Platte INSTITUTE for economic research

Removing Barriers in Nebraska

PART THREE:

How Our Taxes and Spending Compare

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Everyone in Nebraska wants a thriving and successful economic landscape, yet the economic measures previously discussed show that Arizona, Colorado, Florida, Iowa, and Texas are doing something better. Many economists will say the first essential ingredient for an economically prosperous state is a government sector that has sound fiscal policy, with reasonable and appropriate taxes, and spends its money frugally on a core set of public goods without moving into areas that can be handled more appropriately by the private sector.

Let's take a look at the fiscal side of our five competitor states and see how Nebraska ranks.

There has been great debate about Nebraska's taxes for decades, and more recently whether or not Nebraska's current tax policy promotes or harms economic growth. Would lower taxes motivate people to stay in or move to Nebraska? Nebraska is losing thousands of people every year and hundreds of millions of dollars in income to these comparison states, all of which have lower tax burdens than Nebraska in one or more taxes.[1]

A great example of how people respond to taxes is our neighboring state, Iowa. Nebraska may appear to have a lower tax burden than Iowa on the surface, yet more Nebraskans are moving to Iowa each year than any other state. One reason may be that when only tax treatment of veterans and retirees is considered, Iowa has a substantially lower tax burden.

Iowa offers property tax exemptions to veterans[2] along with exempting pension and retirement income from the state income tax[3] which are reasons why retirees and the

FIGURE 1

Top Tax Rates Compared

	Florida	Texas	Colorado	Arizona	Iowa	Nebraska
Personal Income Tax	0%	0%	4.63%	4.54%	8.98%	6.84%
Corporate Income Tax	5.5%	0%[i]	4.63%	5.5%	12%	7.81%
State Sales Tax	6%	6.25%	2.9%	5.6%	6%	5.5%
Property Tax per Capita	$1,216	$1,559	$1,333	$1,009	$1,515	$1,649

[i] Texas levies no corporate income tax, but does have a modified gross receipts tax called the Margin Tax, with rates ranging from 0.331 percent to 0.75 percent.

Source: 2016 State Business Tax Climate Index, Tax Foundation.

many veterans or active duty members at the Offutt Air Force Base choose to live in Iowa. Because of the close proximity of Omaha and other cities to the state line, people can live in Iowa and enjoy all the benefits of Nebraska within a short drive.

Knowing what we know about Iowa, would lower taxes motivate these people to stay in or move to Nebraska? The simple answer is yes. Nebraska is not alone; other high tax states across the country are experiencing the same migration and loss of income, many of which are states losing population to Nebraska.[4] There is a link between high government spending and high taxes and high rates of migration towards lower cost-of-living states.

Some argue Nebraska's tax rates are high because the tax base is much smaller than other states, thus there are less people to spread the tax burden. While a broad tax base is certainly important to have for stable revenue and lower tax rates, we decided to look into how much revenue Nebraska's state and local governments collect when compared to the other states of interest.

We found that even though Nebraska has the smallest population of all the states in our comparison group, Nebraska's state and local governments collect much more revenue; over $1,000 per person more on average than in the comparison states.

When averaging the tax burdens of residents of Texas, Florida, Arizona, Colorado, and Iowa on a per person basis, Nebraskans pay 52 percent more in personal income tax and 36 percent more corporate income tax.[5]

Nebraska's high income tax rates that contribute to this difference have not substantially changed over the years in which these states have gained income and population from Nebraska and other states. While a recent move toward indexing the state individual income tax brackets is a positive step that prevents the burden from becoming worse, other proposals that have been made to raise the state income tax, or to establish local income taxes, would make Nebraska's tax burden even less competitive—and more importantly, move its policies further away from those of the states with demonstrated records of economic success.

It's clear that the biggest difference in Nebraska's tax system from its more successful competitors is the extent to which income is taxed in Nebraska. Texas

