

Hoosiers Prefer Potholes to Taxes

One of the fundamental operating principles in the market economy is that in the long run, you get what you pay for. Better products command higher prices. Lower prices buy goods of lesser quality.

The same principle applies to things bought with state and local tax dollars. And here is where Indiana comes in next to last. Of all fifty states, Indiana had the second lowest level of state and local taxes on a per capita basis.

In the year 2000, the latest available data from the U.S. Census Bureau, Indiana's state and local tax revenues amounted to \$5,381 per person in the state population. That placed Indiana forty-ninth out of the fifty states (see **Figure 1**).

Arkansas slipped below Indiana, coming in last with a figure of \$5,175. The highest revenue per capita was \$16,787 in Alaska, thanks to the oil well revenue. Next came Wyoming at \$14,231, New York at \$9,955, and in fourth place Oregon at \$8,373. All of Indiana's northern Midwest neighbors—Illinois, Minnesota, Michigan, Ohio, and Wisconsin—scored in the top twenty-five.

Now before celebrating the “low tax burden” in Indiana, take a drive on an Indiana highway (be sure to steer around the potholes), or review the rankings of test scores in Hoosier high schools.

It boils down to market economics. State and local tax collections are not dollars that just disappear. They get spent on the citizens of Indiana. Almost 40 percent of state and local tax expenditures in Indiana go toward education. Another 10 percent of the total is spent on roads. The main things government spends the rest of its tax dollars on are hospitals and health care, police and fire protection, and other social services. A few dollars for sewers, parks, and prisons are in there too.

So take the full economic effect into account when looking at Hoosier taxes. Indiana is a low-tax state. And that means it is a low services state.

Education and Other Services

Indiana's total expenditures per capita for elementary and secondary education fall only slightly below the midpoint for all fifty states. Much of Indiana's education funding, however, comes from fees and charges generated within the educational system. In particular, Indiana University and Purdue University attract thousands of students from out of state, and the fees paid by those students help support the state's education system in general.

Apart from the fees that get collected and then plowed back into the education system, how has Indiana chosen to support education?

One measure of that support is tax expenditures for education per capita, after deducting the fees and charges. That net amount represents the tax money Indiana citizens have chosen to allocate to education, over and above the revenue from fees. By this measure, Indiana ranked thirty-third in the nation (see **Figure 2**). All its Great Lakes neighbor states beat Indiana with higher net per capita expenditures for education. Louisiana, Mississippi, and Arkansas spent less than Indiana, as did Kentucky (though Kentucky's basketball programs do pretty well).

In spending on state and local police protection, Indiana ranked forty-second out of fifty states. In spending on solid waste management, it was forty-fourth. And if you

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Figure 1
State and Local Tax Revenue Per Capita, 2000

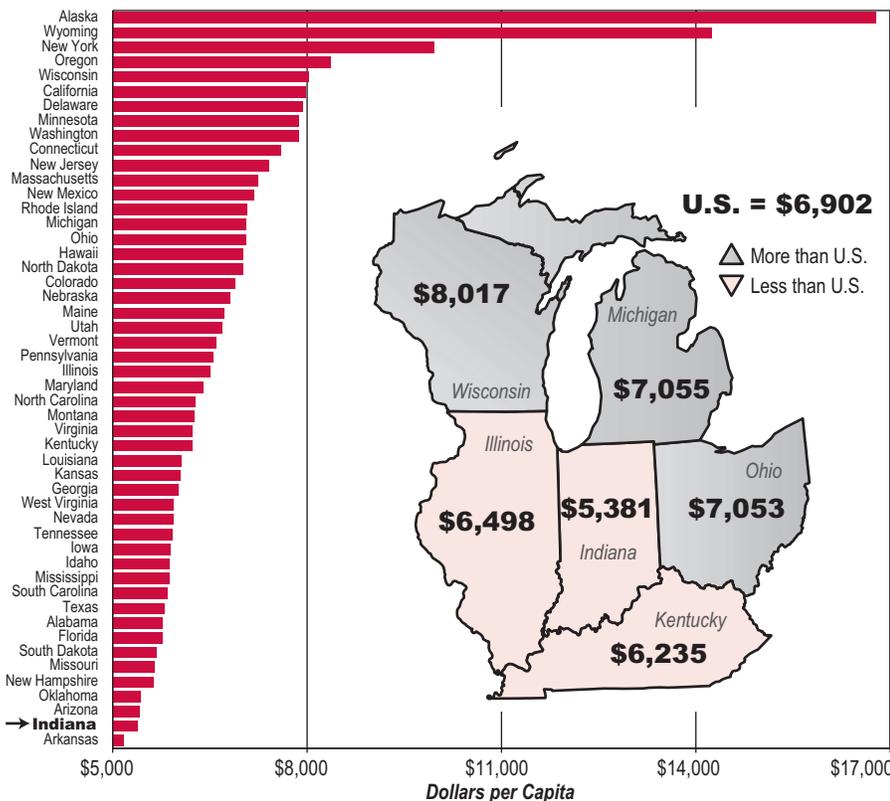
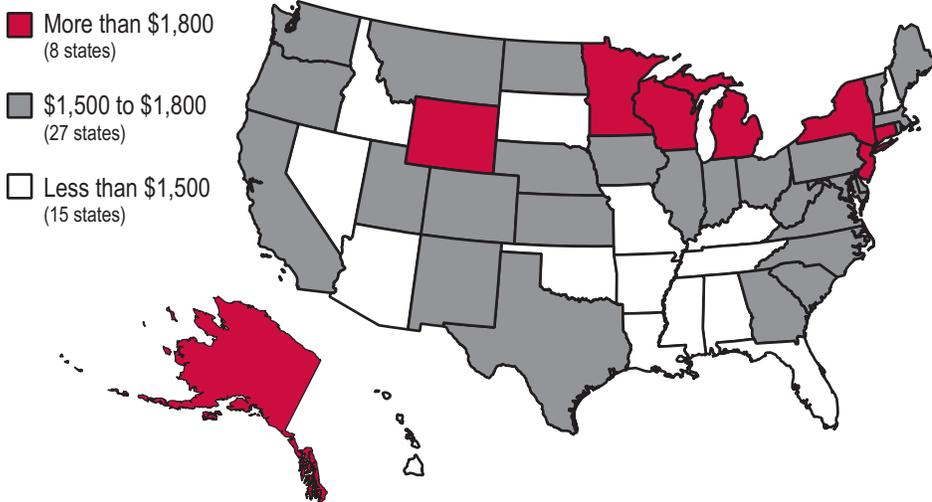


