Chapter 4

Read Our Lips, No New (Income) Taxes

The federal Tax Reform Act of 1986 offered state governments an incentive to utilize personal income taxes and to decrease their reliance on sales taxes. By maintaining a deduction for state and local income and property taxes and eliminating the deduction for sales taxes, Congress sustained a subsidy of a particular subnational tax while eliminating another. Since 1986, however, only Connecticut has adopted a personal income tax, and the trend among state governments has been away from income taxes toward sales taxes (Gold 1990). State legislators' have several perceptions about why state governments have not responded to the federal incentive for income taxation. Although the 1986 Tax Reform Act encouraged states to adopt income taxes, other federal policies, such as wage tax increases, and the persistent federal politics decrying income taxes created a political climate in which state representatives found it difficult to even propose increases in income tax rates (Steuerle 1991).

In states with and without an income tax, representatives' aversion to income tax increases illustrates how the political costs of a specific policy change can override the objective economic and distributional benefits of the same change. In every state, representatives explained that although they supported progressive income tax increases as a matter of principle and as a matter of economic equity among their constituents, the political firestorms that could result from such tax increases and their subsequent political costs simply made them too risky. With tax policy, legislators perceived that the political costs of taxing according to ability-to-pay principles were likely too high. Consequently, legislators proposed and enacted more obscure tax increases in sales and "hidden" business taxes in the wake of the federal income tax increases in 1990 and 1993.

Legislators' arguments against income taxes focused on citizen disdain for federal income and wage taxes and suppositions that state legislators would continually increase income tax rates. Most representatives perceived that constituents resisted sales taxes less than income taxes because of the obscurability of the former. Other arguments favoring sales taxes identified their universal incidence and horizontal transferability. In the case of obscurability, legislators framed their arguments in terms of not overtaxing working individuals via income taxes. With respect to horizontal transfers, legislators argued that sales taxes paid by nonresidents alleviated tax burdens for residents.

Legislators perceive that their constituents loathe income taxes and believe support for income taxes indicates support for "big government." Many suggested that their constituents felt taxes were as high or higher than at the start of the 1980s despite decreases in federal income tax rates in the early 1980s, substantial reform in 1986, and two presidential campaigns in which the winning candidate ran strongly opposed to new or additional taxes.

Income taxes have thus become a political target for citizens who are disgruntled with government and seek a political outlet for their frustrations. With New Jersey's enactment of a substantial income tax increase and the federal enactment of an income tax increase in 1990, income taxes became the "powerful condensation symbol" for various complaints against government (Edelman 1964, 172). Politicians have responded by attempting to reduce income taxes and by not increasing income tax rates even when their states' fiscal conditions are dire. The conflict for state legislators requires balancing funding needs with a political desire to lower income taxes. Consequently, state legislators have declined to utilize an avenue of federalism available to them by choosing sales and excise taxes that cannot be deducted from federal income taxes.

Representatives' perceptions about citizen distrust of taxation find support in public opinion data. A 1993 Gallup Poll reported that 50 percent of citizens thought federal income taxes would be raised unfairly, while 42 percent felt taxes would be increased fairly. Sixty percent of the respondents did not believe that the money raised from a federal income tax increase would be used to reduce the deficit despite pledges by President Bill Clinton and members of Congress to do so (Gallup 1994, 235). Paradoxically, 75 percent of the respondents supported increasing taxes on incomes greater than seventy-five thousand dollars yet demonstrated little support for any tax increases or faith that such increases would be used for their intended purposes. The resistance to income taxes is thus rooted in the distrust that politicians will direct tax increases at those with modest incomes.

A variety of means could provide tax relief that would offer greater tax equity, offer greater revenue dependability, or negatively affect vertical transferability less than would income tax reductions. Yet popular political demands to reduce income taxes override these considerations, and politicians find themselves developing policies in which accommodating an income tax decrease is primary and in which other components depend on the size and nature of the income tax reductions. Many state legislators argued that a lack of latitude to raise income taxes has left their state coffers relatively empty even in flush economic times (see Galper and Pollock 1988). In these circumstances, legislators find themselves unable to provide for programs even when majorities of their colleagues support them.

With income tax politics, legislators referred to all six governing principles. Despite their desire to tax citizens according to the ability-to-pay principle or to vertically transfer taxes onto the federal government by raising federally deductible state income taxes, legislators found that the principle of obscurability and the political symbolism of the income tax preempted their efforts to apply these other principles. In the case of income tax politics, representatives' desires for obscurability trumped other governing principles. In other circumstances, when federal income tax politics are not as salient, other principles may emerge and interact with obscurability, but in the early and mid-1990s, such was rarely the case.

Background

The trend away from income taxes follows a flurry of state tax changes in the 1980s. Concomitant with income tax reductions, states increased sales tax rates. In the early 1980s, states enacted thirty-seven sales tax increases to grapple with fiscal crises created by the severe recession in 1982 and reductions in federal assistance (Gold 1986). Many of these states also raised income tax rates but then lowered them during the late 1980s. While fifteen states lowered income tax rates from 1985 through 1989, only one state lowered its sales tax. Overall, thirty-two states ended the 1980s with higher sales tax rates than they had at the beginning of the decade.[1]

Measured in terms of real dollars and as a percentage of personal income, state tax revenues grew dramatically during the 1960s and 1970s. Indeed, by the 1970s, many states cut income tax rates in response to the revenue bounces as a result of the effects of inflation and increases in tax rates enacted in the previous two decades. The 1980s, however, were a different story. During 1982 and 1983 most states raised sales and income tax rates. Unlike the 1960s, they raised rates at a time when they simultaneously cut spending. States began the 1980s facing reduced federal assistance and the worst economic contraction since the Great Depression (Gold 1982).

