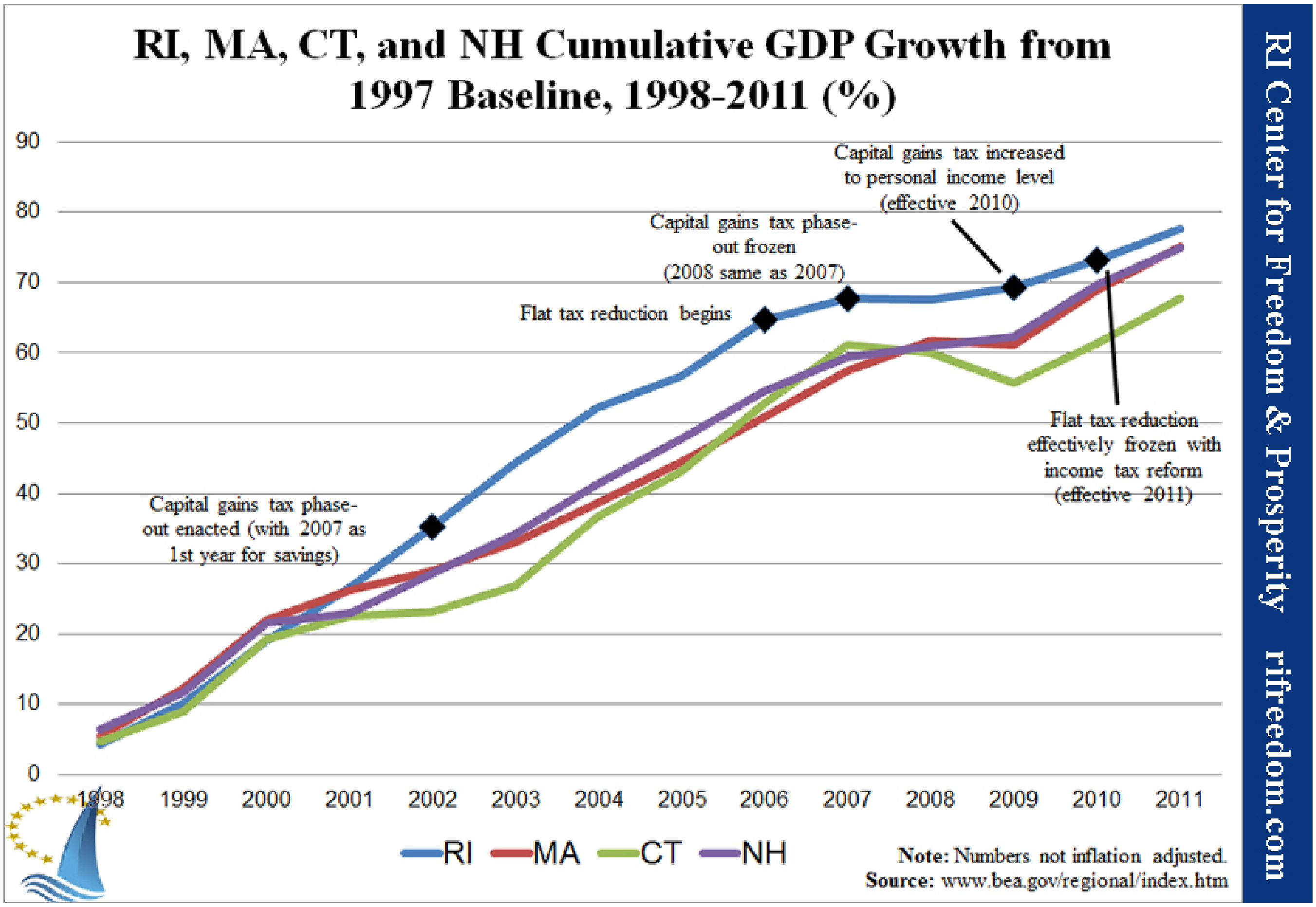
Proponents of tax-the-rich policies have presented misleading data to argue that lowering taxes on the wealthy has increased unemployment in the past. This distorts both the numbers and the history.

While we applaud the efforts to reform Rhode Island's tax system in the last decade, they represented a relatively small step out of a deep ditch of destructive policies that have made our state the economic backwater that it is. Moreover they were never allowed to be fully implemented, much less to change the direction of our economy.

Nonetheless, the following charts give some evidence that, far from hurting the state's economy, the tax reforms were helping in the context of larger economic trends.

The first chart plots some milestones in tax policy along the growth in the state's economy, as measured by GDP. While more significant forces are always in play, the chart suggests that, when the public debate and legislative action in Rhode Island was centered around easing the tax burden, its economy kept pace with or outperformed those of nearby states. When the conversation and legislation turned toward reversing those improvements, our neighboring states began rapidly closing the gap.

The second chart shows taxpayer migration, as measured by the Internal Revenue Service. After a reversal from immigration to emigration early in the decade, the trend began to subside during the period of the tax reforms. (The end-date of the chart was the most recent data available when we published the report containing this chart last spring.)