Figure 2
State and Local Tax Expenditures for Education Per Capita (After Deducting Fees and Charges)



have bounced through a lot of potholes recently, here is the main reason: Indiana placed forty-second in per capita expenditures for highways in the year 2000.

Roughly half of the taxes in Indiana go toward buying education and roads. Almost every other state in the nation spends more per capita than we do. And in a capitalist economy, you get what you pay for.

Hoosier Standard of Living

Indiana's position almost at the bottom of all states in tax support for state and local services appears to be having an effect on the Hoosier standard of living.

The search for correlations with economic indicators is hobbled, however, by one problem: for some states, other economic factors far outweigh the effects of state and local tax spending. Correlations are obscured by these outliers. So to clarify the trends in standard of living, it makes sense to leave out the most obvious outliers.

In the case of the economic indicators shown below, the outliers number seven. Arizona and Florida were excluded because of the extraordinary population growth in each case and the comparatively high average age. Alaska was dropped because of the distortions from huge state oil income per capita. Wyoming and New Hampshire were unusual because of the large recent increases in state and local taxes there. Nevada was ruled out on account of gambling revenue, and Hawaii because it is too small, too far away, and has been in a recession for years.

That leaves forty-three states. Among these states, one finds reasonably good correlation coefficients (near 0.4) between state and local taxes per capita and important indicators of state economic health.

A more telling measure, however, is to compare the top five with the bottom five. In the sample of forty-three, the five states with the highest tax collections and expenditures per capita in 2000 were New

York, Oregon, Wisconsin, California, and Delaware (Minnesota was sixth). The five states with the lowest tax collections and expenditures per capita were Arkansas (the lowest), Indiana, Oklahoma, Missouri, and South Dakota.

Over the five-year period from 1995 to 2000, the real Gross State Product (GSP) rose an average of 29 percent in the five states with the highest per capita taxes. For the five states with the lowest tax rate, GSP rose only 19 percent (see **Figure 3**).

Per capita personal income (PCPI) is another good indicator of a state's standard of living. For a comparison of states, it is useful to compare PCPI as a percent of the national average, as published by the U.S. Bureau of Economic Analysis.

In 2000, the five states with the highest per capita taxes averaged 4.2 percentage points above the national average PCPI. The five low-tax states averaged 14.8 points below the rest of the country (see **Figure 4**).

Job loss has been the subject of much attention in Indiana. Once again, the top five states in taxation fared better. Over the five-year period from 1997 through 2002, the five states with high per capita taxes averaged an increase in jobs of 5.8 percent. Indiana and the other four low-tax states showed an average increase of only 3.9 percent.

Correlations do not imply causation, of course. These trends do not provide any evidence that higher state and local taxes cause a higher standard of living. But it is still interesting that the economic patterns are so consistent. Maybe the market economy also guides a state's standard of living. And once again, you get what you pay for. ◀

Figure 3
Growth in Gross State Product, 1995–2000

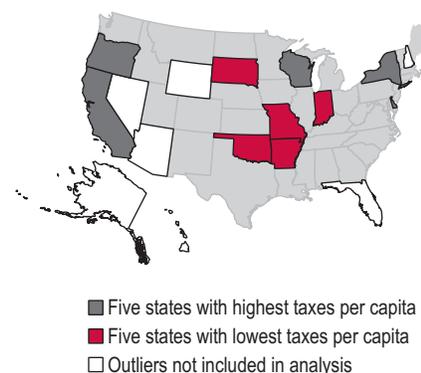


Figure 4
Per Capita Personal Income, 2000