By the mid-1980s the economy had recovered enough for most states to have sufficient latitude in their budgets to make tax reductions. Unlike previous periods of enacting new taxes and increasing tax rates, this period of tax change marked a definite shift from progressive taxes to regressive and obscure taxes. Table 5 details the changes in state sales and income tax burdens over time as a proportion of citizens' personal income.[2]

Table 5 depicts income taxes rising to near parity with sales taxes by the late 1980s. Income taxes accounted for 39 percent of state revenues in 1990 but declined to 37 percent by 1993. While this trend is not dramatic, it marks a shift away from income taxes. Many states that increased income tax rates during the 1990–91 recession are now considering large tax reductions.[3] In New Jersey, Governor Christine Todd Whitman has proposed a 30 percent reduction in income tax rates that would more than offset the 1990 increase. In Connecticut and Arizona, successful Republican candidates for governor ran on promises (as yet unfulfilled) to abolish state income taxes.

In addition to the political attention paid to income taxes, the actions of state legislatures further demonstrate shifts from income to sales taxes. In the 1990s, a recession and tight federal fiscal policies led states to increase taxes. During 1991 and 1992, when many states suffered economic recessions, ten states enacted increases in their income taxes, while three states cut income taxes. At the same time, eighteen states increased sales taxes.

TABLE 5. State Taxes per $100 of Personal Income, 1970–87 (1987 dollars)

	Total State Tax	Personal Income	General Sales
1970	$6.29	$1.20	$1.86
1975	$6.68	$1.57	$2.07
1980	$6.78	$1.84	$2.14
1987	$7.02	$2.16	$2.26

Two structural factors have counteracted the federal incentive for state income taxes. States increased their reliance on income taxes by enacting new taxes and increasing rates during the 1960s and early 1970s. The "bracket creep" spurred by the high inflation of the 1970s furthered this reliance as citizens found themselves in higher state tax brackets as their nominal wages rose (Gold 1986; Steuerle 1991). By 1987, state income taxes claimed about the same amount of personal income as did state sales taxes. The inflation of the 1970s thus increased income tax burdens for many individuals and may have tempered any incentive from the Tax Reform Act to further increase state income tax rates in the late 1980s.

A second structural factor that has led states away from income taxation comes from the nature of the 1986 act. Although Congress maintained the deduction for state income taxes, it decreased the value of the deduction by lowering the top marginal income tax rate to 28 percent. In 1981, the top marginal rate was 70 percent, and individuals in that bracket received reductions of seventy cents in federal taxes for every dollar paid in state income taxes. With the 1986 changes, these same persons received federal tax offsets of only twenty-eight cents for every dollar in state taxes and lost much of the exportability or transferability of their state tax liabilities (Gold 1990). Although the 1986 Tax Reform Act advantaged persons paying state income taxes relative to persons paying sales taxes, income taxpayers lost some cushioning that had previously been a part of the federal tax structure. For most taxpayers, this loss amounted to less than 10 percent of their tax liabilities (Courant and Gramlich 1991).

In the next section, I offer case studies of legislators' responses to the symbolic politics of income taxes. I begin with the politics of income taxes in states that have no income tax. In these states, legislators run against the federal income tax and differentiate themselves from their national counterparts by proclaiming that they do not tax citizens' incomes. I then detail the policy initiatives and trade-offs in four states—New Jersey, Mississippi, Michigan, and Vermont—where substantial tax changes have taken place. In Michigan and Mississippi, legislators sought explicit alternatives to obvious income taxes in more obscure sales taxes. In New Jersey, Republican legislators supported Governor Whitman's efforts to reduce income tax rates by one-quarter, although such reductions imply vertical transferability will become relevant as fewer state dollars imply less state assistance to local school districts. In Vermont, the Democratic-controlled House of Representatives bucked the national trend, rejected an income tax cut, and cut the sales tax rate instead. However, Vermont tax politics resulted in state representatives voting to retain the current sales tax rate to fund property tax relief programs—a subject I consider in chapter 5. Finally, I offer two examples of how the symbolic politics of taxation generated largely symbolic political responses in Colorado and New York. In these states, representatives touted rather marginal tax reductions as proof that they were committed to lower taxes, although some argued that the specific nature of the tax reductions could be counterproductive for revenues or economic growth.

Legislators and Taxes: The Quandary of Governing

State legislators find themselves in a quandary when it comes to taxes. The threat of tax revolts and electoral defeat limits state legislators' opportunities to raise taxes without high political costs (Berry and Berry 1992). Conversely, constitutional mandates for balanced state budgets occasion elected officials to periodically confront the unpopular prospects of raising taxes and cutting state services. Thus, legislators have come to seek the least objectionable revenue increases (i.e., sales taxes) while seeking political favor by reducing, however modestly, more obvious and objectionable taxes (i.e., income taxes). In addition to calculations about their own constituents' response to tax changes, representatives must consider how various interest groups will likely mobilize for or against tax proposals. In the case of progressive tax proposals, representatives can likely assume that those whom the proposal most affects will be the same voters with the most resources available to mobilize against the proposal.

There are two important questions affecting the understanding of subnational politics and federalism. The first question is why state policymakers trade one tax for another even when such a shift is revenue neutral. The second question concerns what consequences can be expected from these shifts. There are consequences for state public policies, for state politics vis-à-vis elected representatives, and for politics that traverse the levels of federalism.

I describe four distinct developments in tax politics.

1. In states without an income tax, the income tax offers a symbol of what is wrong with the federal government.
2. In three case-study states, the income tax has served as either the catalyst for or a major determinant of substantial policy changes.
3. Vermont may be considered the exception that proves the rule.

Liberal representatives enacted a sales tax decrease, rejected an income tax cut, and later voted to retain the current sales tax because they wanted to fund property tax relief programs.

