

A conceptual illustration of a hand holding a funnel. The funnel is positioned at the top, and a stream of money, including several hundred-dollar bills and a few coins, is falling through it. The background is a dark, textured surface with a pattern of small, light-colored circles. The overall tone is somber and critical.

TAXING THE POOR

How Some States Make Poverty Worse

BY KATHERINE S. NEWMAN
AND ROURKE L. O'BRIEN

In the fall of 2007, Alabama Arise, a coalition of congregations and organizations based in Montgomery, Alabama, mounted a campaign to persuade the state legislature to cancel the sales tax on food for home consumption, a levy that—between state and local taxation—was adding as much as 12% to consumers' grocery bills. State taxes of this kind hit everyone, rich and poor alike, in the pocketbook. But Alabama citizens at the bottom of the ladder, who live at the very edge of survival to begin with, were finding themselves unable to feed their families at the end of the month. Looking to stretch the dollar or the allotment of food stamps, poor families were going without or switching to cheap food that fills the stomach, but leads to obesity and all the damaging consequences that follow.

Twenty senators had promised their support. One more was needed to pull the measure over the threshold. Arise was convinced they had a winning strategy. Instead of going after comprehensive reform of income, sales, and property taxes, they proposed a modest plan: eliminating the state portion of the grocery tax, expanding family-friendly income tax deductions, and capping a lopsided deduction that benefited those at high incomes. The requisite three-fifths vote seemed within reach; only one more senator was needed. To the lasting disappointment of the reformers, none of the opponents broke ranks. The measure failed once again, leaving Alabama, one of the poorest states in the country, with the dubious distinction of being one of only two states to exact the full sales tax on food. For the poor and the near-poor, the consequences are dire.

Alabama and Mississippi exact the highest tax levies from the poor, but they are not alone. Most of the Southern states rely on regressive taxation of this kind and have done so for decades. Property taxes are a mirror image in that part of the country; they are very low and have been that way for a long time. Accordingly, compared to states in the Northeast, wealthy people are able to escape tax burdens while the poor are burdened with them, to their detriment in terms of longevity, health, education, and family structure. While these outcomes are familiar to most researchers interested in inequality and poverty, the role that regressive taxation plays in their distribution and magnitude is a little-studied aspect of fiscal sociology. We argue it is time to “bring tax back in.”

Although it is commonplace to point to the states as “laboratories of democracy” and crucibles of policy experimentation, the policy domains that attract attention tend to be limited to education, housing, and welfare policy. Yet in some respects, the most critical instrument that policymakers have at their disposal for alleviating poverty—the tax system—remains in the shadows. Divergent state policies determine how much money is left in the hands of poor families, a fact that is not well understood in antipoverty circles. The argument that we lay out in the following pages is that in the last three decades, states and localities have pursued sharply divergent tax policies that have a direct impact on the resources poor households hold at the end of the day.

FIGURE 1 State and local income tax liability for a family of three at the poverty line, by region, 1982–2008.

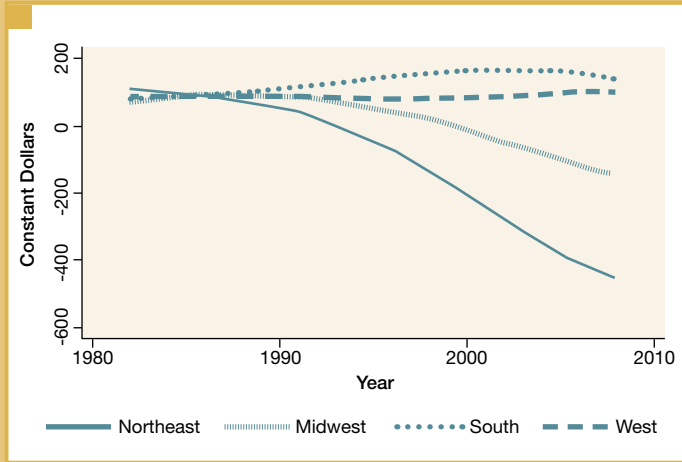


FIGURE 2 State and local sales tax liability for a family of three at the poverty line, by region, 1982–2008.

