ECONOMIC SENSE

A data-driven policy summary that examines the issues most important to families and businesses across the state.

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The Regressivity Study: A Wolf in Sheep's Clothing

Bottom line up front

When your models for a successful tax code are California, New York, New Jersey and the District of Columbia. . .

A closer look at the Institute on Taxation and Economic Policy's report, which advocates for broad-based progressive personal income taxes as the state tax ideal, and ranks Washington and the other no-income tax states as having the worst tax systems.

<u>The bottom-ranked states? All lack a personal income tax.</u>
The 5 states ranked lowest in ITEP's report share one tax commonality: they lack a personal income tax. They also generally have a lower tax burden, rank among the nation's best in 21st-century job and economic growth, and are "destination" states with net millions in positive migration.

The top-ranked states? High taxes, low job growth, & people fleeing

Their tax burdens are among the nation's highest, with the lowest economic & job growth this century, and millions more people leaving than choosing to locate there.

Regressivity is a Canard for Almost All Working Washingtonians

Washington households with incomes of $25,000 to $250,000 pay state and local taxes in line with the national average. For the vast majority of Washingtonians the "regressivity" argument is a canard.

For the poorest Washingtonians, there is a better approach than ITEP's prescription

For those extremely low-income Washingtonians (household income under $25,000/yr), there is a better approach than emulating the tax systems of California, New York, New Jersey and Washington, D.C. This Economic Sense identifies three policy markers.

Simply put, the ITEP study is a Wolf in Sheep's Clothing, pushing for policies that would harm our state, including its lowest-income residents.

In what world would you rather have the tax system found in California, New York, New Jersey and the "other Washington"?

Option #1: A world where you want to pay higher taxes, have lower economic and job growth, and more people leaving than moving to the state.

Option #2: If you are a Washington, D.C. think tank.

Let's take a deeper dive into why both are correct answers!

1. ITEP Ideal: Progressive, Broad-Based Personal Income Tax

Bottom 5 States: All Lack an Income Tax

The Institute on Taxation and Economic Policy is transparent about what it believes a state tax system should look like and its policy goals. The following are direct quotes from the report about the ideal system:

- "**Highly progressive income tax brackets and rates.** All of the most equitable tax systems include personal income taxes which are progressive."[1]
- "**Broad based income taxes.** State personal income taxes with few deductions or exemptions"[2]
- "Of the three major taxes used by states, the personal income tax is the only one under which effective tax rates rise with income levels."[3]
- "State personal income taxes… are the main progressive element of state and local tax systems."[4]

This is seen quite clearly in their results, for the five worst states according to ITEP are:

- Washington
- Texas
- Florida
- South Dakota
- Nevada

What do these states have in common in terms of tax structure? All lack an income tax. The analysis in this much-touted report comes down to one thing: a state that doesn't impose an income tax ranks at the bottom of ITEP's tax fairness.

Which states have a tax system to be admired? The top 5 are:

- California
- Vermont
- Delaware
- Minnesota
- New Jersey

The District of Columbia, while not a state, ranked 2nd best, between California and Vermont. New York ranked 7th best.[5]

The study is not complicated, nor does it hide its values:

Broad-based personal-income taxes, with few deductions, and highly progressive rates are the ideal. States which lack a personal-income tax are – by virtue of that fact alone – confined to the "worst" tax systems, according to the study.

2. The ITEP Ideal vs. States without a Tax on Personal Income

It's one thing for a think-tank to advocate for a policy. But it's important to check the real-world fruits of that policy. Let's look at the tax burden, economic performance, and migration data in states without a personal-income tax versus the states ITEP most admires.

A. States without a Personal Income Tax

For decades, 7 states have had no income tax. (Tennessee joined the ranks this year, eliminating its tax on investment dividends. Its data is at the bottom of the following table, for informational purposes.)

States without a personal-income tax generally have a lower tax burden and better economic performance, with more people migrating to them.

States without a Personal Income Tax								
		Overall Tax Burden[6]		Economic Performance in 21st Century[7]		Domestic Net Migration (2010-19)[8]		
	ITEP Rank	Per Capita	Per $1,000 Personal Income	Personal Income Growth (%)	Employment Growth (%)	Rank	Net	Total
Washington	50	13	29	5	7	7	+	336,251
Texas	49	30	35	3	3	2	+	1,145,629
Florida	48	44	48	10	8	1	+	1,289,614
South Dakota	47	29	39	12	15	21	+	13,480
Nevada	46	27	21	9	2	10	+	234,563
Wyoming	41	25	47	8	13	26	-	(13,514)
Alaska	25	34	50	16	17	33	-	(58,591)
Tennessee	45	49	49	23	22	8	+	259,342

B. The ITEP Top 7 States to Admire

ITEP's top-ranked states have a higher tax burden, generally lower economic performance, and a net domestic exodus to other states.