4. In Colorado and New York, politicians have offered largely symbolic responses to demands for tax relief.

No-Income-Tax States

In the three states with no personal income taxes—Florida, Tennessee, and Washington—the influence of symbolic politics was clear. Among forty-one legislators, thirty cited citizen disdain for the federal income tax as the reason they either could not support an income tax or did not envision that the state would adopt such a tax. This latter group typically supported an income tax as a matter of policy but opposed it publicly for political reasons. Table 6 details legislators' positions on state income taxes and their observations about why the tax would not be adopted in their states.

The table indicates that representatives identified several reasons for citizens' disdain for income taxes. Among proponents and opponents of an income tax, nearly two-thirds of the representatives cited the federal income tax as the impetus behind citizens' opposition to state income taxes. Income tax opponents were marginally more likely to cite distrust of politicians as a reason for anti–income tax sentiments than were propo-

TABLE 6. Legislators' Reasons Why an Income Tax Will Not Be Adopted

Percentage of legislators in Florida, Tennessee, and Washington suggesting primary reasons why their state will not adopt an income tax.

	Personal Position	
	Favor (N = 21)	Oppose (N = 19)
Symbol of federal tax	62	74
Distrust of politicians	38	53
Deserves-to-pay principle	5	32
Obscurability of the sales tax	62	21

N = 40 (Washington = 14; Tennessee = 13; Florida = 13).

nents. Conversely, proponents believed the obscurability of the sales tax encouraged its acceptance, particularly in comparison to the more obvious income tax.

Citizen distrust of politicians manifests itself in the symbol of the income tax. As a reason for opposing income taxes, representatives mentioned distrust of politicians second only to citizens' disdain for the federal income tax. Forty-five percent of legislators in the no-income-tax states and 25 percent in the five income tax states suggested that their support for alternative taxes resulted in part from citizen disdain for politicians.

Tennessee. Tennessee offers the most striking example of a case where traditional economic and political considerations could lead legislators to support an income tax, yet the political symbolism of the income tax overrides these influences. Of thirteen legislators interviewed, eleven agreed that the state loses money to other states because of a lack of reciprocity with its neighbors. Commuters to Tennessee do not pay income taxes in Tennessee, and Tennesseeans remitting income taxes to neighboring states also pay no taxes to Tennessee. These eleven agreed that Tennessee's tax system was regressive and that tax burdens could be shifted away from poor and moderate-income citizens by imposing an income tax and lowering sales taxes. Yet only seven of these eleven legislators publicly supported an income tax, and no legislator thought it likely that the state would adopt the tax by popular referendum. Despite the possibilities for the state to cut tax burdens for a majority of its citizens, to increase revenues by enacting a tax system with reciprocity, and to create a more diversified, dependable tax base, nearly all legislators rationalized either their inactivity toward or their opposition to an income tax on the grounds that citizens hate the federal income tax and distrust elected officials with income tax revenues. As one legislator mentioned, "I could support it as a matter of tax equity because I have a very working-class district, but they'd vote me out before I could explain the benefits of it. They wouldn't believe me, and it would get nowhere. It's just too hot for them to handle."

As a result of not having an income tax, Tennessee legislators enjoyed the political benefit of being able to run against a federal tax and of distinguishing themselves from their national counterparts in Congress—a benefit about which many expressed relief in 1994. Conversely, legislators perceived implicit political costs from not being able to offer tax rebates or reductions to citizens regardless of economic conditions. More objectively, legislators both supporting and opposing income tax proposals recognized objective losses in terms of jobs and fiscal-drain issues resulting from Tennessee's almost singular reliance on its sales tax.

Florida. A state's current tax system often shapes any efforts at tax reform and the changes legislators contemplate in financing their services. In Florida, all of the legislators interviewed discussed the state's numerous sales tax exemptions on more than 150 categories of merchandise and more than one thousand specific items. Legislators argued that before they could ask their constituents to vote for an income tax, these exemptions would have to be eliminated, with the possible exception of the food exemption. But even the current exemption for food is complicated in Florida. As a rather colorful legislator explained,

> Well, yes, we exempt food, but then you get into a discussion of "What is food?" If you're buying shrimp, for example, they're supposed to ask you at the cash register, "Are you going to eat that?" and if you are, then okay, it's food and it's untaxed. But if you're going to use if for fishing bait then they're supposed to tax it since it's now a recreational item, unless you promise to only eat the fish and not use it for any trophy purpose, in which case the shrimp is then considered a necessity for food production and then it's once again untaxed, but you have to be a professional fisherman for that. Now remember we're talking about a $4.50 an hour cashier here, having to be an expert on tax law.

Florida's other recent effort to enlarge its tax base ended in failure when Governor Robert Martinez at first indicated support for a services tax in 1987 and then led the fight to repeal it. In 1986 the Florida legislature extended the sales tax to a variety of services, including retail services (e.g., haircuts and home repairs) and professional services (e.g., accounting and advertising). This legislation became effective in 1987. Professional groups opposed to the tax suggested that it would cripple Florida's service-driven economy. Advertisers used their position in media markets to mount a campaign for repeal (Francis 1988). One legislator recalled the advertisements from the campaign:

> The ad agencies bought their own time, and they'd have a metronome ticking away on the screen for fifteen seconds, and then a voice-over would come on and say, "Right now you could be watching a com-

> mercial for hemorrhoid cream, but all you get is this lousy ticking sound." Now, you'd never think that would have led to a successful effort to repeal the services tax. Hell, it made me think about doubling it, but the governor took off and flipped, so we did away with it.

This representative and several colleagues argued that had the governor not retreated, the furor would have dissipated in six months and the state's revenue position would have been much stronger both during the recent recession and in 1994, when calls for new prison spending and health-care reform led a new governor and legislators to seek additional taxes or the elimination of existing spending programs.

The 1986 experience in Florida indicates that powerful interest groups can successfully oppose and roll back obscure taxes such as the Florida services tax. Both the media campaign and the governor's decision not to support the tax he proposed contributed to the legislature's decision to cut its losses and abandon the tax without testing whether voters would penalize them for it despite any fiscal benefits it may have provided.