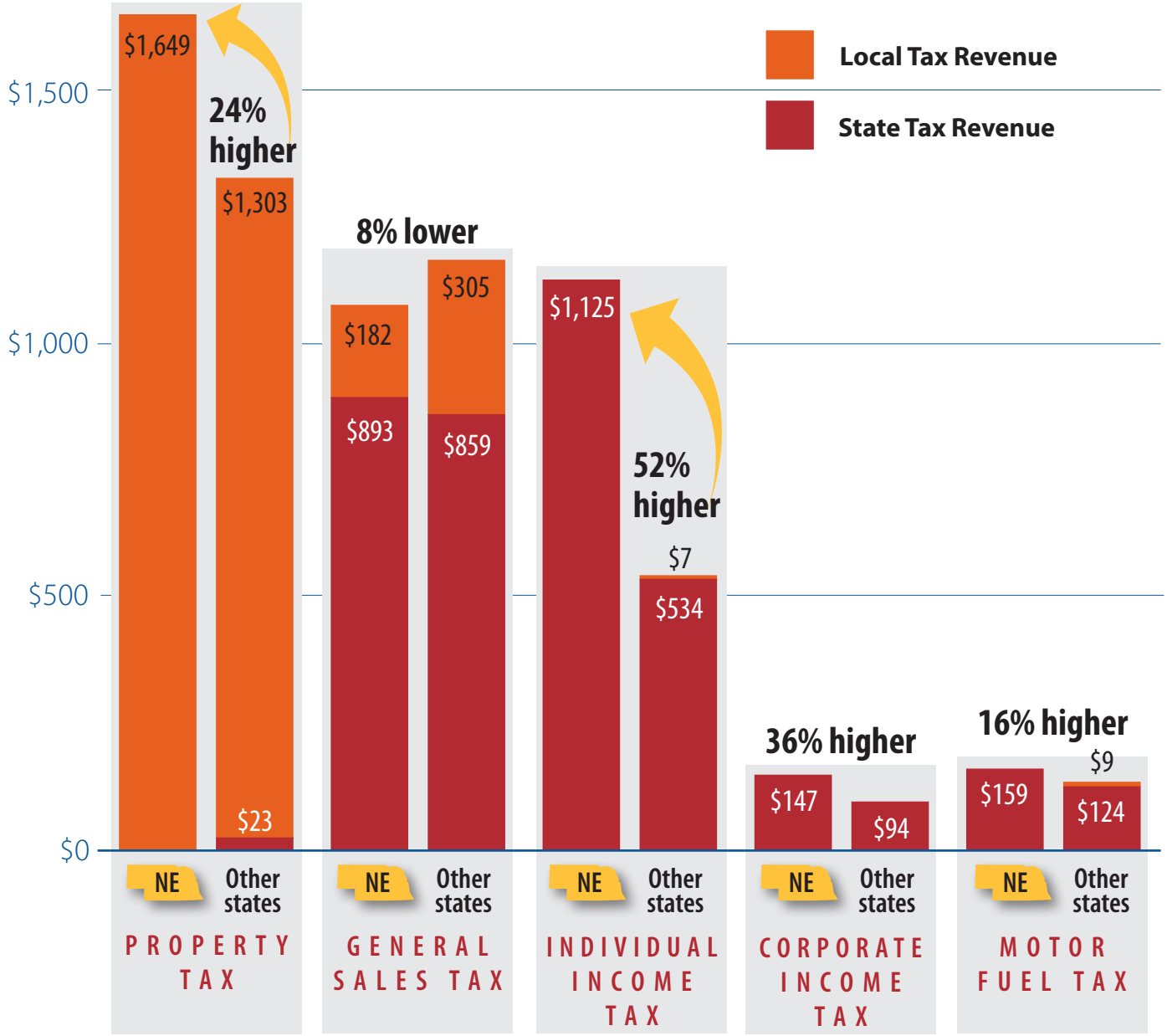
and Florida levy no personal income tax and rely on sales and property tax, while Arizona and Colorado levy lower income tax rates than Nebraska. Iowa, while higher on paper, offers many income tax exemptions and deductions Nebraska does not.

While it would benefit some Nebraskans to mimic Iowa, the best approach for Nebraska's economic growth would be to move closer to other, faster-growing states that have lower tax rates for taxpayers as a whole. Nebraska's personal income tax impacts the daily budgets of seniors,

FIGURE 2

NE Tax Revenue vs. Comparison States

(Percentage increase or decrease based on total state and local per person collections)



Source: U.S. Census Bureau State and Local Government Finances 2013 [http://www.census.gov/govs/local].

small businesses, veterans, and families of every income background, including those who own do not own real estate. The corporate income tax also affects investment, business, and wage growth in the state.