ITEP Top 7 Ranked States								
		Overall Tax Burden[9]		Economic Performance in 21st Century[10]		Domestic Net Migration (2010-19)[11]		
	ITEP Rank	Per Capita	Per $1,000 Personal Income	Personal Income Growth (%)	Employment Growth (%)	Rank	Net	Total
California	1	9	12	13	12	49	-	(912,038)
Vermont	2	10	4	38	41	24	-	(10,907)
Delaware	3	19	22	35	29	16	+	39,538
Minnesota	4	8	6	27	28	28	-	(26,253)
New Jersey	5	3	7	43	39	47	-	(491,174)
Maine	6	14	5	40	42	19	+	15,956
New York	7	1	1	31	23	50	-	(1,379,210)

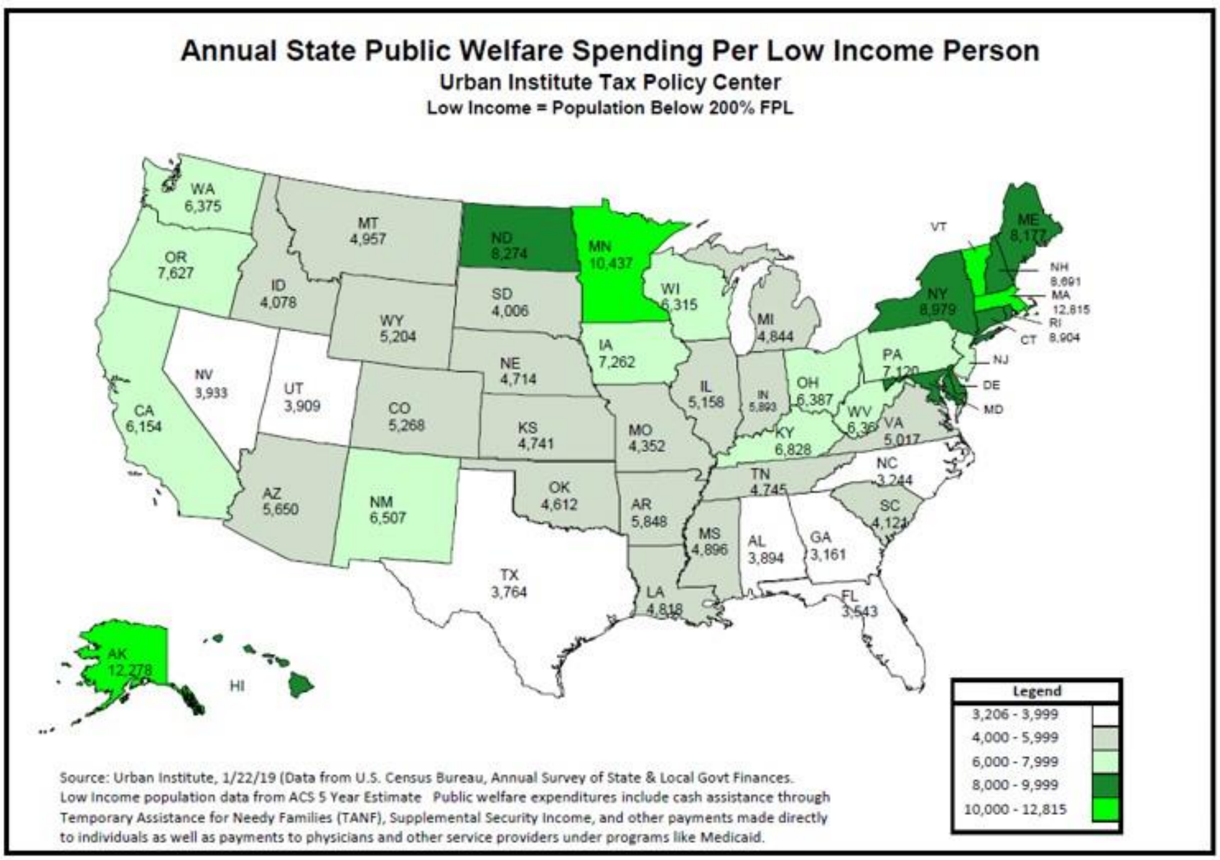
3. Dirty Secret? The "Regressivity" Argument Doesn't Apply to Vast Majority of Washingtonians

Washington households making between $25,000 and $250,000 a year pay essentially the same share of income (10.1%) toward state/local taxes as the national average (9.7%).[12]

4. The Best Policy Prescription for Those with the Lowest Income?

For Washingtonians making less than $25,000 a year, the best policy solution is three-fold:

1. A robust safety net, which Washington has. Social-service benefits for low-income Washingtonians exceed those of California.



2. An economy with ample job opportunities, so these households can climb the economic ladder. The policy approach reflected in ITEP's Top 7 tax systems is precisely the wrong prescription for the lowest income, as those states have seen, on average, much lower job growth than no-income tax states.

3. A tax system which, at the very least, doesn't impose a larger tax burden on those with the lowest income. It should go without saying that raising taxes on the poor does not improve their situation.

