The State of State Tax Policy: Challenges Ahead

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Future Growth in Spending Will Require State Funds, Focus

• Exploding entitlement costs
  – Little option for Federal help
• Property Tax Relief and Reform
• State Tax Options
  – Income Taxes
  – Sales Taxes
  – Alternative Funds
Introduction
• Most state/local governments have balanced budget rules
  – So if want to provide services, need funds
• Federal funds for local governments tightening as entitlements grow
  – Presidents budget limits growth in domestic programs
• Tax options often limited by rules and possible economic effects
• Goal – raise money need with minimal disruption to economy

State Spending Has Been Growing Over Time

Table 2: Total State Expenditures by Function
(Billions of 2003 Dollars)

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<td>706</td>
<td>869</td>
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### Share of Total State Expenditures by Function

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<tr>
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<td>37%</td>
<td>34%</td>
<td>32%</td>
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Source: NASBO “Fiscal Survey of the States”

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### Major Entitlements as a Percentage of GDP, Fiscal Years 1940 - 2080

- **Social Security**
- **Medicare**
- **Medicaid**

Source: C. Eugene Steuerle, Adam Carasso, Elisabeth Bell, The Urban Institute, 2006.

Note: Authors used January 2006 CBO data for Social Security, Medicare, and Medicaid through 2015, and grew Social Security and Medicare levels with 2006 Trustees data and Medicaid with 2005 CBO data.
Spending and Revenue as Percentage of GDP, 1962-2050

Source: OMB, Long-Term Budgetary Trends (2005); Chart assumes entitlement spending grows at the recent trend, revenues equal to historical norms, and other spending grows at rate of GDP plus.

The Big Squeeze on Spending

Property Taxes

- Many calls for property tax relief
- Proposals to Eliminate (GA, IN, FL)
- Property Tax Caps
- Increased Homestead Exemptions
- Smart alternatives
  - Circuit breakers
  - Tax Deferments

WHY THE PROPERTY TAX IS UNPOPULAR WITH VOTERS

- Judgmental Assessment
- Unrealized Gains
- Visibility
- Increasing Burden
WHY THE PROPERTY TAX IS A POLITICAL TARGET

• Unpopular with Voters
• Somebody Else’s Tax
• Delinked from Services?
• Hidden Consequences
• Immediate Tax Relief
• The Accountability Puzzle
The “Invisible” Consequences

- Home Rule
- Regressive
- Hard to take it back
- Financing Local Services
State and Local Tax Sources

State and Local Tax Revenue as a Percentage of GDP

Property Tax
Sales Tax
Income Taxes
Charges and Fees

Income Tax Shows Most Volatility

Figure 3
Annual Percentage Change in Revenue from Major State and Local Taxes

Source: Dye and Reschovsky, 2007
Sales Taxes

• Erosion in revenues
  – Shift from goods to services
  – Shift to on-line sales
• Expansion of taxes to services
• Coordinated Programs
  – Streamline Sales Tax Consortium
    • Consistent definitions potential removal of nexus requirement
  – Federal add-on VAT

Source: Maag and Merriman (2007)
Solutions Going Forward

• Important to budget for downturns
• Long-term need for additional state revenues high
• Protect revenue sources
  – Resist cuts to property taxes
• Potential Role for Energy Taxes
  – Add-on to Federal Policy
• Federal VAT – Could help sales tax erosion