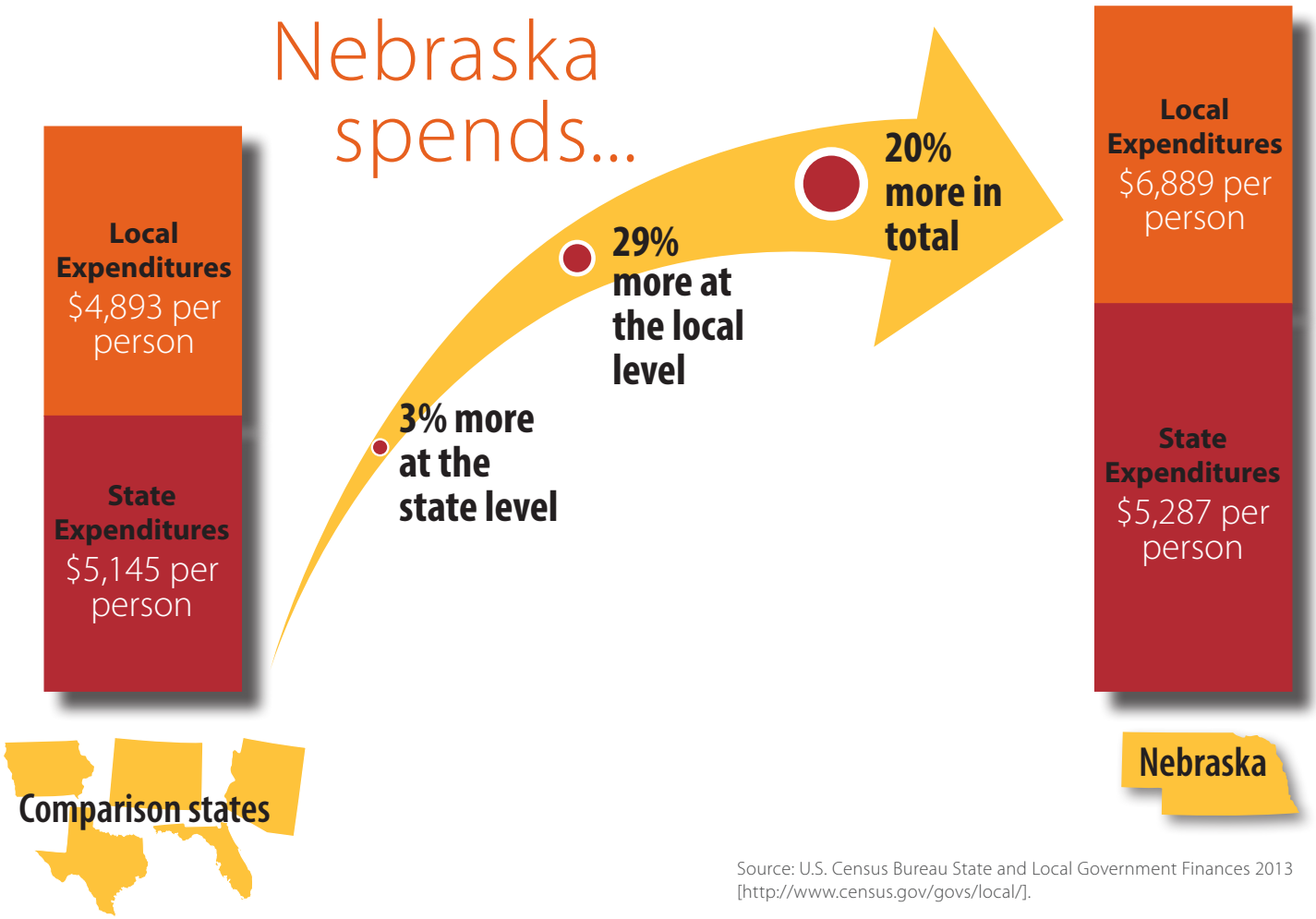
A broad-based reduction of income tax rates in Nebraska would remove a barrier for Nebraskans from all of these walks of life. Relying more on consumption based taxes for the state's needed revenue provides the added benefit of greater stability for tax collections and greater economic growth, since sales taxes do not impose higher prices on saving, investment, and entrepreneurship as the income tax does.

A separate question from the economic impact of the structure of Nebraska's tax system is how much Nebraskans want their government to spend in the first place. While many arguments are made for why specific taxes are high in Nebraska, the state's higher overall tax burden is a product of government spending being substantially higher per person than these other states.

While the average state in the comparison group spends $8,840 per citizen per year, Nebraska spends $11,035.[6] With Nebraska's state and local governments spending $2,195 more per citizen, our average spending is 19.89 percent higher than the average of Texas, Florida, Arizona, Colorado, and Iowa.