Washington. In contrast to Florida, legislators in Washington felt their refusal to enact an income tax left them unable to reform the state's highly unpopular business and occupation (B and O) tax. The state assesses the B and O tax on employers based on gross receipts, with rates varying according to business or professional category. Twelve of fourteen Washington legislators complained that the B and O tax was regressive and depressed economic growth, but they also argued that its dependability compensated for fluctuations in their 8 percent sales tax. One legislator recognized that Washingtonians had a compounding problem. By relying on a regressive and cyclical sales tax, legislators found it necessary to seek a dependable revenue source. Because an income tax has not been a viable option, legislators have chosen a regressive, obscure, but dependable business tax. Consequently, Washington ranks highest among all states in terms of the percentage of income it taxes from the poorest fifth of its citizens (McIntyre et al. 1991).[4]

As in Florida, Washington legislators generally believed that the state might seek alternatives to an income tax if revenues fell far short of spending. Although six Democrats openly supported an income tax, none expected an income tax to be adopted by popular referendum. Most believed the state probably would attempt to increase revenues by enacting a value-added tax or by expanding the sales tax base to cover services in addition to merchandise. Proposals for either value-added or service taxes enjoyed bipartisan support.

In Florida and Washington, the revenue needs justifying an income tax are less compelling than they are in Tennessee. Nonetheless, legislators worried that they served constituents poorly by maintaining regressive tax systems. Several Washington representatives voluntarily identified their state's distinction of taxing more than 15 percent of the poorest fifth of Washingtonians' income in state sales and local property taxes (see McIntyre et al. 1991). In both Florida and Washington, Republicans and Democrats alike discussed the state's inability to fund education, crime, and transportation programs. They ascribed these limitations to their states' limited tax systems.

Among the three no-income-tax states, the influence of the federal income tax was evident in the legislators' perceptions. The perception that constituents would reject an income tax and punish legislators who supported one left few legislators willing to commit much political capital to promoting one. In these states the a priori condition that an income tax is off the table shapes policy agendas and decisions about how to finance public services. For representatives in Washington, Florida, and Tennessee, the potential political mobilization and costs resulting from the enactment of an income tax were simply too high to risk political capital. Considering the repeated failure of income tax proposals in Tennessee and Washington, representatives suggested that unless enactment was assured they would refrain from supporting such a tax for fear of incurring political losses for a failed proposal. Ironically, even if passage were assured, these legislators feared that the political costs of enactment would be high and would jeopardize their careers. Whereas in other states the movement away from an income tax may be unidirectional, decisions about how to finance services and how to change taxes become more complicated.

Substantial-Change States

At the same time that states have sought to decrease income taxes, they have raised sales taxes. Why would legislators trade one tax for another? The answer is that shifting taxes allows legislators to address policy problems and respond to the political demand for income tax relief. Facing education-policy problems, Michigan and Mississippi representatives opted to increase state responsibility for locally administered education programs to address growing disparities in localities' abilities to fund schools. In New Jersey, the converse transpired. Garden State legislators promoted a state income tax cut, and many expect the state to be less capable of assisting localities in providing services despite court rulings mandating that the state government provide "equal education" throughout New Jersey's school districts.[5]

Mississippi. Mississippi legislators assembled a supermajority to pass a one-cent increase in the state sales tax in 1992, raising the rate from 6 to 7 percent. Eighteen months later, the same legislators debated two proposals to reduce state income taxes. Many of the legislators supported the sales tax increase and the income tax proposals or other income tax reductions, arguing that citizens accepted—in some cases, demanded—the sales tax increase because the House and Senate earmarked the marginal revenue for education.

When legislators enacted the sales tax increase, the state still felt the effects of the 1990 recession, and casino gambling had yet to generate revenues. With its economy expanding and riverboat gambling producing a $300 million general fund surplus in 1994, the governor proposed two income tax reductions that would cost the state $68 million annually. He did not propose changing the sales tax despite his veto of the 1992 increase, which two-thirds majorities in both legislative chambers voted to override.

For legislators, the decision to increase taxes in 1992 focused on the need to increase education funding. Eleven of fourteen representatives interviewed eventually supported the increase, although one had initially opposed it because he preferred increasing income tax rates. Most legislators felt that the benefits of providing more assistance to schools outweighed the political costs of voting for a tax increase. House members also reported that their constituents said they could support a sales tax increase but not an income tax increase. As one legislator explained,

> We had a situation where we couldn't get the votes in the House for an income tax increase. If we had them, we'd have lost a lot of seats in that election two months later. Then you'd face repeal of what we fought for. So it came down to either biting the bullet to get two-thirds for the sales tax or mandat[ing] school districts provide the services we were going to provide. . . . The problem with doing the mandates is

> that it doesn't address the issue of getting money to poor districts so they can provide the services. You can't ask a Delta district to go over 10 mills on its property tax. So sure, it was regressive, but I think that's outweighed by the state's ability to redistribute the money to poor districts.

In 1994 Governor Kirk Fordice proposed increasing the personal exemption for the state's income tax from $6,500 to $9,500 and exempting senior citizens from state income taxes. Interestingly, the proponents of these tax changes were conservative Republicans seeking to reduce taxes and liberal Democrats who saw these changes as opportunities to make the state's tax system more progressive. Moderate Republicans and Democrats opposed to the tax cuts cited the state's ill-fated 1979 tax cut, which was followed by fourteen years of deficit projections and various reductions in state spending.