RI, MA, CT, and NH Cumulative GDP Growth from 1997 Baseline, 1998-2011 (%)
90
80
70
60
50
40
30
20
10
0
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
Capital gains tax increased to personal income level (effective 2010)
Capital gains tax phase-out frozen (2008 same as 2007)
Flat tax reduction begins
Flat tax reduction effectively frozen with income tax reform (effective 2011)
Capital gains tax phase-out enacted (with 2007 as 1st year for savings)
RI
MA
CT
NH
Note: Numbers not inflation adjusted.
Source: www.bea.gov/regional/index.htm
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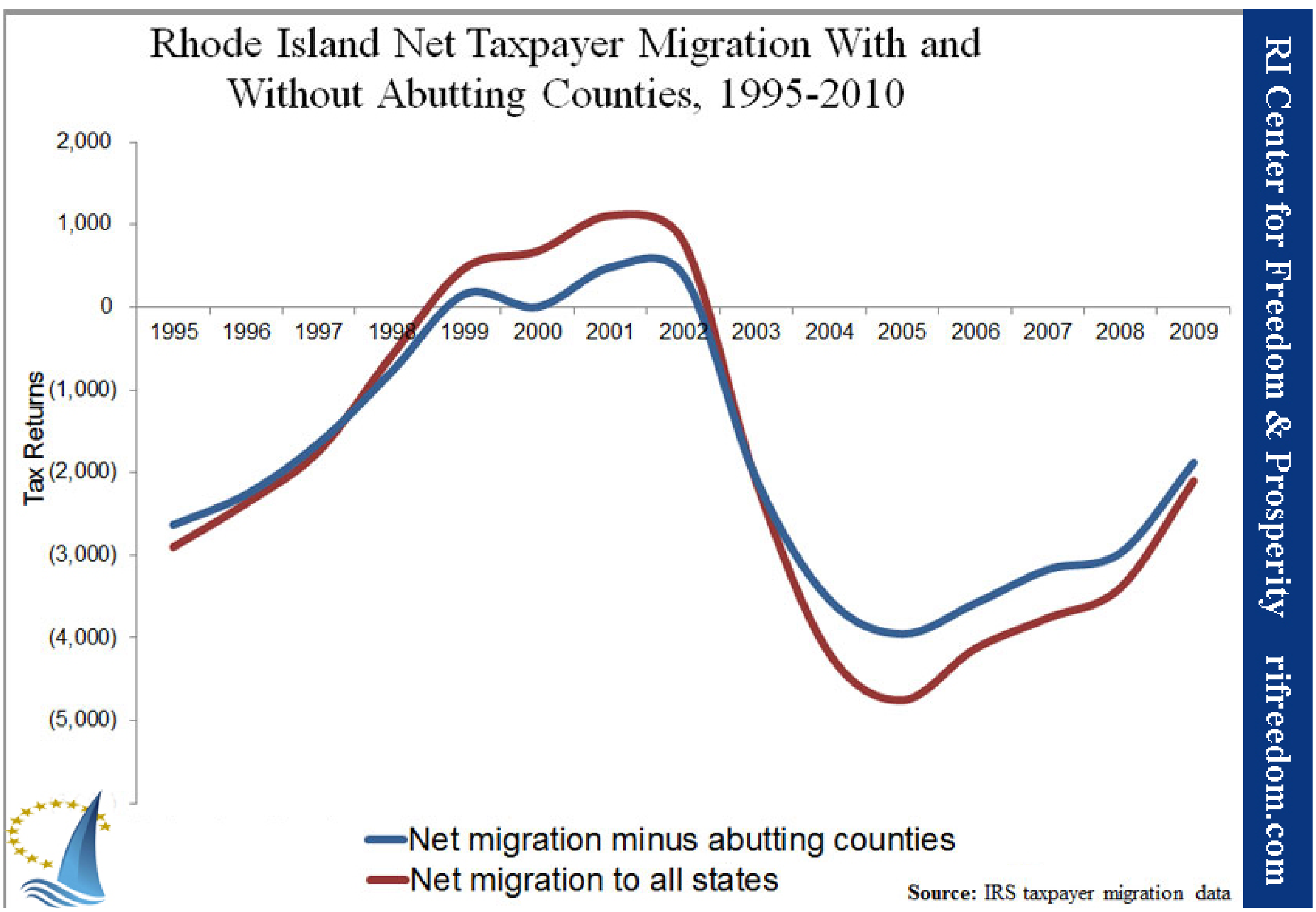
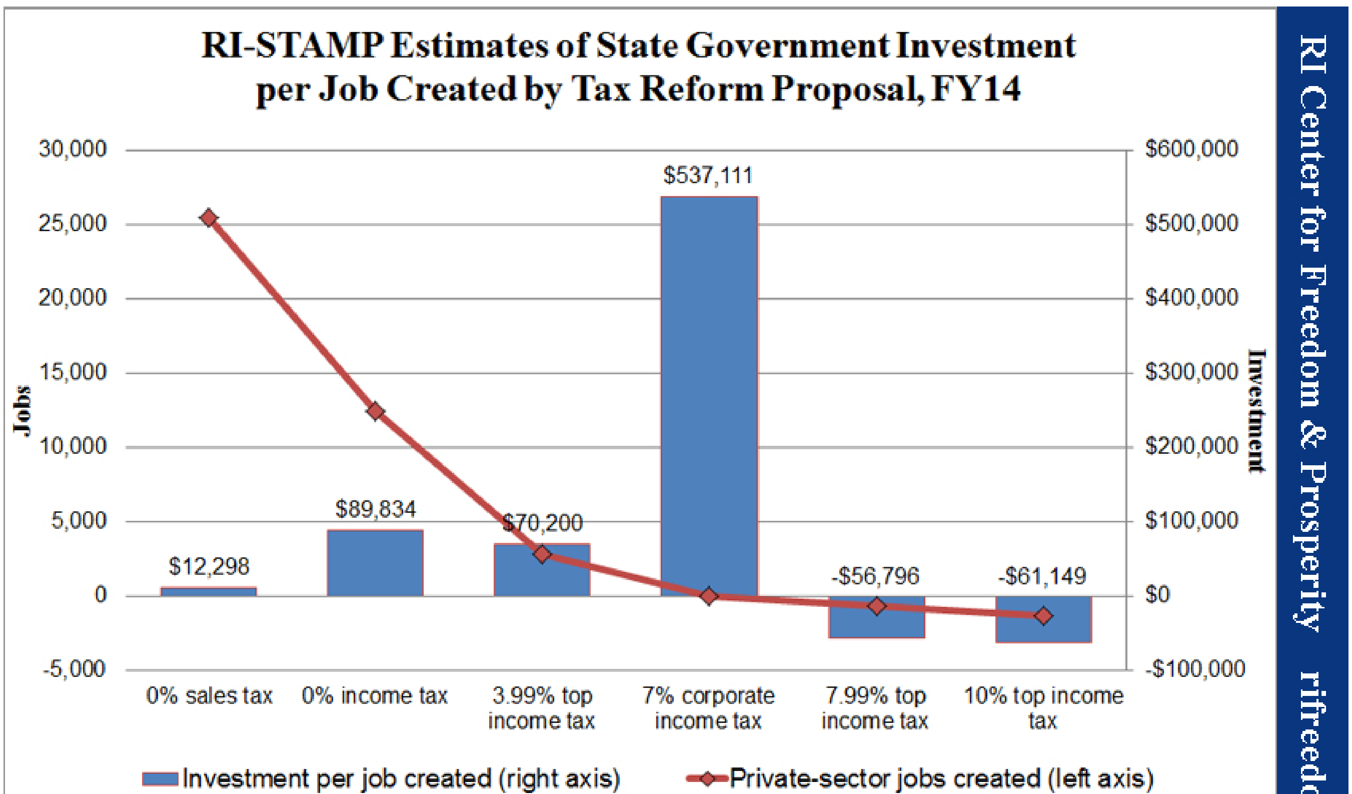

