SENATE TAXATION
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Policy Brief
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Senate Bill 407 Did Not Expand the Economy

Summary

Senate Bill 407, passed in 2003, lowered the top tax rate for the personal income tax and created a credit for capital gains, effectively lowering the capital gains rate. At the time, proponents argued that these changes would spur economic growth in Montana. However, there is no evidence that SB 407 created additional growth in Montana's economy.

1. Using five measures of economic growth, SB 407 did not lead to improvements in 4 of the 5 measures as compared to surrounding states.
2. Using regression analysis, the implementation of SB 407 did not have a statistically significant impact on the growth of the Montana economy.

Major Provisions of SB 407

- Reduced the number of tax brackets from 10 to 6
- Lowered the top bracket rate from 11% to 6.9%
- Reduced the income at which the top rate is effective from $82,400 to $13,900
- Reduced effective rates on capital gains by giving a nonrefundable credit on capital gains of 1% in 2005 and 2006 and 2% starting in 2007
- Capped the allowable itemized deductions for federal income taxes paid at $5000 for single and $10,000 for married filing jointly

Determining Effects of Policy on Economic Growth

In order to determine if a policy has affected economic growth, it is not sufficient to see if the economy grew after the policy was implemented. The economy may have grown without the policy implementation. Likewise, a decline in the economy is not sufficient to say a policy has hurt the economy. The economy may have declined even further without the policy change.

The key to determining the effect of a policy change is to estimate how the economy would have grown without the policy change, and then see if the actual growth is different than what would have been expected.

In the case of SB 407, the income tax changes were implemented in two stages. The bracket and rate changes were effective for tax year 2005. The capital gains credit was implemented at 1% in 2005 and increased to 2% in 2007. The impact on Montana's economy was tested in two ways. First, if the new income tax changes had an effect on economic growth, we would expect Montana's economy to improve relative to the economies of surrounding states after the changes took effect. The surrounding states can provide a baseline for how much Montana would have grown without the change in tax laws. Second, using regression analysis, we estimated the effect of the tax law changes on two measures of economic growth controlling for growth across the country and the faster economic growth occurring in the mountain states.

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Economic Growth Comparison to Surrounding States

By any measure, SB 407 did not increase economic growth as compared to surrounding states. Montana Budget and Policy Centered looked at five measures of economic growth:

- median wage
- unemployment rate
- job growth
- per capita income
- gross state product

Montana was at or better than the median growth in the region prior to 2005. After 2005, Montana was at the median or worse on four of the five measures.

Median Wage

From 2002-2004, Montana's median wage grew at an annual rate of 2.32%, which was the median of the region. The annual growth rate from 2005-2007 was also the median across the region. Montana's median wage growth did not increase compared to the region after the implementation of SB 407.

Median Wage		
	Annual Growth Rate 2002-2004	**Annual Growth Rate 2005-2007**
Idaho	2.10%	3.63%
Montana	2.32%	3.97%
North Dakota	2.88%	4.47%
South Dakota	1.94%	3.62%
Wyoming	2.66%	5.71%
Median	**2.32%**	**3.97%**
Source: BLS State Occupational Employment and Wage Estimates		

Unemployment Rate

From 2002-2004, Montana's unemployment rate fell by 4.55%. That decline was larger than the median for the region. From 2005-2007, Montana's unemployment rate fell by 9.68%. That decline was the same as the median for the region. Montana's unemployment rate did not continue to decrease faster than the region after the implementation of SB 407.

Unemployment Rate		
	Annual Growth Rate 2002-2004	**Annual Growth Rate 2005-2007**
Idaho	-7.70%	-16.79%
Montana	-4.55%	-9.68%
North Dakota	0.00%	-2.99%
South Dakota	5.89%	-8.71%
Wyoming	-3.64%	-9.95%
Median	**-3.64%**	**-9.68%**
Source: BLS Local Area Unemployment Statistics: Annual Average Statewide Data		

Per Capita Income

From 2002-2004, Montana's per capita income grew at an annual rate of 5.41%, which was the median of the region. From 2005-2007, Montana's per capita income was also at the median of the region. After the implementation of SB 407, per capita income in Montana did not increase relative to the region's median.

Per Capita Income		
	Annual Growth Rate 2002-2004	**Annual Growth Rate 2005-2007**
Idaho	4.16%	5.19%
Montana	5.41%	6.16%
North Dakota	5.28%	6.78%
South Dakota	6.77%	5.29%
Wyoming	6.51%	10.23%
Median	**5.41%**	**6.16%**
Source: BEA Regional Economic Accounts, Per Capita Personal Income by State		

Job Growth

From 2002-2004, Montana jobs grew at 1.45%,which was faster than the region median of .88%. From 2005-2007, Montana jobs grew at 2.48%, which was the median for the region. After the implementation of SB 407, Montana jobs lost ground compared to the region.

Jobs		
	Annual Growth Rate 2002-2004	**Annual Growth Rate 2005-2007**
Idaho	0.76%	3.65%
Montana	1.45%	2.48%
North Dakota	0.88%	2.03%
South Dakota	0.56%	2.11%
Wyoming	0.99%	4.20%
Median	**0.88%**	**2.48%**
Source: BLS State Occupational Employment and Wage Estimates		

Gross State Product
From 2002-2004, Montana's gross state product grew at 7.94%, which was higher than the regional median. From 2005-2007, Montana's gross state product grew at 6.91%, which was also higher than the regional median. It is not clear what affect SB 407 had on gross state product relative to the region.

Gross State Product		
	Annual Growth Rate 2002-2004	Annual Growth Rate 2005-2007
Idaho	7.84%	5.03%
Montana	7.94%	6.91%
North Dakota	6.95%	6.06%
South Dakota	5.72%	5.53%
Wyoming	9.26%	8.87%
Median	**7.84%**	**6.06%**
source: BEA Regional Economic Accounts, Gross Domestic Product by State		

Economic Growth Comparison to all States

Only two of the variables that were used in the above regional analysis are currently available for 2008, unemployment rates and per capita income. Using regression analysis to estimate the effect of the initial implementation of SB 407 and the final implementation in 2007, the Montana Budget and Policy Center found no correlation between the provisions of SB 407 on Montana's unemployment rate or personal income per capita. Rather, growth in Montana as measured by these two variables are best explained by economic growth throughout the nation and, even more significantly, economic growth in the states surrounding Montana.

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Appendix: Coefficients Generated by Regression Analysis			
		Growth in Unemployment Rate Coefficients	Growth in Per Capita Income Coefficients
Intercept	Initial starting level	0.018	-0.012
Percent change for US	Controlling for growth across the US will help isolate growth.	0.950	0.912
Mountain State?, 1- yes, 0=no	This variable was included because the mountain states have recently had faster economic growth than the rest of the nation.	-0.033	0
Montana?, 1= yes, 0=no	This variable was included to indentify if Montana was growing faster than other states, before and after the change.	0	0
2005 or after?, 1=yes, 0=no	This variable was included to identify if there was a change for all states after 2005.	0	0
2007 or after, 1=yes, 0=no	This variable was included to identify if there was a change for all states after 2007.	0	0
After initial implementation?, 1=yes, 0=no	This variable was included to indentify if the initial implementation of SB 407 had an effect.	0	0
After complete implementation?, 1=yes, 0=no	This variable was included to indentify if the complete implementation of SB 407 had an effect.	0	0
Coefficients are reported as 0 if they are not significantly different than 0 at the 95% confidence level.			

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