Opponents of Governor Fordice's proposals feared that a repeat of the 1979 tax reductions would result in unpopular spending reductions for years after the benefits of a tax decrease abated. Several Democrats opposed exempting senior citizens on the grounds that retirees with pensions were not overtaxed in Mississippi and that other groups, such as working parents, should be considered for tax preferences along with senior citizens. Nonetheless, legislators found it hard to turn down proposals from a conservative governor offering tax reductions and a more progressive tax system. One liberal legislator from a relatively poor district said, "I don't see how I can vote against Fordice's proposal—it offers tax relief to a lot of people in my district. It may bankrupt the state, and they won't like it when we cut education, but it's a very hard vote to say no to."

Ultimately, the legislature compromised and passed the income tax exemption for senior citizens and defeated the change in the personal exemption. According to a member of the Fordice administration, moderate Democrats and a few Republicans voted down the personal exemption change because of their concerns about revenue dependability and because of the state's experience with the 1979 tax cut. The majority of Republicans and a few liberal Democrats supported both tax reductions.

Comparing Mississippi's sales tax increase and its competing income tax proposals in 1994 demonstrates how difficult it can be for individual representatives to translate their governing principles into public policy. All but one Democrat and a few of the Republican legislators recognized that the income tax was the best way to tax citizens according to the ability-to-pay principle. The need to assemble a two-thirds majority to override the governor's veto and the resistance to impose an unfunded mandate on local school districts generated support for the relatively regressive sales tax increase to increase education funding. Concerns about revenue dependability made the governor's most progressive revenue proposal, the three-thousand-dollar increase in the personal exemption, prohibitively expensive. Horizontal tax competition with other southeastern states and the targeted benefits of the seniors' exemption (which made it less expensive than the general exemption increase) created the situation in which legislators set aside some of their equity concerns and voted to create particular benefits.

There was greater support for the seniors' exemption because its Democratic and Republican proponents viewed it as a component of economic development policy. Ways and Means Committee members hoped the seniors' exemption would attract relatively wealthy retirees to the state and cited estimates by the state revenue department that the state would recoup foregone income tax revenues with increased sales tax revenues in three to seven years. During the debate on the measure, legislators pointed out that a number of other southeastern states either exempted pension incomes from their income taxes or were considering proposals to do so. In this respect, the proposal became an implicit development policy as well as a competitive response to neighboring states' income tax policy changes. With respect to development, legislators hoped that an influx of retirees would create new jobs in construction and various service industries.

Mississippi representatives have thus found that the timing and packaging of tax proposals affects their position on the proposal. Perceptions of widespread support for education spending led legislators to vote for a sales tax increase. The need to assemble a two-thirds majority to override the governor's veto along with concerns about the variation in resources among local districts led legislators to seek a sales tax increase rather than an income tax increase or mandates on local districts. Less than two years later, a good economic climate and new revenues from riverboat gambling created a situation in which the Republican governor could propose progressive income tax reductions. Although the proposals may have been popular with many voters, some legislators still opposed the changes, fearing the state had not established sufficiently dependable revenues to warrant major tax reductions that might be rescinded later.

Michigan. Representatives in the Great Lakes state discovered two things about tax changes. First, when given the choice, voters would not cut taxes irresponsibly. On two occasions when voters perceived that property tax reduction referenda would provide no alternative or inadequate funding for primary and secondary education, they rejected the proposals. Second, tax proposals could be presented in such a way as to insulate representatives from the political costs associated with major tax changes. By using Michigan's referendum process, representatives made voters responsible for choosing the level and method of tax reform. When voters overwhelmingly enacted a sales tax increase and rejected an income tax increase, they indicated to legislators their strong desire for obscure taxes, and they let legislators avoid having to decide how to relieve voters of obvious and highly unpopular property tax burdens.

Michigan legislators presented voters with a referendum designed to alleviate property taxes and growing financial inequities among school districts. Regardless of whether voters approved or rejected the referendum, Proposal A, property taxes would be reduced. If voters rejected Proposal A, a statutory alternative crafted by legislators would have become law. In addition to lowering property taxes, Proposal A increased the state sales tax from 4 to 6 percent, whereas the statutory alternative replaced lost property tax revenues by increasing the state income tax. Table 7 provides

TABLE 7. Elements of Michigan's Proposal A

Proposal A	Statutory Alternative
Reduced basic millage to 8 mills on homestead property	Basic millage at 12 mills
Raised sales tax to 6 percent	Retained 4 percent sales tax
Lowered income tax from 4.6 percent to 4.4 percent	Raised income tax to 6.0 percent
No change in the personal exemption	Raised personal exemption from \$2,100 to \$3,000
Raised tobacco tax from 25 to 75 cents per pack	No change in tobacco tax
Lowered single business tax from 2.75 percent to 2.35 percent	No change in single business tax

a comparison of Proposal A and the statutory alternative. Voters approved Proposal A by a 40 percent margin.

Legislators addressed a growing policy problem with Proposal A. With increased state sales tax revenues, legislators and the governor reformulated the state's primary and secondary education financing and offered greater assistance to schools with moderate property values but more modest income profiles—the districts in which voters had opposed millage increases, thus forcing administrators to close schools as early as March because of a lack of funds.

Legislators both opposed to and in favor of Proposal A noted that its authors designed it to be politically attractive. The statutory alternative distinguished it from previous tax reform proposals, which had offered property tax relief without alternative financing. Consequently, citizens did not have to wonder how their schools would be funded if they voted in favor of property tax relief. Michigan legislators emphasized that the proposal not only addressed the property tax issue but also decreased a highly visible tax while raising a more obscure incremental tax. All of the opponents and proponents of the proposal suggested that the obscurability of the sales tax made it preferable to income and property taxes.

The modest reduction in the income tax rate meant that the governor and legislative proponents could campaign for Proposal A as a tax decrease for all citizens regardless of whether they owned property. Several proponents noted that the statutory alternative decreased income taxes only for those with low incomes.[6] For representatives, the political benefits started with their option to exercise the referendum process, by which they shifted the responsibility for the tax change to voters. The second benefit came from proposing a statutory alternative that ensured relief from property taxes, and the question for voters then became one of choosing between their own preferences for tax progressivity or tax obscurability. By an overwhelming margin, they chose obscurability. For representatives, the process was fail-safe in that it addressed a growing policy problem—inequitable and in some cases inadequate property taxes to fund local schools—and voters held the onus for deciding how to fix the problem.

