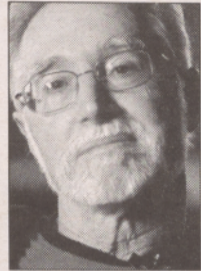


Oregon state taxes: What's fair, what's not

There is one thing everyone in Oregon agrees on: the state tax system is a mess and something needs to be done. And that is where agreement ends. Everyone has a different solution, and nobody likes anyone else's.



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Why are taxes so controversial?

Every one of us can find something the state is buying with our money that we would not buy if we had the choice. And every one of us can think of someone beside us we think should be paying more taxes. Unlike private goods where each of us can choose what to buy, we must all buy the same public goods together, when the truth is that we would all prefer to buy somewhat different public goods. In other words, when choosing public goods we are like Siamese twins with different preferences who must constantly bicker over what to buy. And regrettably when we address how much tax each of us should pay we are not in what the philosopher John Rawls called his "original position" where a "veil of ignorance" keeps us from knowing our personal economic situation. Instead, we are well aware of how any tax would affect us personally. In other words, debates over tax justice will inevitably be tainted by self-interest.

When are taxes fair?

Moving beyond the most common answer – mine are too high and yours are too low – requires a philosophy of fairness. Any tax will either be progressive, regressive, or proportional. A progressive tax is one where the higher your income, the higher percentage of your income you will pay. A regressive tax is one where the higher your income the lower the percentage of your income, you will pay. And a proportional tax is one where everyone will pay the same percentage of their income, irrespective of how low or high their income.

One philosophy of fairness concludes that proportional taxes are the only fair taxes: We all consume the same public goods so it is only fair that we should all contribute the same percentage of our income to pay for them. A different philosophy concludes that progressive taxes are the only fair taxes: While true that we all consume the same public goods, since richer people are more capable of paying, it is only fair that they should contribute a higher percentage of their income to pay for them. Another philosophy concludes that only progressive taxes are fair, but for an entirely different reason: Because of the way capital and labor markets work the pre-tax distribution of income is demonstrably unfair – a higher percentage of the income of those in higher income brackets is undeserved as compared to those in lower brackets. Therefore, progressive taxes are required to ameliorate pre-tax inequities. I am aware of no philosophical argument which concludes that regressive taxes are fair – which is astounding since

most taxes in the United States are regressive. So what do those urging us to adopt regressive taxes say?

Those who support regressive taxes most often change the subject. Instead of asking what percentage of one's income one pays in tax, they want us to focus on how many dollars one pays. Consider a highly regressive tax where a person with a \$50,000 annual income pays 20% while a person with a million dollar annual income pays only one percent. Both would pay \$10,000 in taxes, which those who favor regressive taxes would like us to believe is fair. But notice, for everyone to pay the same amount the tax system would have to be as regressive as the pre-tax distribution of income is unequal!

What anyone who pretends to hold "progressive" values should understand is that because a higher percentage of richer people's income is undeserved in the first place, and because those who are richer can afford to pay a higher percentage of their income in taxes, progressive taxes are more fair than proportional taxes, which are, in turn, more fair than regressive taxes.

Which taxes are progressive, and which are regressive?

There are well-known answers to these questions that all economists agree on. Corporate income taxes are invariably progressive because not all of the tax can be passed onto customers, and only the wealthy have significant dividend income. Personal income tax rates are usually progressive. For married couples filing jointly federal personal income tax rates for 2014 range from a low of 10 percent on taxable income below \$18,150 to a high of 39.6% on taxable income above \$456,600. However, loopholes that favor the rich make the federal income tax much less progressive than one would expect from the rate schedule, and federal income tax rates have become much less progressive over the past sixty years. In 1955, when a Republican named Eisenhower was in the White House, the rate for a married couple filing jointly with taxable income above \$456,600 (in 2010 dollars) was 62%, and taxable income above \$3,255,000 was taxed at 91%. Oregon personal income tax rates are also progressive, but much less so than federal rates. Currently rates range from a low of 5% to a high of 9.9% on taxable income over \$250,000 for couples filing jointly. Why a state that is more progressive than average should have a state income tax that is so much less progressive than the national income tax is a question that needs to be asked.

Sales taxes are almost always regressive because they only tax what people spend. Since on average richer people save a higher percentage and consume a lower percentage of their income, a sales tax applies to a smaller percentage of the income of the rich than the poor. Property taxes are notoriously regressive for two reasons: One,

landlords, who are on average richer than their tenants, pass on most of a property tax to their renters. Two, whereas the wealthy have many other forms of wealth in addition to their houses, the only wealth an average American has is in their home. An important, yet little appreciated fact is that property taxes are a wealth tax which unfortunately applies to close to 100% of an average family's wealth, but to only a tiny fraction of a wealthy family's wealth. Finally, licenses and fees, like the lottery, are a regressive way to raise revenues since on average, the poorer you are the higher percentage of your income you spend on licenses, fees, and lottery tickets.

Don't Throw Out the Baby with the Bathwater

As strange as this may seem, compared to other states, there is much that is not only good, but very good about the Oregon tax system. Because we have an income tax, and many states do not, and because we do not have a sales tax, and most states do, Oregon taxes are more progressive than most states. This is both very good, and suits a population that, on average, is more progressive than the U.S. population at large. So this is not the part of our tax system we should be changing. Instead, we should protect and expand the progressivity of the Oregon tax system: We can do this by continuing to reject a state sales tax and making state corporate and personal income taxes more progressive.

Our problem is that we tax ourselves too little in light of the amount of public goods Oregonians prefer, especially education. And the reason has become apparent: Over the past 20 years conservative anti-tax strategists passed ballot initiatives restricting increases in property taxes, and requiring any annual surpluses that should go into a rainy day fund be rebated instead. This has made it impossible to fund the level of public services Oregonians desire, including decent education for our kids.

In effect, these conservative political strategists are blackmailing Oregonians into acquiescing to a more regressive tax system – give up and pass a sales tax to stop the erosion of public services. Why this campaign, which is primarily responsible for our tax mess, was so successful historically is important to understand if we are to devise a successful strategy to reject blackmail and fix the mess. First things first. What would fix the mess? We need to both increase state tax revenues and make the system more – not less progressive. How to do this is not rocket science: Increase personal and corporate income taxes substantially. Minimize the impact of raising personal income taxes on middle and lower income Oregonians by making the rates much more progressive. If we do this we can adequately fund the social services Oregonians want without passing a regressive sales tax, or increasing regressive property taxes, licenses, and fees.



Dignity



Poverty