

November 15, 2018

Executive Summary: Advancing Racial Equity With State Tax Policy

By Michael Leachman, Michael Mitchell, Nicholas Johnson, and Erica Williams

States and localities could do more to help undo the harmful legacies of past racism and the damage caused by continuing racial bias and discrimination. If state budget and tax policies were better designed to address these harms and create more opportunities for people of color, state economies would be more equitable and likely also would be stronger, which in turn could benefit many state residents of all backgrounds.¹

States and local governments account for nearly half of all domestic public-sector spending, and most of the funding for education and certain other investments important for economic growth. As such, how states and localities raise and spend revenue, including what services they finance, has major implications for racial and ethnic equity. Yet, while in recent decades people of color have made progress in many areas, state and local fiscal policies too often have not been part of this progress and instead have extended or cemented racial disparities in power and wealth.

Discriminatory public policies and racially prejudiced public and private actions of the past contributed to a historical context in which people of color were systematically held back. For much of our nation's history, people of color had little to no power in state legislatures, and white lawmakers could set policies that sustained white dominance, even in states where people of color were a significant share or even a majority of the population. In that sort of environment, state and local tax policies often deepened the profound challenges that people of color faced, even when those tax policies were not explicitly race-based. Examples of such policies that remain in place today include:

- **The oldest supermajority requirement.** In the post-Reconstruction era, wealthy white landowners in Mississippi demanded and won a constitutional requirement for a three-fifths vote in both houses of the legislature for all state tax increases, the oldest such requirement still on the books in any state. Delegates adopted the measure at a state constitutional convention in 1890, the same convention at which they disenfranchised nearly all of the state's Black voters. Referring to his fellow convention delegates, the delegate who introduced the

¹ The full version of this report is available at <https://www.cbpp.org/research/state-budget-and-tax/advancing-racial-equity-with-state-tax-policy>.

supermajority requirement stated, “All understood and desired that some scheme would be evolved which would effectually remove from the sphere of politics in the State the ignorant and unpatriotic negro.” While he was referring to the convention’s aim of stripping political power from Black people, the supermajority requirement that the delegate championed added further to the barriers that Black people faced (and continue to face), by making public investments in schools and other public services that much more difficult to secure and adequately fund. Later in the Jim Crow era, Arkansas and Louisiana also adopted supermajority requirements to raise revenue, which remain in place today.²

- **Some of the earliest property tax limits.** During state constitutional conventions called in 1875 and 1901 to re-establish white dominance following Reconstruction, Alabama adopted constitutional property tax limits that are among the oldest still on the books. Installing highly restrictive property tax limits in Alabama’s constitution protected white property owners in the state from the possibility that African Americans and their allies could return to power and substantially increase property tax rates to fund education and other such measures. These limits have now been in place for *over 140 years*, producing a harmful cumulative effect. Today, Alabama’s property tax revenue as a share of its economy is the lowest of any state in the country, seriously hampering the ability of local governments to provide adequate schools and other public services. During this period in Southern history, Arkansas, Missouri, and Texas also adopted constitutional property tax limits that remain in force today.³
- **The first modern sales tax.** In 1932, Mississippi adopted the nation’s first modern retail sales tax, a tax that generally falls hardest on those with the least income (because sales taxes consume a larger share of their income). The state’s governor urged adopting the new tax in part by emphasizing that the revenue would be used to reduce property taxes, and that as a result it would shift the state tax base away from property owners and more heavily onto consumers. What that meant in practice was a reduction in taxes owed by mostly white property owners and an increase in those owed by Black households that owned little or no property and had little else to tax. Other states across the country adopted sales taxes not long after Mississippi demonstrated the tax’s feasibility and its significant revenue-raising power.⁴

If states work to overcome racial inequities, in part by improving their tax and budget policies and more adequately financing needed public services such as education, the well-being and productivity

² Today, 16 states have some form of supermajority requirement to raise revenue, including states with statutory (as opposed to constitutional) requirements. In January 2019, Florida will implement a new constitutional supermajority requirement to raise revenues, expanding an existing requirement that is more narrowly targeted to increases in corporate income tax rates. See Center on Budget and Policy Priorities, “Policy Basics: State Supermajority Rules to Raise Revenue,” updated February 5, 2018, <https://www.cbpp.org/research/state-budget-and-tax/policy-basics-state-supermajority-rules-to-raise-revenues>.

³ Today, 44 states and the District of Columbia impose some kind of limit on property taxes. See Iris J. Lav and Michael Leachman, “State Limits on Property Taxes Hamstring Local Services and Should Be Relaxed or Repealed,” Center on Budget and Policy Priorities, July 18, 2018, <https://www.cbpp.org/research/state-budget-and-tax/state-limits-on-property-taxes-hamstring-local-services-and-should-be>.