FIGURE 3

Comparison of Nebraska Government Spending to Comparison States



Source: U.S. Census Bureau State and Local Government Finances 2013 [http://www.census.gov/govs/local/].

Taken individually, Nebraska's total government spending is still higher than all five of the comparison states, by a fairly wide margin. Arizona's government spending is almost $3,300 less per citizen per year, Florida's is about $3,000 less per year, Texas is approximately $2,600 less per year, Colorado is about $1,300 less per year, and even Iowa spends almost $1,000 less per citizen per year.[7]

While state government spending is indeed higher in Nebraska, a major contributor to the difference is in local government spending. Relative to other successful states, Nebraska's local governments are too big and spend too much. The higher tax rates that come with higher spending are evident when we look at Nebraska's property taxes. On average, our comparison states also rely much more heavily on local option sales taxes than do local governments in Nebraska. If local governments in Nebraska were to reduce property taxes and replace their revenue with local option sales taxes, they would look more similar to the local governments in the other comparison states, again putting an emphasis on a greater use of consumption taxes.[8]

We have now taken a close look at Nebraska's taxes, revenue generated from those taxes, as well as the associated spending of those dollars. It is abundantly clear that over the long haul, greater numbers of Nebraskans and Americans are choosing to live, work, and invest in states that allow citizens to keep more of the money they earn.

If Nebraska wants to properly compete with the identified comparison states, then it is time to follow the lead of lower taxed states and reduce the tax burden. At the very least, if Nebraska wants to increase its economic prosperity, the Unicameral needs to raise its revenue with policies which promote individual work effort by lessening the tax penalty on earning income. Lower tax rates on income and more focus on broadening the sales tax base can accomplish both objectives.

Although Nebraska's economy has been growing well in recent years relative to other states, and the state's unemployment rate is one of the lowest in the nation, the state is well positioned to make some changes that can not only ensure this growth continues, but increase it and create a more prosperous Nebraska.

Since we have discussed fiscal policy, it is natural to discuss how our state's spending compares with the others in one of the largest, and some would argue most important areas of government: education. Our next brief will take a look at what each of our identified comparison states offer their residents when it comes to education choices and policies, and see how Nebraska's education policy measures up to Texas, Florida, Colorado, Arizona, and Iowa.

Endnotes

1 Data taken from Tax Foundation facts on state tax climate, accessed May 25, 2016.

2 Iowa Department of Veterans Affairs, accessed July 11, 2016, *"Property tax exemption reduces a veteran's assessed home value for property tax purposes by $1,852. In 2014 legislation allows 100% exemption of property taxes for 100% disabled service-connected veterans and Dependency and Indemnity Compensation (DIC) recipients and exempts federal retirement pay received for military service and survivor benefits from state individual income tax."*

3 Iowa Department of Revenue, accessed July 11, 2016, *"If you or your spouse receive a pension, an annuity, a self-employed retirement plan, deferred compensation, IRA distribution, or other retirement plan benefits, you may be eligible to exclude from Iowa income tax part or all of the retirement income that is taxable on your federal return. The Roth conversion income, included in net income, is eligible for this exclusion." "Governor Branstad signed Senate File 303 on May 26, 2014, which provides for the exclusion of military retirement benefits from Iowa individual income tax retroactive to the tax year beginning on or after January 1, 2014."*

4 California, Illinois, New York, and New Jersey.

5 This data is for fiscal 2012–13, so the impact of Nebraska's recent changes to the income tax are not included in this analysis and should help to move Nebraska more in line with the other states.

6 Bar charts in the graphic will not sum to total referenced in text due to intergovernmental transfers that are removed from total expenditure per-capita. Both intergovernmental revenues are spent at the local and state level, thus are reflected in the 'state and local' category, but only counted once in the total figure.

7 The data are from U.S. Census Bureau State and Local Government Finances 2013 report, and are for the most recent fiscal year available (FY12–13).

8 In South Carolina, for example, local option sales taxes are used to rebate local property taxes.

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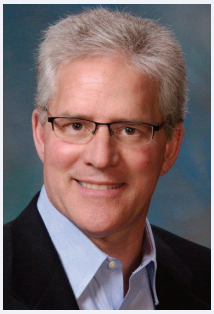

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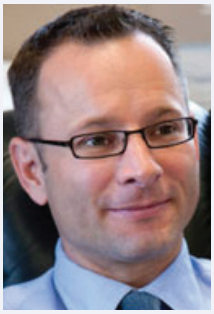

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