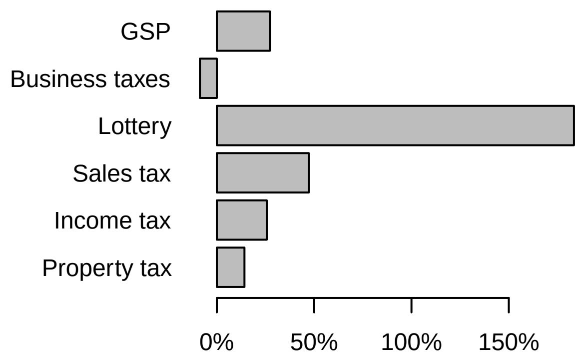
Testimony on H-7950
House Finance Committee

Tom Sgouros, 26 March 2008



Growth 1997-2006 (2000 dollars)

History

- Since 1997, the lottery, sales and income taxes are up far more than the property tax or business taxes (which have actually declined).
- Property taxes have increased at a rate far slower than the growth of the state's economy, and personal income.
- Yet property taxes are the biggest source of complaint. Prospective property tax increases routinely produce near riots in city and town halls.

There is something that needs explaining here.

Obviously, the amount of money raised via property taxes is larger than the other taxes, but the real difference among these taxes is that they fall with different weights on different groups of people.

- A cut in one tax that forces an increase in another is not an unimportant change to a large number of people.
- A cut in a progressive tax countered by a rise in a regressive tax results in a cut for wealthy people and a hike for the poor and middle. This is not ideology, but simple arithmetic.
- Over the past 15 years, we have done exactly that. By decreasing business and income tax rates while property taxes rise, we've decreased the taxes on the top end, at the expense of the middle and the bottom.

Representative Handy's H-7950 is a complicated piece of legislation, 82 pages long. What it does is to try to restore balance to the system, and undo a part of the shifts that have occurred. It does this by increasing the circuit breaker property tax credit, and restoring the income tax to roughly the rates that prevailed in 1996. The bill also tries to reduce the regressive nature of the sales tax by broadening the items to which it applies. It also closes a large number of loopholes whose value to the state is unknown or unproven. There is certainly a place for stimulating sectors of the economy with tax legislation, but our tax code contains many such provisions that outlived their usefulness a long time ago.

I think of this as a "zero-based" budget. The point of a zero-based budget is to justify each expense that is usually automatically carried forward as one budget year leads to another. This is a year for close scrutiny of everything, and I suggest equally close scrutiny of the tax breaks we offer. Are we getting what we need for the cost?

Municipal Budgets

There is an obvious desire in the Assembly to lower municipal taxes, but it seems clear that simply increasing the pressure on municipal budgets isn't doing the job.

My observations are that the desire to lower taxes burns as fiercely at the municipal level as at the state level — local officials can see as well as anyone that people on a fixed income are routinely priced out of neighborhoods they've lived in for decades. But towns' freedom to act is much more constrained — by state and federal law, but also by some grim realities that have nothing to do with union contracts. For example, as our suburban towns have sprawled, police and fire protection costs have risen just because there is more area to cover. Union contracts do, of course, have something to do with this, but in my opinion less than is usually supposed.

I sit on the board of my local library. Union rules and our contract does produce pressure on our budget, but the much larger pressures come from the demand for more hours, more books, more computers and better services. We have cut back this year, and we've cut from everything (including personnel) and what we'll deliver next year is fewer hours, fewer books and fewer services. What I've learned from experience on that board is that the quality of our service is exactly what is discretionary in our budget. We can cut, but we hurt ourselves in doing so, and it's our reluctance to give up the quality that is where the resistance lies.

The Wealthy

An argument is often made that it's important to keep taxes on wealthy people down because they are the source of investment that power our economy. It is true that without investment, our economy will grind to a halt. However, it is not true that *any* investment will help, and the evidence is that the vast bulk of investments made by Rhode Islanders have nothing at all to do with the health of the economy. Purchases of stock, money market shares, and consumer durables all count as investment in national income statistics, but except for a few car and appliance dealers, they have virtually no effect on the local economy.

- Federal Reserve flow of funds statistics show that we are disinvesting from businesses in favor of money market funds and washing machines.
- Fed statistics and the behavior of the stock market show that there is plenty of money out there to invest, but very few places in which to invest it. If there were an alternative to the stock market, prices there would have plummeted by now. They haven't simply because there is little else to do with one's money.
- In Asia, where there *are* many productive investment opportunities, the financial investments related to the US have fallen further.
- Under other circumstances, providing more money to investors might be a good idea. Under the actual circumstances we face today, increasing the funds available for investment it cannot produce the economic gains we all hope for.

After all, investment is only one piece of the puzzle. Funds to invest without investment opportunities cannot be productive. Ask yourselves: if $40,000 dropped in your lap, with instructions to invest it productively, what would you do with it besides buy stocks or real estate?

If you can't think of anything, you're not alone, and *that's* our biggest problem. It is my contention that Rhode Island currently suffers from a lack of places to invest. There are investment opportunities available to a government that are not available to individuals or corporations. In other words, concentrating state policy on developing our workforce, improving education, looking for new markets and the kinds of public investment that will improve our roads, bridges and public transportation would be economically far more productive investments than simply offering some money to wealthy people in the hope that they'll invest it usefully.

The Economy

I'd like to take one more brief moment to address the economic situation. We stand now peering into an abyss of economic uncertainty. The immediate future looks a bleaker than it did a year ago. Rhode Island stands in a precarious place, at least in part because our state's resources are so small, and our state is not in any way separate from the national economy.

But it still has to be said that it wasn't through tax cuts that we got out of the Great Depression. Ronald Reagan's tax cuts get lots of credit for the boom of the 1980's, but it's credit given by people who need to lionize him. The Reagan tax cuts were not nearly as deep as is commonly imagined, especially when combined with the massive restructuring of Social Security taxes, and they were accompanied by gigantic increases in defense spending. The 1990's saw substantial tax increases at the federal level, starting with George Bush, Sr. and going on to Clinton's tax changes in 1994 and 1996. I think any one of us would trade the economy of 2008 for the economy of 1998.

To the extent that Rhode Island's spending will have any effect on the greater economy, it will only be a negative one if we persist in disinvesting in our schools, our roads and our citizens. We can do better than simply spiral down and down, and I urge the committee to try.

Tom Sgouros is the editor of the Rhode Island Policy Reporter, and a freelance researcher and writer about economic and policy issues.