⁴ For a list of which states adopted retail sales taxes, and when, see W. Bartley Hildreth and James A. Richardson, eds., *Handbook on Taxation*, Marcell Dekker, Inc., New York, 1999, p. 73.

of states' workforces should improve, which in turn should broadly benefit state economies.⁵ While the specific needs of states vary, lawmakers can pursue fiscal policies that:

- Ensure that households with high incomes pay a larger share of their income in state and local taxes than households with lower incomes — the opposite of the upside-down tax systems in place in 9 of every 10 states today. Most states' tax structures actually worsen racial and ethnic inequities because the tax structures are regressive and households of color are more likely to have lower incomes and less wealth than white households. States can take steps such as strengthening their income taxes and otherwise improving the structures of their tax systems, better taxing wealth, enacting or expanding tax credits for low-income families, and eliminating various fees used to raise resources for the courts, and other parts of the justice system, that can trap low-income individuals — often people of color — within cycles of debt and criminal justice involvement.
- Raise sufficient revenue for high-quality schools in all communities and for other investments in education, infrastructure, health, and the like, and target spending to help overcome racial and ethnic⁶ inequities and build an economy whose benefits are more widely shared. Specific steps that states can take include eliminating wasteful subsidies that allow corporations to avoid paying taxes on their profits, raising income tax rates for the most affluent, modernizing state sales taxes, and better taxing carbon pollution and natural resource extraction. States can also better target their current spending, for example by reforming their criminal justice policies and using the savings from reduced incarceration to finance investments in low-income communities — particularly communities of color — and by reforming their school funding formulas to invest more in such communities. (Other education reforms are also necessary, but likely won't be sufficient by themselves in the absence of additional funding.)
- Improve the fiscal policy “rules of the game” so lawmakers don't face artificial constraints that prevent them from raising more revenue from wealthier residents or to finance public investments that can promote broadly shared prosperity. Steps that states can take include reforming or repealing constitutional limits on property taxes; overturning other formulaic restrictions on revenue raising; eliminating supermajority requirements for raising taxes or eliminating unproductive, inefficient tax breaks; and improving the rules governing their “rainy day” funds.

⁵ Racial inequities that impede people of color's ability to take maximum advantage of their innate abilities can limit overall productivity and economic growth. See Chang-Tai Hsieh *et al.*, “The Allocation of Talent and U.S. Economic Growth,” April 6, 2018, Version 5.0, <https://web.stanford.edu/~chadj/HHJK.pdf>. One measure of inequity, the racial wage gap, tends to be larger in states where surveys show greater racial prejudice. See Kerwin Kofi Charles and Jonathan Guryan, “Prejudice and the Economics of Discrimination,” NBER Working Paper No. 13661, December 2007, <https://www.nber.org/papers/w13661>. Recent research suggests that lower levels of inequality are associated with stronger economic growth, and redistributive public policies seem benign in their impact on growth, at least unless they are extreme in their impact. While this research is not definitive, it is strongly suggestive. See Ostry *et al.*, “Redistribution, Inequality, and Growth,” International Monetary Fund, April 2014, <https://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf>. See also Heather Boushey and Carter C. Price, “How are economic inequality and growth connected?,” Washington Center for Equitable Growth, October 2014, <https://equitablegrowth.org/economic-inequality-growth-connected/>.

⁶ The report often refers to racial and ethnic equity rather than just racial equity to acknowledge that some people of color identify more with their ethnic heritage than with a racial group.

State economies and communities generally do better when they make public investments that can enable their residents to more fully realize their potential, including: good schools to offer low-income children a better chance at a successful future;⁷ affordable colleges to boost opportunities for a broader group of students;⁸ economic supports to help struggling working families have stable housing, nutritious food, and lives that aren't filled with intense stress that has been found to affect children adversely;⁹ and health coverage to protect against health-related bankruptcies and other financial hardship, while producing a healthier, more productive workforce.¹⁰ When they are strong and administered with equity in mind, these kinds of public investments can help break down barriers to opportunity for communities of color and help more Americans achieve their potential, to the benefit of the broader economy. These investments will be still more effective if states and localities couple them with other policies that can improve equity such as boosting minimum wages, adopting family leave and sick leave policies, and protecting workers' right to form unions.

⁷ See, for example, C. Kirabo Jackson, Rucker C. Johnson, and Claudia Persico, "The Effects of School Spending on Educational and Economic Outcomes: Evidence from School Finance Reforms," *Quarterly Journal of Economics*, October 1, 2015.

⁸ See Michael Mitchell *et al.*, "Unkept Promises: State Cuts to Higher Education Threaten Access and Equity," Center on Budget and Policy Priorities, October 4, 2018, <https://www.cbpp.org/research/state-budget-and-tax/unkept-promises-state-cuts-to-higher-education-threaten-access-and>.

⁹ See, for example, Chuck Marr *et al.*, "EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children's Development, Research Finds," Center on Budget and Policy Priorities, updated October 1, 2015, <https://www.cbpp.org/research/federal-tax/eitc-and-child-tax-credit-promote-work-reduce-poverty-and-support-childrens>; Elizabeth Wolkomir, "SNAP Boosts Retailers and Local Economies," Center on Budget and Policy Priorities, updated April 6, 2018, <https://www.cbpp.org/research/food-assistance/snap-boosts-retailers-and-local-economies>; Barbara Sard *et al.*, "Federal Policy Changes Can Help More Families with Housing Vouchers Live in Higher-Opportunity Areas," September 4, 2018, <https://www.cbpp.org/research/housing/federal-policy-changes-can-help-more-families-with-housing-vouchers-live-in-higher>.

¹⁰ See, for example, Center on Budget and Policy Priorities, "Chart Book: The Far-Reaching Benefits of the Affordable Care Act's Medicaid Expansion," October 2, 2018, <https://www.cbpp.org/research/health/chart-book-the-far-reaching-benefits-of-the-affordable-care-acts-medicaid>.