Two proponents and one opponent suggested that the cigarette tax was really more for political packaging than for policy purposes. The designers of the proposal anticipated tobacco companies would vigorously oppose Proposal A and that a citizen backlash against their advertising would increase chances for approval. One proponent noted that it was hard in Michigan to discredit the teachers' union, the Michigan Education Association, but that having the tobacco lobby and the union stand out as the two principal interest-group opponents of the proposal was "a unique opportunity to associate a generally supported group, the MEA, with a group most believe to be lower than a snake's belly, the cigarette people."

In Michigan and Mississippi, representatives offered no reduction in services but substantial tax changes. However, these changes contained elements of compromise resulting from the politics of income taxes and citizen preferences for obscure taxes. In Mississippi, representatives imposed a regressive statewide tax increase to provide more education funding to poorer school districts. Yet the districts that would gain the most in services would pay disproportionately in taxes, although not as much as if they had had to fund services with local property taxes. The following year, legislators had the opportunity to make the state's income tax more progressive, thereby offsetting the regressivity of the previous tax increase for some citizens. Other legislators perceived the income tax changes as an attempt by the governor to bankrupt the state and precipitate future service cuts. Legislators thus opposed the income tax reductions out of concern that their constituents' benefit/tax ratios would suffer in the long run.

In Michigan most legislators viewed both Proposal A and its statutory alternative as a means to increase their citizens benefit/tax ratios. The cleavage among legislators resulted from their views on whether constituents should pay for state assumption of education funding according to income or consumption. The voters of Michigan clearly preferred the incremental, albeit regressive, sales tax increase to the more obvious income tax increase, which could have been deducted from their federal income taxes.

New Jersey. Shifting among taxes can suggest a major shift in the direction of government. Governor Christine Whitman pledged to reduce income tax rates by 25 percent over three years. Several legislators pointed out, however, that few voters know that under New Jersey's laws, state income tax revenues are dedicated to assisting local governments. Consequently, many citizens may find themselves paying higher local property taxes. All ten legislators interviewed agreed that local governments would either raise taxes or reduce spending. The four Democrats interviewed supported the governor's initial proposal for a 5 percent cut in 1994. They believed the state could replace lost local aid by shifting revenue out of its own departments, such as higher education. These four either opposed or had apprehensions about further income tax reductions if such reductions led to decreases in state assistance to localities. One Republican from a traditionally urban Democratic district predicated his support for further tax cuts on the pledge he felt the governor had made to not harm localities financially because of the state's tax reduction. Two Republicans claimed that state aid to localities should be cut so citizens could better understand exactly which governments provided which services and at what costs. They contended that forcing local officials to make tough decisions would enhance the accountability of government and end citizen complaints about waste and inefficiency in Trenton.

In addition to supporting an initial tax cut and having concerns about future cuts, assembly members in New Jersey leaned in favor of relying more heavily on the sales tax in the future. One member of the Republican leadership commented that he was not worried about having to raise sales taxes if the income tax reductions created revenue shortfalls:

> *Assembly Member:* I think we acted a bit early by rolling back the sales tax increase Florio put on, but politically we had pledged to do it in '92, so we did. Actually, that worked out well because Christie got to run on the income tax, then, and if we had rolled back that increase she couldn't have run on a sales tax decrease because it's more complex and doesn't crystallize voter thoughts. . . . Now, if we run short [of money], I think we could go back and ask for a sales tax increase, particularly if we tie it to property tax relief and education. In fact, several of my constituents have come up to me and asked, "Why don't you put that penny back on the sales tax?"
>
> *GB:* Really?
>
> *Assembly Member:* Yes, it's not a groundswell, but they like the sales tax. Everybody pays it, it helps with education, and it's not the income tax.

In New Jersey, legislators and the governor were not able to offer tax proposals similar to those in Michigan and Mississippi. Whereas legislators in the latter states offered tax changes with no decrease in services, legislators in New Jersey knew that tax reductions implied either state or local service reductions. Thus the question of what happens to benefit/tax ratios becomes a function of which services the legislature reduces or eliminates, which constituents utilize those services, and who benefits from tax reductions. Republicans and Democrats overwhelmingly agreed that higher-income individuals would benefit from the income tax reductions since their marginal 7 percent tax rate would be reduced to 5.2 percent under Governor Whitman's proposal. What was less known outside the legislature is that under its original implementing legislation, the income tax is dedicated to financial assistance to localities. Localities will bear the burden of deciding which of their services to cut or which taxes to increase to make up for lost state funds. Consequently, assembly members from poorer urban districts worried that their constituents would be made worse off by the state income tax reduction—their benefit/tax ratios would decline—but would not make the connections among local service reductions, property tax increases, and a state income tax cut. Legislators from wealthier districts defended the potential benefits of the tax reduction and said localities should face the same difficult choices the state faces. They also argued that giving less money to localities would allow citizens more local determination of which services to offer in their communities.

In several states, income taxes became entangled in significant policy decisions. In these states, legislators were unified in their desire to provide some sort of relief from income or property taxes and debated how to package such relief politically and simultaneously address other policy problems. In both Michigan and Mississippi, legislators felt they could campaign for sales tax increases but not income tax increases, and indeed, many legislators advocated income tax reductions. In New Jersey, nearly all legislators supported a 5 percent cut in income tax rates, and many supported further rate reductions. Those who were not prepared to support an additional 20 percent reduction cited their concerns about localities in their assembly districts losing state aid. In all three states, income tax policy has played a central role in the development of other policies—education in Mississippi and Michigan and local aid in New Jersey.

