Presentation to Senate Finance & Revenue Committee

Steve Robinson, Decision Metrics, March 26, 2013

Mr. Chairman and members, my name is Steve Robinson and I've been asked to show you some of the research I've compiled around the topic of Oregon's income tax expenditures. I started putting this analysis together a couple years ago and have presented earlier versions of it to several dozen business, civic and government groups across the state during that time. I have shown it to three current and former state economists and other revenue and budget experts, so I'm confident that the picture is generally accurate. All of the data I'm using is readily available on the Web.

As background, I'm not a **professional** economist, but I was an econ major in college, and have done a lot of quantitative analysis in my career. I managed the Performance Measurement Team at ODOT and the Research & Analysis Division at SAIF Corporation before retiring in 2009. Since then, as Decision Metrics, I have been working with several NGOs and the Human Services Coalition as a policy analyst and consultant.

Today, I'd like to begin with my • perspectives on Oregon's income tax expenditures over time as reported by the Department of Revenue through its biennial Tax Expenditure Report, about which I know you have heard a presentation a couple weeks ago. I will show how the • growth – not just the size, but the **real growth** – of these tax breaks since 1999-2001, particularly those in the federal tax code, has really crippled Oregon's General Fund.

I will show how these income tax breaks turn Oregon's state and local tax system into a • **regressive** one that impacts **most heavily** the people who can **least afford** it. I will give some • examples of tax breaks that are prime targets for actions you can take to gain control over their damaging growth. And I will close with some observations on • how this situation evolved, and • some things you could choose to do about it.

Let's start with a graphical picture of where we are now. • This green blob represents Oregon's total **personal income** as reported by the state economist. • Of the $329 billion available to citizens, our tax system **potentially** generates about $28 billion of income taxes, based on our current tax rates. • But we grant about $12.5 billion in tax breaks, or 45% of the potential revenue, leaving only the $15.5 billion projected to fund general state programs.

Now let's look at the **relative magnitude** of the various tax breaks. • • I'm sure you are familiar with the few large ones I'm showing you, • • • • • • • including these itemized deductions in a different color. There are another 200 or so that are less significant individually, but add up to a whole lot of money.

• This information is all contained in the Tax Expenditure Report, which is a gargantuan effort by the Revenue Department and a wonderful resource. The newest edition is a **significant improvement** over previous ones, in response to suggestions from their users. • They increased the number of distribution tables by 60% and improved their usefulness • by showing the **actual** revenue impacts. I suggest you look carefully at these tables, perhaps starting with home mortgage interest on page 90. • I am very concerned, however, that DOR is still not closing the loop on **past** biennia. • Here you can see that they are estimating the revenue impacts for the **current** biennium, for which they had only about six months of good data. But we **never find out** how accurate their impact estimates **really** are, after the fact.

• The heart of my analysis looks at the trends in income tax breaks versus General Fund or discretionary spending over time. I start at the 1999-2001 biennium and include the next **seven** biennia through 2013-15. • In order to make apples-to-apples comparisons I have adjusted all these data for the long-term **growth of statewide personal income**.

• This graph shows some very important relationships. Note that the total potential revenue, the black line at the top, is very consistent over time at around **$29 billion**, plus or minus a few percentage points. Without tax breaks, the General Fund would receive all this money, but of course we **do** have tax breaks – **hundreds** of them. In 99-01, tax breaks consumed about **36%** of potential revenues. • But since then, this percentage has **grown by 9 points** and is now about **45%.** Just the **growth alone** has impacted the General Fund by **$14 billion** over that period. More on that later.

• Here's a closer look at these two components, broken apart on this graph. While resources available to the General Fund declined in the first recession by 12%, and the last recession by 16%, and recovered in between, they now stand at a deficit of **$3.2 billion** compared to 99-01. I don't need to tell you what effect the deficit is having on our citizens and the economy. The growth of tax breaks has contributed mightily to this shortfall. • In 13-15, income tax breaks will be **$2.3 billion**, or **23%** higher than before.

• It's probably worthwhile to test this conclusion – since we sometimes hear comments about the **supposed "growth"** of government – by comparing the spending trend (in blue) to total **employment** in the government sector (in green). The $3.2 billion drop in the General Fund I just showed you amounts to a **16.6%** decline. In comparison, employment in state and local governments relative to the total workforce has **declined 9.1%.** The drop in jobs hasn't been quite as sharp because the government sector includes education, which also gets funding through property taxes, tuition, and other sources. It also includes programs that receive federal funds, which are sometimes counter-cyclical. These other sources create **a little more stability** in government jobs, which are even so declining relative to the workforce.