On this point, an old adage comes to mind:
"Watch What I Do, Not What I Say"

My Democrat colleagues have had complete control of the Legislature since 2018. For much of that time, state revenues grew at an unusually fast rate. Yet, despite having spent years touting the ITEP regressivity study, and lamenting the tax plight of the poorest among us, did the majority lessen the tax burden for any in Washington, least of all those with the lowest income? No.

In fact, the Democrats have done exactly the opposite, dramatically increasing the tax burden (by $25 billion over 10 years), most of which falls upon working Washingtonians. This includes three "Ps": A new payroll tax on workers' wages (equal to $9 billion/10 yrs) to take effect in January; raising local school property-tax authority (another $9 billion/10 yrs), which disproportionately impacts lower-income communities; and raising the tax on petroleum, which gets passed to consumers in the form of higher gas-pump prices.[13]

And this session? There is hope the Working Families Tax Credit, endorsed by both sides of the aisle, will be funded for the first time.[14] That would be a good step. But this is decidedly not progress if it is overwhelmed by other tax burdens.

Under active consideration this session are: (a) a gas-tax hike of 18 cents/gallon, which would make Washington's tax highest in the country and disproportionately impact lower-income residents; (b) a $25/ton carbon tax, roughly equivalent to a 25-cent gas-tax hike; (c) a low-carbon fuels standard, which the Puget Sound Regional Council estimates would raise pump prices 57 cents/gallon; (d) a regressive tax on health-insurance premiums, which would raise the cost of health care for working Washingtonians; and (e) a sugary-drink tax that would add more than $5 to the price of a case of soda.[15]

Before concluding: ITEP did get one thing right, though…

Despite its misguided policy prescription, the ITEP report did correctly characterize a capital gains tax. It is labeled a progressive personal income tax, not an excise tax.[16]

As we all know it to truly be.

Conclusion

The much-ballyhooed ITEP regressivity study is a Wolf in Sheep's clothing, pushing policies that would harm the people of Washington, including our lowest-income residents.

We should not attempt to model California, New York or Washington D.C.'s tax systems. Washington's system, with its lack of a personal income tax, has served our state exceedingly well.

If the policy aim is to benefit the lowest income among us, we should have a robust social-safety net (check!), ample job opportunities (check!) and avoid raising taxes on lower-income and working-class people (a clear "fail!" in recent years; whether 2021 follows suit is to be determined).

Footnotes

1. Institute on Taxation and Economic Policy, "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States" (October 2018), page 9 https://itep.sfo2.digitaloceanspaces.com/whopays-ITEP-2018.pdf
2. Id., page 10
3. Id., page 12
4. Id., page 14
5. Id., page 10
6. Dept. of Revenue Comparative State & Local Taxes (Dec. 2019), Table 1 & 7 https://dor.wa.gov/sites/default/files/legacy/Docs/Reports/Comparative/Comparative_2017.pdf
7. Bureau of Economic Analysis, 2000-19 (SAINC 4 - Personal Income and Employment), courtesy of Economic & Research Forecast Council
8. U.S. Census Bureau, Population Change (2010-19, nst-est-alldata)
9. Same as footnote 6.
10. Same as footnote 7.
11. Same as footnote 8.
12. ITEP, p.4 (national) and p.126 (Washington). Breakout: 10.1% to 12.4% for 20-40% income; 9.9% to 11% for 40-60% income; 9.5% to 9.2% for 60-80% income; and 8.9% to 7.1% for 80-95% income.

13. HB 1087 (Payroll Tax for Long-Term Care Services), https://aor/billsummary/default.aspx?bill=1087&year=2019&initiative=false
SB 5313 (Local School Property Tax Authority), https://aor/billsummary/default.aspx?bill=5313&year=2019&initiative=false
SB 5993 (Petroleum Tax - Model Toxics Control Account),
https://aor/billsummary/default.aspx?bill=5993&year=2019&initiative=false
14. Funded in Senate & House Republican Budget proposals (http://leap.leg.wa.gov/leap/budget/detail/2021/so2123Bien.asp)
(http://leap.leg.wa.gov/leap/budget/detail/2021/ho2123Bien.asp)
Democrat bills on topic: SB 5387 & HB 1297
15. House Transportation Chair Proposal (18 cent gas tax, $15 ton initial carbon tax, rising to $25 by 2025-27
http://leap.leg.wa.gov/leap/Budget/Detail/2021/htRevenueAndSpendingFramework1_19.pdf)
HB 1036 (Low Carbon Fuel Standard), for price pump impacts see: https://www.awb.org/low-carbon-fuel-standard-proposals/#:~:text=The%20Puget%20Sound%20Clean%20Air,the%20same%2010%2Dyear%20timeframe.
SB 5149 (Health Insurance Premium Tax), https://app.leg.wa.gov/billsummary?BillNumber=5149&Year=2021&Initiative=False
SB 5371 (Sweetened Beverage Tax of 1.75 cents per ounce),
https://app.leg.wa.gov/billsummary?BillNumber=5371&Initiative=false&Year=2021
16. ITEP, p.140, stating that personal income tax model in report includes capital-gains taxes and rates. See also pages 10, 137, and 139, all referencing capital gains tax as personal income tax.