Vermont. There is one exception to the move away from cutting income taxes, and it involves decisions about cutting taxes, not raising them. Vermont representatives initially voted to cut the state sales tax from 5 to 4 percent but then indefinitely delayed the rate decrease. The additional $33 million in revenue still went for tax relief, but instead of coming from state sales taxes the legislature dedicated the revenues to fully funding Vermont's four property tax-relief programs.

Although the process remained within the legislature, Vermont's experience with tax changes in 1995 was similar to Michigan's in 1994. Legislators perceived greater political benefits if the state assumed greater responsibility for education funding and in turn relied on the relatively obscure sales tax to finance this assumption. In Vermont, the funding for property tax relief was indirect. Vermont legislators voted to retain a higher sales tax to fund various property tax rebates, whereas in Michigan legislators and voters supported a direct trade in which a higher sales tax mandated decreased property tax rates. The marginal sales tax revenue funded tax-relief programs for locally imposed property taxes that in turn funded primary and secondary education.

Liberal Democrats had sought to decrease a relatively regressive tax, but in the current political climate, calling for decreased property taxes and facing irreconcilable differences on how to rationalize the state property tax system, legislators instead chose to continue using the least objectionable of taxes, retail sales, as a means of addressing other political and financial problems.

Symbolic Responses to Symbolic Politics

In the final cluster of states, tax politics does not play a central role in determining the broad policy agenda or in eliminating policy options, as it did in the no-income-tax states. Tax politics also does not have a major role in policy development. In Colorado and New York, the symbolism of tax politics has been met with pro forma, but not trivial, responses from citizens and legislators.

In Colorado, a series of ballot initiatives regarding tax capitations and reductions demonstrated voters' antitax mood, but most representatives felt that the voters' actions were symbolic responses to federal taxes and that providing outlets for such citizen sentiment created latitude for legislators and local officials to sell other, more pressing revenue concerns to their citizens. In November 1992 citizens approved Amendment 1, which mandates that all further tax increases are subject to citizen approval. Simultaneously, citizens rejected Amendment 6, which would have provided additional funding for public education by raising the state sales tax from 3 to 4 percent. In 1993 voters exercised their power under Amendment 1 and elected to end the state's tourism tax and Denver's culture tax. Both taxes were earmarked portions of the 3 percent sales tax.

Legislators generally viewed these citizen actions as largely symbolic revolts against taxes that did little to change the state government's resources. Eight of eleven legislators said they felt that their constituents were taking advantage of the state-provided outlet to express their disdain for federal taxes as much as for state taxes.

In New York, the governor, assembly members, and state senators forged compromises during the winter and spring of 1994 to offer about $80 million in tax relief to low-income individuals and corporations. The Democratic governor and Democrat-controlled House promoted an earned-income tax credit for low-wage workers with children, while the Republican-controlled state senate promoted cuts in business taxes. The eventual compromise contained an earned-income tax credit for families with annual incomes below $37,000 and a reduction in the corporate-profits tax rate. Two points deserve mention. First, neither cut had a dramatic fiscal effect on New York's $37 billion annual budget. During the negotiations, policymakers reduced the earned-income tax credit as a percentage of income while increasing the scope of taxpayers eligible. A senior member of the House Ways and Means Committee told me it was no coincidence that about half of all families in New York would be eligible for a credit: "It's nice to say you cut half the people's taxes. It sure beats a third, even if the bottom quarter isn't getting the help they need."

All eight legislators interviewed in New York agreed that the corporate tax cuts were receiving much more attention than the income tax credit from both politicians and the media. Most legislators ascribed this situation to the public perception that business tax cuts would create jobs and that the assembly was sending a signal to businesses that the Empire State was becoming more business friendly. Legislators said this tax change was largely symbolic in terms of how probusiness New York would become and in terms of which businesses would benefit. One assembly member detailed how the same cut in corporate-profits taxes could have been used to eliminate gross-receipts taxes on commercial gas and electric bills that businesses find onerous regardless of their profitability. A second legislator pointed out that several of the state's largest corporations had deferments on their state income taxes well into the decade because they could roll over losses from the 1990 recession to the current tax year. Consequently, the state would not necessarily assist businesses in retaining more profits than would have otherwise been the case. The assembly member noted,

> If we had cut the gross-receipts tax, we'd be out money, no question. But here Cuomo and the senate majority leader can announce a big tax cut that because of deferments, credits, roll forward, and, Christ, actual

losses will cost the treasury not a dime. It's really ingenious. They get the mileage of a tax cut without much consequence on revenues.

In New York, enough legislators emphasized the ability-to-pay principle to gain an earned-income tax credit as part of its 1994 tax-relief package. Senate Republicans emphasized development and reached agreement with Governor Mario Cuomo on a reduction in the corporate-profits tax despite admissions from both Republicans and Democrats that economic development might be better served by reducing utility taxes.

Discussion

Legislators have shifted away from obvious levies, such as property and income taxes, to relatively obscure gross-receipts and sales taxes. Most legislators feel that because citizens pay sales taxes in small albeit frequent increments, they are less objectionable than income taxes. Additionally, consumers pay the tax when purchasing items they want—merchandise that presumably improves their well-being. Most legislators feel political acceptance of sales taxes outweighs the dilemma they present by complicating government accountability.

Legislators' largest overriding concern with respect to the state tax shifts focused on equity. Only three of ninety-seven legislators disagreed with the premise that sales taxes were relatively regressive. Many legislators felt it unfortunate that sales taxes were the first choice of taxes to increase. These representatives reasoned that they provided less for their poorer constituents than they could have or failed to appropriately tax wealthier citizens. But again and again, representatives defended the decision to support sales tax increases and income tax cuts. In Mississippi, the need for a two-thirds majority support to override the governor's veto and concerns about localities' abilities to raise funds via property taxes led to a sales tax increase. Michigan legislators defended their support for Proposal A over the legislative alternative, noting that constituents perceive the sales tax to be more fair than the income tax and that a portion of the sales tax is paid by tourists. A Tennessee legislator even argued that regressive taxation made sense because "while rich people make the sacrifices necessary to save their money, poor people don't. If we tax them disproportionately, it's like getting them to invest their money—even in something as inefficient as government. And the more we tax them, the more services we can provide the poor, and the higher the return on their investment becomes."

