

Taxes Take Their Toll on Arkansas Manufacturing

By Jacob Bundrick

Arkansas and the states belonging to its region continue to rely on the manufacturing industry for economic growth and jobs. Among its neighbors, however, Arkansas is the least competitive in the industry. Bureau of Economic Analysis (BEA) data shows Arkansas' manufacturing GDP has grown at an annual rate of less than one percent per year since 2002, a rate more than seven times less than Texas' growth rate. The Bureau of Labor Statistics (BLS) reports that, in this same time span, Arkansas manufacturing jobs have been cut by more than three percent annually. Both metrics rank Arkansas last among nine neighboring states – Alabama, Kansas, Louisiana, Mississippi, Missouri, Oklahoma, Tennessee, and Texas.

The driving force for the industry lag has been Arkansas' relatively low labor productivity. Output per worker can be calculated using BEA GDP and BLS employment data. In 2013, Arkansas ranked last in the region with the typical manufacturing employee producing less than \$109,000 worth of output. The BLS reported that Arkansas manufacturing workers were paid the least in the region with an average annual salary of close to \$42,500. To put these figures into perspective, workers in both Kansas and Missouri were more than 29 percent more productive and earned over \$10,000 more than Arkansas workers.

Arkansas' high tax burden is largely responsible for the state's lackluster labor productivity. When looking at corporate income taxes as a percentage of state GDP, Arkansas has the third highest tax burden in the region, ahead of only Mississippi and Tennessee. Arkansas Center for Research in Economics research finds corporate income taxes have a significant, negative relationship with labor productivity. In addition, [Federal Reserve Bank of San Francisco](#) research finds states with lower taxes see faster economic and employment growth than high tax states.

Corporate income taxes are but one channel through which taxation affects productivity. They raise the cost of capital, making labor less expensive relative to

equipment. Distorted relative prices between capital and labor lead firms to invest in more labor than capital, which ultimately results in factor misallocation. This is detrimental to productivity because workers rely on equipment to make them more productive, as each worker is able to produce more output with the appropriate amount of machinery. Corporate income taxes, thus, shift investment incentives away from the optimal capital-labor ratio.

A recent [Organization for Economic Cooperation and Development](#) study shows that research and development tax incentives positively impact productivity. Providing r-&-d tax breaks effectively lowers costs for firms and boosts investment in such endeavors. This, in turn, improves long-term productivity.

Marginal personal income tax rates, on the other hand, adversely affect entrepreneurship. Increasing personal income tax rates dissuades individuals from becoming entrepreneurs and establishing new manufacturing firms. With less firms being created, industry growth suffers.

It is crucial for Arkansas to lower its tax burden in order to move towards creating a regionally competitive business environment. As long as Arkansas' continues to boast one of the highest tax burdens in the region, the state's manufacturing industry will continue to be last in productivity, wages, GDP growth, and job losses. By reducing taxes, Arkansas will promote prosperity among both manufacturers and residents.

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