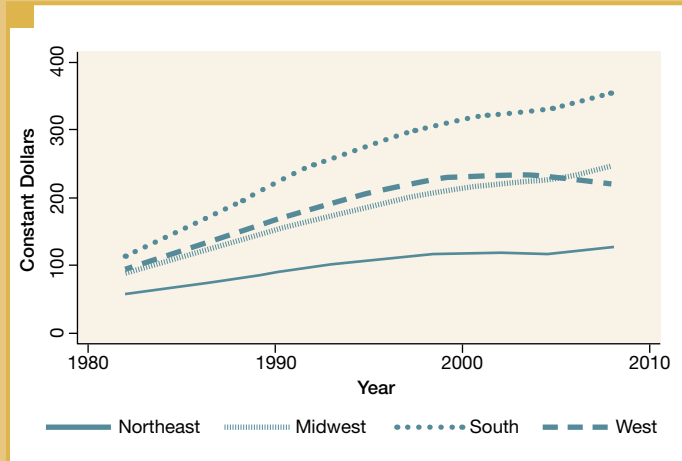
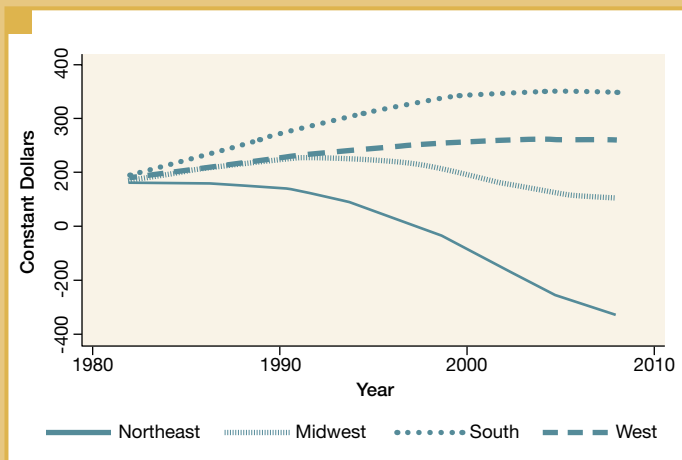


FIGURE 3 Total state and local tax liability for a family of three at the poverty line, by region, 1982–2008.



Our purpose here is to spotlight taxation’s unrecognized impacts on the nation’s poor. We argue that much of the action in these impacts lies at the state and local level, rather than at the federal level where most social science research on taxation has focused. In particular, we examine the role of regressive taxation and argue that overreliance on sales taxes has had a punishing impact on the poor in many states. Particular regions of the country have, for historical reasons, moved in that direction over time. Although the origins of the divergence lie in the distant past, this is not a historical artifact; the regional divergence in tax regimes has actually grown over the last 25 years. Hence, it makes a big difference for a poor household to be located in the South—and increasingly the West—as opposed to the Northeast, even after controlling for the cost of living, the racial composition of the states, poverty levels, or state expenditures. As such, these states offer a poignant lesson in “what not to do” when it comes to alleviating poverty through the tax system.

