

Time to Pop the Balloon

Expanding tax breaks drag down Oregon's economy

Sometimes you wind up in places you didn't know you were going.

That happened to me a couple times as I investigated why state and local services are always suffering budget cuts. There are many possible explanations: ballot measures limiting property taxes and increasing prison costs, hyper-inflation of health care and energy costs, ill-advised wars, aging Baby Boomers, climate change, economic cycles.

While these and other factors are all important, I was surprised to ferret out a culprit that even the wonkiest are only dimly aware of: tax breaks. The official term used by governments is "tax expenditures," but you may think of them as tax incentives, loopholes or even giveaways. This malefactor may even be the most important contributor to state funding shortfalls in this century (see graph).

Since the 1999-2001 biennium, income tax breaks in Oregon have increased* an astounding \$2.9 billion, *more than enough* to account for the current general fund shortfall of \$2.7 billion. Back in 2001, tax breaks consumed about 36 percent of "potential" income tax revenues. Since that time, they have ballooned to 46 percent and are still rising. If only we had figured out a way to cap tax breaks at the 36 percent level of 12 years ago, Oregon would have an extra \$2.9 billion to spend in the general fund today, plus an extra \$1 billion of federal matching funds for human services.

I calculated the total loss of discretionary resources at \$15.5 billion over the 12 years. About half of this largess went to the federal treasury in the form of matching funds we've been leaving on the table, plus the increase in *federal* income taxes Oregonians pay because of lower *state* income tax deductions. More than 80 percent of the benefits were captured by the top two-fifths of taxpayers (not counting people who didn't earn enough to file a return).

We could use the money. That's a lot of teachers, home care workers, state hospital beds, drug treatment centers, police and other critical services, all of which are now being cut back.

Another surprise: By far the largest share — 81 percent — of this growth in tax breaks is tied to the federal tax code. That's surprising because most of the attention in Salem is given to state tax breaks like BETC (Business Energy Tax Credit), enterprise zones and the senior medical deduction. The state has made some progress in recent years by putting sunset dates on many of the state tax credits and establishing the Legislature's Joint Tax Credit Committee. But laudable as they are, these actions surround only a small piece of the problem.

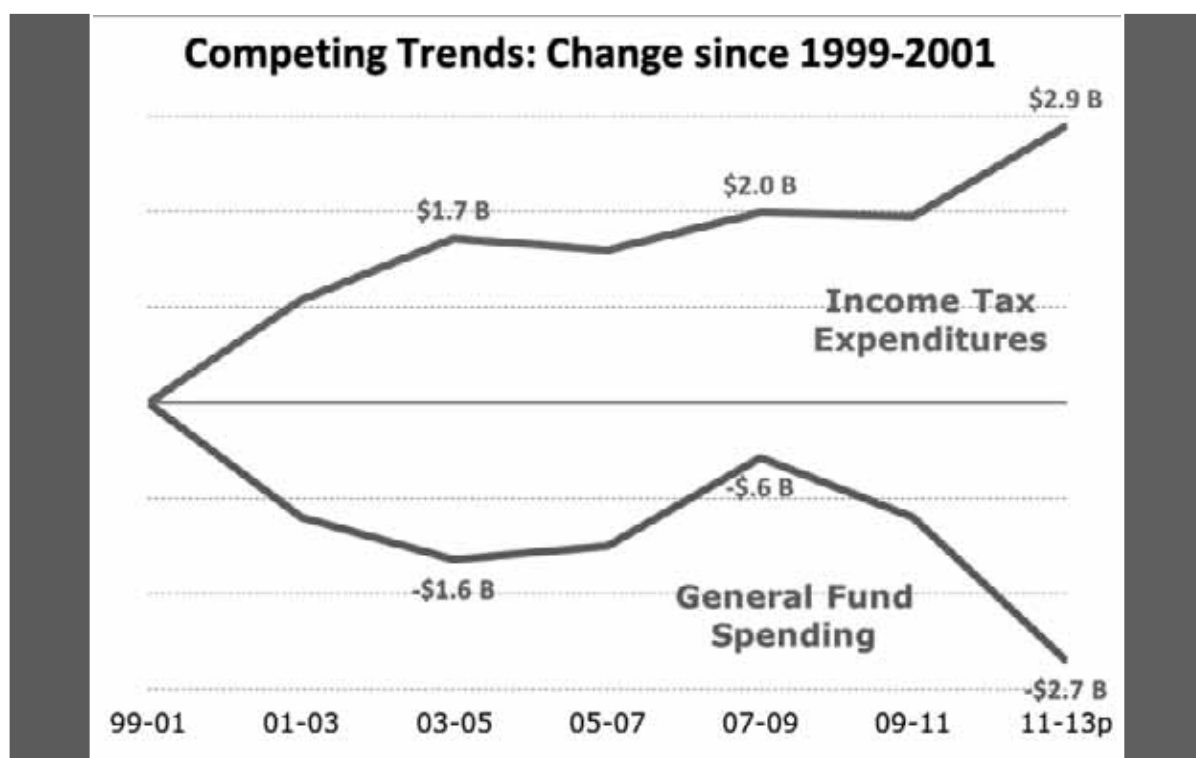
We are becoming increasingly concerned about how income and wealth in America are getting ever more concentrated at the top end. It is an obvious explanation as to why the federal tax breaks are growing so fast: The higher your income, the more tax-saving tools you have at your disposal. These upper-income folks are able to utilize tax breaks at the federal level that also help reduce their Oregon taxes. That's because of the "rolling reconnect" — the periodic legislative action that adopts the most recent federal code as the primary basis for figuring Oregon taxable