During this period, some sectors of the population that depend heavily on government services have grown rapidly; for example, the over-85 population is **up about 37%.** So we have more folks needing services, and less money and staff to help them.

A few years ago, the legislature took a big step forward and set up a sunset schedule for selected state tax credits. As members of the tax credit committee, you'll be looking carefully at some of these later this session. • Unfortunately, these Oregon credits only play a **minor** role in the huge problem of growth in tax breaks. Federal breaks account for **over 70%** of the total, and this share is growing.

• I was shocked to learn how much damage the growth of tax breaks has done to Oregon's economy over the past seven biennia. This chart shows the winners and losers from that process. The winners are overwhelmingly the highest-income taxpayers. Of the total $14 billion in tax break growth I mentioned earlier, • over **half, or $7.1 billion,** has gone to the top 20% of taxpayers – the group that averages $150,000 of income. The losers, of course, are the people who depend on the state services that have to be cut when resources are insufficient – school kids, at-risk seniors, and really, all of us. • Education took the biggest hit, nearly $7 billion. • • Human Services lost about $4 billion from the General Fund, but we also have to consider that • we receive on average about $1.66 of **federal funds** for every dollar spent on human services, including health care. So that's another $6.4 billion of lost program funding, for a total hit to the budget of **$20 billion**.

• The biggest "winner" in all this is the federal treasury. On top of the $6.4 billion in matching funds that we've left on the table, the reduction of state income taxes means less deductions on Oregon's Schedule-A returns. The smaller state tax bill increased the amount of income taxes paid to the IRS by nearly **$4 billion**. So if we had managed to cap income tax breaks at the ratio of potential revenues they were in 99-01, our economy would have received a net **$10 billion** more from the feds. This multiplies into some **$20-30 billion** of economic blood that it really would have been nice to have, flowing through our economic veins.

Now I'd like to take a look at what these tax breaks do to the **overall fairness** of our state and local tax system. • This graph, based on reports from the respected Institute on Taxation and Economic Policy, shows how **sales, excise and local property taxes** impact Oregon taxpayers at various income levels. We all know that such taxes are inherently • **regressive**, since they apply to necessities that lower-income people spend much of their incomes on, like housing and fuel. Note the disparity between the bottom quintile of taxpayers, who pay an average 6.4%, to the top one percent, who pay less than a third as much, only 2.0% of their income. In states that rely more heavily on consumption taxes, this graph looks much, much worse. Washington state creates problems for us simply because it has a comparatively regressive tax structure.

So let's say we wanted to have an income tax **policy** that promotes equity among these income tiers. While there's no way to achieve "perfect" equity, the result would look something like • this, with a total state and local tax incidence of about 7.8 percent across the board.

If instead we decided to create an overall • **progressive** structure, varying from say 7.6% to 8.5 percent, it might look like this.

• Here is what the system **actually** looks like today. Looking at this, one might wonder whether we should continue imposing the highest tax burden on the very lowest-income people. To me, it just seems inequitable. But it's also clearly bad for the economy, considering that lower-income people tend to spend locally, instead of on the foreign travel, imported goods and investments in big national companies favored by those with more disposable income.

Now let's consider why our system doesn't achieve a more equitable result. • The main reason is our system of tax breaks, or subsidies, and this graph shows just how lopsided it is. Taxpayers received about $1,270 on average in 2010 from the variety of subsidies shown on the left – mostly deductions and exemptions. Now, we **could** have a policy that said okay, we've decided to give $6 billion dollars a year back to taxpayers out of potential revenue, so let's just divide up the money and give everybody the same $1,270. But instead, we give the top 1% of taxpayers over $7,300 apiece and we give those at the bottom end less than $300. That's a ratio of **25 to one**, That's even though we know tax breaks for lower-end folks would be more economically productive, and create more jobs and profits for everyone.

• Here are a few examples of how the **benefits** of tax breaks are distributed. The dark green segment shows the percentage of each tax break going to the top 20%, that same group averaging $150,000 of income I mentioned earlier. Their split is over 50% for **all income tax breaks** – the bar at the top – while the dark blue sliver at the left shows how the bottom 20% receives hardly any benefit at all. I would particularly note the • college savings plan and cultural trust, with over 84% in each case going to the top tier. All these breaks warrant a very close look.

