INSTITUTE ON TAXATION AND ECONOMIC POLICY

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Repealing Estate Tax Will Not Create An Economic Boom

Laffer/Winegarden Report Utterly Fails to Support Claim That Tennessee's Estate Tax Cost State 220,000 Jobs

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Founded in 1980, the Institute on Taxation and Economic Policy (ITEP) is a non-profit, non-partisan research organization, based in Washington, DC, that focuses on federal and state tax policy. ITEP's mission is to inform policymakers and the public of the effects of current and proposed tax policies on tax fairness, government budgets, and sound economic policy. Among its many publications on state and local tax policy are *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States* and *The ITEP Guide to Fair State and Local Taxes*. ITEP's full body of research is available at www.itepnet.org.

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Since Tennessee Governor Bill Haslam proposed reducing the state's estate tax in February, Tennessee lawmakers have shown increasing interest in this idea. Recently, a House subcommittee one-upped the governor by approving a bill that would gradually repeal the tax outright. House Speaker Beth Harwell explained this move by noting that "[w]e know this tax drives people, capital and jobs out of the state."[1] As evidence of this claim, a number of observers (including the *Wall Street Journal*'s editorial board) have approvingly cited a recent report, coauthored by Arthur Laffer and Wayne Winegarden, which asserts that Tennessee's estate tax has singlehandedly cost the state as many as 220,000 jobs.[2] However, the Laffer/Winegarden report is severely flawed, and fails to provide any evidence for this dramatic claim. This brief explains the shortcomings in the Laffer/Winegarden analysis.

The Source of Laffer's "220,000 Jobs" Claim

The report, *The Economic Consequences of Tennessee's Gift and Estate Tax*, makes a number of very specific claims about the effect that Tennessee's estate tax has had on the state's economy. Easily the most eye-catching claim is that "[h]ad Tennessee eliminated its gift and estate tax 10 years ago, Tennessee's economy would have been over 14 percent larger in 2010 and there would have been 200,000 to 220,000 more jobs in the state."

220,000 jobs is an impressive total. However, the reasoning that leads Laffer and Winegarden to this conclusion is less than impressive. They start by claiming that "Tennessee's economic policies are first rate," as evidenced by the state having enacted most of the conservative policies on a 15-item wish list created by Arthur Laffer and the American Legislative Exchange Council (ALEC). That list is titled the "Laffer-ALEC State Competitiveness Index," and it comes with a heavy emphasis on policies such as low taxes, few public employees, and a low minimum wage.[3]

But despite having followed most of Laffer's 15 recommendations (including refusing to levy a broad-based personal income tax), Tennessee has recently experienced disappointingly slow economic and employment growth. Specifically, Tennessee's gross state product grew by just 38.6 percent between 2001 and 2010, compared to an average of 58.5 percent among all states without income taxes—the group Laffer considers to be Tennessee's "pro-growth" peers. And the size of Tennessee's workforce actually *shrunk* by 2.8 percent over that same period, compared to 5.4 percent growth in the states without income taxes.[4]

Rather than cause Laffer to second guess the importance of the 15 policies he recommends, he takes these findings as evidence that the one area in which Tennessee has not followed his advice—its decision to levy an estate tax—must be really, *really* important to the state's economy.

With little explanation, Laffer describes Tennessee's estate tax as the "single greatest detriment to Tennessee's growth" and the "most important policy obstacle that differentiates Tennessee from the other high growing pro-growth states." He then goes on to assert that if Tennessee's estate tax had been repealed 10 years ago, the state's economy would have been unleashed, and would have grown—rather bizarrely—at a rate exactly equal to the average among states not levying an income tax. And from there, the math is simple: applying the higher economic and employment growth rates mentioned above leaves Tennessee with an economy that is 14 percent larger and a workforce with 220,000 additional members.

[1] Lawmakers move toward repealing inheritance tax." Nooga.com. March 22, 2012. www.nooga.com/154427/lawmakers-move-toward-repealing-inheritance-tax/

[2] Laffer, Arthur and Wayne Winegarden. "The Economic Consequences of Tennessee's Gift and Estate Tax." March 2012. www.laffercenter.com/wp-content/uploads/2012/03/2012-03-EstateTax-LafferCenter.pdf

[3] The Index is discussed in more detail in Laffer, Arthur, et al. "Rich States, Poor States." 2011. 4th Edition. www.alec.org/publications/rich-states-poor-states/

[4] ITEP took issue with the economic measures chosen by Laffer in a report titled "'High-Rate' Income Tax States Are Outperforming No-Tax States," available at www.itepnet.org/pdf/junkeconomics.pdf . But even by ITEP's preferred measures, Tennessee's economic performance is no doubt below average.