income. This connection is largely a very good thing, reducing the complexity of figuring and filing state taxes for everybody. The problem: When there are so many loopholes in the federal code, *it blows a \$3 billion hole in the state budget.*

We should take some positive steps in order to get our arms around this explosion of tax breaks that flow mostly to the high earners.

We need to stop enacting new tax breaks that only make the problem worse. The only exception: Expanding the Earned Income Tax Credit would help balance the income disparity and stimulate bottom-up economic growth — the best kind.

I call it the "hold harmless" provision. We would just calculate the *increase* in federal tax breaks from one year to the next, and then *recapture the increase* out of itemized deductions at the next opportunity. For example, federal tax breaks are currently increasing about \$350 million a year. Itemized deductions are saving taxpayers around \$1.4 million a year. So the recapture percentage in this example would be 25 percent. The hold harmless provision would require a change to only one line on the Oregon income tax return. It would not affect low-income earners at all, or anyone else using the standard deduction. It would put a bandage on any further injury to general fund revenues arising from the federal tax code. And it would not increase



We should demand greater accountability from businesses that receive tax breaks intended to stimulate job creation. (There's very little evidence that they work.)

We should convert some tax breaks into general fund allocations. For example, the extremely generous Oregon College Savings Plan is used almost exclusively by the top 20 percent of earners, many of whom wind up sending their kids to out-of-state schools. Why do we subsidize that? The millions we spend on rewarding these folks — for doing what they would do anyway — would be better spent beefing up financial aid for students attending Oregon colleges today.

Here is my last surprise. I used to think a part of the fix would be to end the "rolling reconnect" described above, but further study showed me that wouldn't really help. We would just stay tied to the federal code at that particular time, and the tax breaks would just keep on growing. So I have a new strategy to propose.

the percentage contribution of high income earners to state revenues.

It's all good, right? The only problem is that it takes a three-fifths majority in both houses of the Legislature, or a constitutional amendment passed by the people, to do anything at all that would increase tax revenues. With a narrowly divided Legislature, that's a tall order. But if we do nothing, Oregon's budget will continue losing a quarter billion dollars every year as tax breaks continue to balloon. We know what that would do to budgets for schools, health care and everything else we care about.

There is a lot more detail on this topic on my website, www.decisionmetrics.org

Steve Robinson of Eugene has an MBA in finance from Stanford and retired from SAIF Corporation. He is a member of the Human Services Coalition of Oregon and lobbies on behalf of the coalition on budget and revenue issues. He spoke to City Club of Eugene Jan. 20 on "Are Tax Breaks Keeping Oregon in the Red?"

** To compare apples and apples, I adjusted all dollar figures by an index based on the long-range growth of total personal income in Oregon.*

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