DOR tax statistics give us • even more detail. The gold and silver bars on the right represent the shares taken by the top 1% – and the next 4% – of taxpayers. These folks average $700,000 and $200,000 of income respectively, and in these examples they take down a large hunk of the benefits going to the top 20%. And just in case you are ever again tempted to go after • capital gains taxes, take a look at how **over 60%** of any such new tax break would provide a **windfall** benefit to the wealthiest **1%** among us.

Bear in mind • two numbers that come from the US General Accounting Office and a study by ECONorthwest: for every million dollars of **general** tax cuts, about 7 jobs are created. That's nationally, so it's probably fewer at the state level. But if you have to **pay** for tax cuts by cutting human services a million dollars, about 88 jobs are lost, partly because federal matching funds are reduced. That's 13 jobs **lost** for every job **created** by a tax cut.

• Finally, I have some observations about how this situation evolved and some things we could do about it. • First, we do not have sunsets on **federal** breaks, so they have grown unchecked for many years. • Related to this is the well-known and growing **disparity of wealth and income** in our state and nation. I showed how subsidies are much greater for the **high end**. As their share of the state's wealth grows, so does their share of income, along with the **large subsidies** that we give high earners. Remember the 25-to-one ratio.

Part of the problem is the • imbalance of power between advocates of a tax subsidy and the advocates for spending those **same** dollars on government programs. Suppose there's a proposal for a new tax break in the range of $15 million, about 0.1% of the General Fund. The **R&D credit** might be a good example. Those who would receive such a subsidy will put on a full-court press, with their trade associations and paid lobbyists on the job. But since the **threat to other programs** is tiny – only a tenth of a percent – the advocates of **those** programs are not equally motivated to put forward a strong case, especially if the subsidy is sold as a job creator. Each **individual** item may be a small piece, but **211** of those breaks add up big-time.

Then there's the • **ratcheting-up effect** of requiring only a **majority** vote to start or renew a tax break, but a **3/5 vote** to terminate or reduce it. Continuing with the R&D example, its sunset was extended in 2011 by majority vote. But if you were somehow persuaded to **kill it** next year, such action would require a 3/5 majority in both houses. (Of course, to oppose the R&D credit is to be accused of being **anti-business**. But this is a prime example of a windfall subsidy that doesn't create jobs. It benefits a paltry75 taxpayers a year just for doing what they **always** do, and they're **already** receiving a federal credit that the General Accounting Office has concluded is ineffective.)

I'm not holding my breath on doing away with the R&D credit, but here • are some actions I hope you **will** consider.

• Let's get DOR to "close the loop" by calculating the revenue impact of tax breaks for the two previous biennia, **as well as** the current and next one. This would be important for increasing the accuracy of their models, and our confidence in them.

Let's finally trim back the • $187 million senior medical deduction by limiting it to low-income taxpayers and capping the amount. Oregon is the **only state in the nation** with this kind of windfall that overwhelmingly benefits the top tier.

Some proposals are already afoot that would • cut back on federal itemized deductions. I hope you will give them serious consideration. Many states don't grant this windfall to their taxpayers, and Oregon could follow suit.

Please • make sure any tax breaks you support are actually **producing more public benefits** than the existing programs that will surely have to be cut **even more** than the 17% they have already suffered since 99-01. So I hope you will • apply very tight criteria for public benefits and require much more accountability from recipients of these public funds.

Finally, whenever tax expenditure bills come before you – either sunsets or new ideas – please • look carefully to determine whether they are mainly **windfall** subsidies that just transfer money to the upper tiers **without** creating significant public benefits. If the words “**capital gains**” appear anywhere, it’s a good sign there’s a windfall for the top 5%. • Here’s an item I came across just this week in the Kiplinger Letter, commenting on state-level efforts to attract new industry and create jobs. Kiplinger’s verdict: they don’t work. • lFour fifths of any jobs created would have come about without the subsidy, which means that 80% of the tax breaks are just wasted. Let’s be very vigilant against windfall benefits.

Thanks for having me today. Please feel free to challenge anything I’ve said that doesn’t seem right, or needs clarification. And consult my • website if you want more information and links on this topic.

Steve Robinson

Decision Metrics Δ `