This somewhat magical effect is explained very simply as such:

> *With [the estate tax] removed, there is no reason to believe that Tennessee's rate of economic growth would not resemble the average rate of economic growth [in other states lacking a broad-based personal income tax].*

Of course, in the real world, there are very important reasons that Tennessee's rate of growth would not resemble that of the average state without an income tax. To take the most obvious example, the two non-income tax states Laffer identifies as growing far more quickly than any other also happen to be the two with the most lucrative mining sectors: Alaska and Wyoming.[5] Nevada and Texas possess much larger mining sectors than Tennessee as well (relative to their economies), and it doesn't take much imagination to come up with a list of other factors that could explain differences in state economic performance.

Educational attainment, for example, is linked closely to income growth and economic performance more generally, but Tennessee trails both the nation and the region by this measure.[6] Quality infrastructure, the state's industry mix, and even climate are other key variables that don't appear to have crossed the minds of Laffer and Winegarden.

The truly astounding part of Laffer and Winegarden's analysis is that they are not simply asserting that Tennessee's choice to retain an estate tax has had an effect on Tennessee's growth—**they're asserting that no other difference between Tennessee and the other no-income-tax states can possibly explain Tennessee's slower economic and employment growth.**

But economic analysts in Wyoming, for example, have explained their state's strong growth at the end of the 2001-2010 period examined by Laffer as such:

> *After a short, but severe recession, Wyoming's economy has turned around since the beginning of 2010,* ***thanks to the robust rebound of the energy industries****. The State's gradual recovery continued to be faster than the U.S. average. For the third quarter of 2011, Wyoming's recovery was still on track, and may have picked up speed.*[7] *(emphasis added)*

Laffer and Winegarden's estimate clearly implies Wyoming's analysts are simply wrong, and that the state's growth has been driven by lawmakers' choice not to levy an estate tax.

Is There Evidence that Estate Taxes Affect Economic Growth?

While few economists (other than Laffer and Winegarden) would assert with a straight face that the estate tax can explain all of the divergence in economic fortunes between Tennessee and other no-income tax states, it's still worth asking whether Laffer and Winegarden offer any meaningful evidence that the estate tax explains *any* of this divergence.

Laffer and Winegarden argue that a comparison between Tennessee and Florida offers a good case-study-style illustration of the economic impact of having a state estate tax, since Tennessee has one and Florida currently does not. Looking at estate tax filings, they find two noticeable differences between the two states:

> 1) In 2009, Florida had almost twice as many federal estate tax returns filed, on a per capita basis, than Tennessee.
>
> 2) In 2009, the average value of an estate in Florida was roughly 67 percent higher than in Tennessee.[8]

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[5] ITEP. "'High-Rate' Income Tax States Are Outperforming No-Tax States." February 2012. www.itepnet.org/pdf/junkeconomics.pdf

[6] Tennessee Higher Education Commission. "Higher Education Profiles & Trends." March 2012. www.tn.gov/thec/Legislative/Reports/2012/Profiles--Trends-2012_w_cover_page.pdf

[7] Wyoming Economic Analysis Division, "Economic Summary: 3Q2011," December 2011, p. 1.

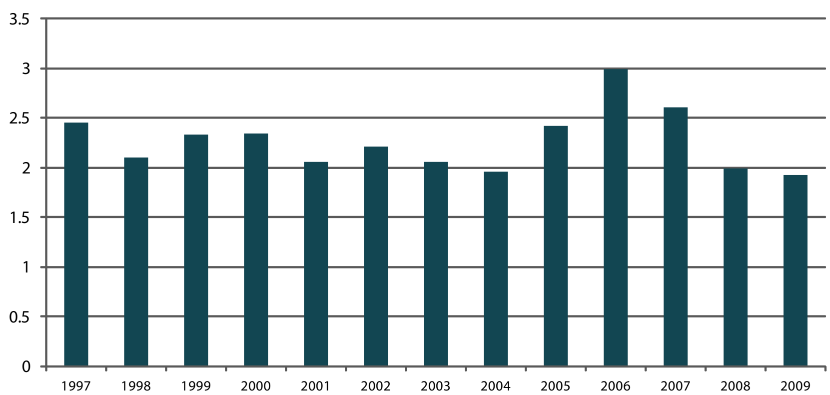
[8] The authors oddly round this figure up to 75 percent in the text of the report.