The tax changes demonstrated that in the federal tax politics of the mid-1990s, the shift to obscurability created several potential political benefits. Representatives in Michigan, New Jersey, and New York could claim they were cutting income taxes, however modestly, in the wake of two federal income tax increases. Vermont representatives could use slack in their sales tax revenues to offer additional relief from obvious, and varied, local property taxes. Representatives in Tennessee, Florida, and Washington could use the absence of state income taxes to differentiate themselves from their federal counterparts. These responses go beyond the structural vertical-base competition created by the 1990 and 1993 federal income tax increases, which affected upper-income people. The substantial tax changes in Michigan, Mississippi, and New Jersey go far beyond what legislators would have enacted to offset the federal income tax increases of 1990 and 1993. These tax politics demonstrate that states will engage in wholesale policy changes motivated by their own politics and policy challenges.

State representatives perceive that the shift away from income taxes may leave them without a relatively dependable, broad-based revenue source, although they differ on the consequences. In Michigan, New York, and Washington, legislators surmised that their states would continue to be saddled with unpopular gross-receipts taxes on businesses to provide dependable revenue sources. Repeatedly, I heard expressions to the effect of, "We'll soon have only a two-legged stool. So, much as you might hate that second leg, you can't change it, because you have no way to stand if that leg goes too." In Colorado, Florida, Mississippi, and Tennessee, legislators bemoaned their state's erratic revenue fluctuations. Some believed that the state could compensate by establishing greater reserve funds and more stable spending practices, but most believed the state governments would continue their traditions of feast and famine—increasing spending dramatically during economic expansions only to cut it all the more drastically during recessions. One legislator in Tennessee noted that with his state's reliance on consumption taxes there were no means by which the state could rebate surplus revenues to citizens, as it could with income tax rebates.

Further complicating state politics is local tax politics. Legislators perceived continued citizen resistance to property taxes and thus sought to alleviate citizens' tax burdens without sacrificing funding for basic services and particularly for education. Such resistance to the primary source of local revenues has left state legislators in a bind in which they face pressure not to enact income taxes because of federal politics, to assume greater responsibility for locally administered services, and to provide tax relief for middle-income individuals who protest property taxation. Consequently, state legislators are left to seek relatively obscure revenues and taxes that meet the least public resistance. For most states this situation has meant an increased reliance on the sales tax.

In the short term the "no new income taxes" philosophy that pervades state politics is likely to mean that few states will engage in sweeping income tax reform designed to make generally regressive state tax systems progressive. By blocking such reform, citizens will continue to pay obscure regressive taxes, and thus state governments will continue to operate under the benefits-received principle. Moreover, an unwillingness on the part of legislators to lead fights for tax reform will hamper their efforts to attain other collective goals, such as economic development. For example, in Washington, Michigan, and New York businesses will continue to pay gross-receipts taxes. Most legislators believe that these taxes depress job creation but have few alternative revenue sources outside of personal and corporate income taxes.

Another possible consequence of the abandonment of income as a large and stable tax base may be that the intergovernmental competition among subnational governments posited by Peterson (1981) and Dye (1990) may shift to a vertical competition among federal, state, and local governments. As governments compete for these revenue bases, they may increasingly find themselves unable to cooperate with one another in financing endeavors as they have in the past twenty years. Subsequently, disparities in the abilities of localities to provide services may increase and exacerbate differences in the benefits citizens receive from governments.

An unintended consequence of an increase in sales taxes is that regardless of voter sentiments, state tax revenues may no longer keep pace with economic or population growth. Several Washington legislators noted that state tax revenue growth corresponded poorly to economic growth during the 1980s despite impressive employment and income growth fueled by the defense buildup and the expansion of computer-related industries. As one legislator said,

> We were probably in the top ten states as far as economic growth, but the state government lagged and has had to increase tax rates upward. Part of it was to alleviate growing discrepancies in property tax bases, but the main problem was that our tax system gave us no way to

> access that income growth. If you have no income tax, all the income growth in the world only helps you as much as people who spend money in the state on things other than food, and as people get wealthier they travel more, and we lose to places like L. L. Bean, for God's sake.

The unintended consequence of the current shift in tax policy may be that states will find themselves unable to generate the revenue needed to meet demands for services that expand with state economies and population. As interstate sales via mail order and other means continue to expand along with the service sector of the economy, states may need to either expand sales tax bases into interstate sales and services or return to taxing income to have taxes that are responsive to economic changes.

Conclusion

Looking to the future, one can reasonably predict that the politics of cutting state income taxes cannot go on forever, if only because tax rates have a lower bound of zero. At that point, the politics of income taxation will have run its course. Politicians at all levels of government may emphasize principles that lead them to again promote income taxes. However, states will likely continue to grapple with tough tax questions, and recent experience indicates that legislators will contend with the perceived benefit/tax ratio changes as much as they will with objective changes in spending and taxes.

Overall, the movement away from income taxes at the state level moves states away from a quasi-Lindahl tax system and thus implies that consumer surplus is lower for many constituents than it could be if states relied more on progressive tax policies. It is ironic that the federal government's reliance on a modestly progressive income tax and regressive wage tax constrains states from enacting more progressive tax policies. This situation leaves states with few options other than to seek to enlarge existing tax bases, limit services, and rely on obscure, regressive, but revenue-yielding sales and business taxes. Among these options, pursuing economic development has become universal, and legislators view it as the most desirable means to increase revenues. I consider this subject in the next chapter.