Rhode Island Net Taxpayer Migration With and Without Abutting Counties, 1995-2010
2,000
1,000
0
(1,000)
(2,000)
(3,000)
(4,000)
(5,000)
Tax Returns
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
Net migration minus abutting counties
Net migration to all states
Source: IRS taxpayer migration data
RI Center for Freedom & Prosperity rifreedom.com

The Center does not suggest that the above charts present irrefutable proof that tax reduction policies were wholly to credit for any positive trend in Rhode Island's economy during the last decade. We do, however, think they indicate that arguments that reducing tax rates had no effect or even harmed the economy are not credible.

As further evidence of that point, we analyzed various tax policies, several of them currently under your evaluation, to predict their actual costs to the state and effect on the number of private sector jobs, here. For this purpose, we used our RI-STAMP modeling tool, which applies academic economic research to published statistics in order to determine where tax revenue put into or taken out of the economy will go.

The chart shows that both of the tax-the-rich policies before you today will have negative investments, meaning that they will bring the state more money. However, that increase in revenue will come at the cost of up to $61,000 per job. In other words, for every $61,000 that the state government adds to its general fund, it will kill one Rhode Island job.

By contrast, tax reforms that reduce rates will require some government investment, but they will create jobs. The most efficient and effective of these policies would be the zero percent sales tax that you will review next week when you receive testimony on H5365.



Notes:
- A negative cost per job indicates increased revenue for the state.
- The estimate for the 10% income tax starts bracket at $250,000, so it is conservative.
- Bills under consideration are as follows: 0% sales tax (H5365/S0246), corporate income tax reduction (H5127 article 3), 7.99% top income tax bracket (H5196/H5374/H5751/S527), 10% top income tax bracket (H5805).