Laffer and Winegarden assert that "these differences are growing sharply" and conclude that "people really do move as a result of Tennessee's gift and estate tax." But the data don't bear out this conclusion at all, and therefore certainly do not show that Tennessee's estate tax has destroyed jobs and increased poverty, as Laffer and Winegarden go on to assert.

Florida Had More Estate Tax Filers than Tennessee Even When Both States Levied Estate Taxes

It is true, as Laffer and Winegarden assert, that in 2009 "Florida had almost twice as many federal estates filed per 100,000 population than Tennessee."[9] But this is not particularly surprising given the state's well-known appeal to retirees with the financial means to follow the sun. And as **Figure 1** shows, this discrepancy was actually *larger* before Florida's estate tax began to disappear in 2002 as a result of the federal Bush tax cuts. It's therefore odd, to say the least, that the authors would claim that the presence of an estate tax in Tennessee (and the absence of one in Florida) is the cause of this discrepancy.

Figure 1: Per Capita Federal Estate Tax Filings in Florida, Relative to in Tennessee



For the first seven of the thirteen years examined by Laffer and Winegarden (1997-2003, out of the 1997-2009 period), Florida actually had more than twice as many estate tax filings per capita as Tennessee. Florida not only levied an estate tax during each of these years, but also a separate property tax on intangible assets that presumably affected many of the same people as the estate tax.

After a brief spike in Florida's per capita estate tax filings, most dramatically in 2006, the gap between filing rates in Florida and Tennessee has since narrowed to less than a 2:1 ratio for each of the last two years.

Clearly, the difference in filing rates between Florida and Tennessee is not "growing sharply," in the wake of estate tax repeal in Florida, and in fact it was smaller in 2009 than in any other year examined by Laffer and Winegarden. But this doesn't stop the authors from asserting that if Tennessee had repealed its estate tax before 1997, it could have enjoyed as many estate filings per capita as Florida during each year of the 1997-2009 period, as well as any economic benefits associated with having more wealth located within the state's borders.

No Evidence that Estate Tax Has Reduced Average Tennessee Estate Values

Laffer and Winegarden also argue that the average value of estates is substantially larger in Florida than in Tennessee, and that this discrepancy is a result of Tennessee's estate tax having driven many wealthy individuals from the state. Once again, however, this is a long-running discrepancy that also existed when both states levied estate taxes.

In each of the thirteen years examined by Laffer, the average value of estates in Tennessee has been smaller than the average value of estates in Florida. Specifically, in most years the average Tennessee estate has been between just 78 and 88 percent of the size of the average Florida estate. It's true that Tennessee values fell below this range in 2005, 2008, and 2009, but three slightly below average years is far from a convincing trend, especially given how volatile these data can be.[10]

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[9] The authors erroneously refer to this finding as being based on 2010 data.

[10] And the data are more vulnerable to volatility in recent years than ever before. This is because increases in the federal estate tax exemption have dropped many estates from the estate tax rolls, and have thus shrunk the pool of estates used in calculating average gross estate value.

Arkansas, for example, saw the average value of estate tax filings within its borders surge by over 600 percent—from $4.7 million to $34.5 million—in 2008 largely as a result of the passing of Helen Walton, wife of Wal-Mart founder Sam Walton. More than half of all states, including Florida, have seen their average estate value change by 50 percent or more from one year to the next, and 11 states have seen their average value change by over 100 percent in a single year's time. Given the level of "noise" contained in these data, it is simply impossible to use it to show that state estate tax laws are driving changes in average estate size.

Conclusion

Lawmakers owe it to their constituents to think seriously about how various policy choices—including features of the state's tax system—affect the long-term health of their state's economy. A recent report by Arthur Laffer and Wayne Winegarden claims that a single policy choice made by Tennessee lawmakers—the choice not to repeal the state's estate tax a decade ago—is singlehandedly responsible for the divergence in economic and job growth between Tennessee and other non-income tax states. But nothing even resembling a compelling case is made in support of this claim, and lawmakers seeking a clear-eyed assessment of the estate tax will have to look elsewhere.

Figure 2: Average Gross Value of Tennessee Estates, Relative to Florida Estates