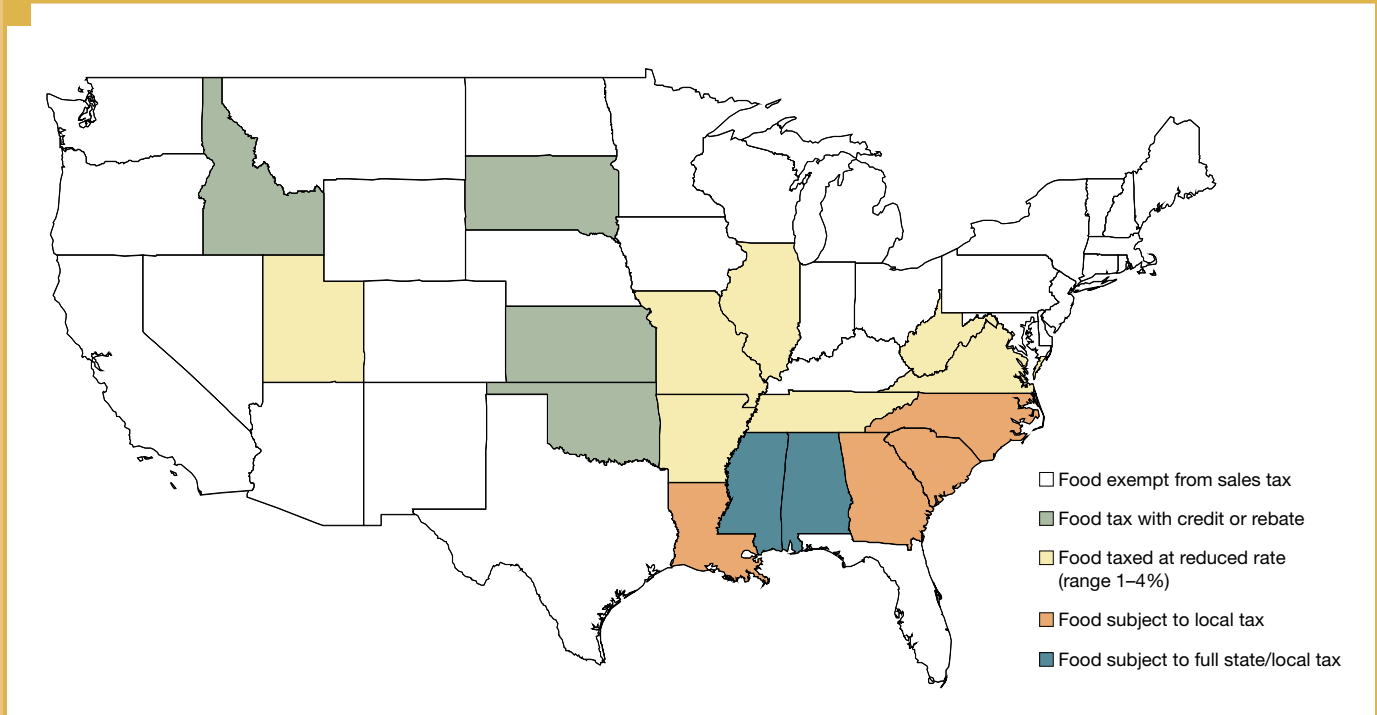
Diverging Destinies

Southern states have long favored the use of sales tax for funding the public sector, in sharp contrast to most northern states, which rely more heavily on progressive property and income taxes. Indeed, this story begins at the end of Radical Reconstruction when the Deep South first shifted to sales tax and then began to impose supermajority rules and constitutional limits on spending to limit the use of any other kind of taxation. Because of these divergent trajectories, the states entered the modern era with markedly different tax regimes.

Estimating the tax burden on the poor is a complicated endeavor (a process we discuss at length in *Taxing the Poor*). Briefly, using data drawn from state income tax returns, administrative data on sales tax rates, and information on patterns of household consumption, we estimated the income and sales tax burden for a hypothetical family of three for every state. We then repeated this exercise using data for every year from 1982 to 2008. This provides us with a picture for the taxes paid by the “Jones family” both across states and over time.

Figure 1 displays the average state income tax paid by our hypothetical family in each region from 1982 to 2008. Here we see that over the past 25 years, many Southern and Western states increased income taxes on the poor while most Northeastern and Midwestern states significantly reduced the tax burden on those below the poverty line. By 2008, most poor families in the Northeast actually had a *negative* state income tax liability, that is, they actually received a rebate in the form of a State Earned Income Tax Credit (EITC) or other refundable credit. Figure 2 shows the trend in the sales tax; here we see that the Northeastern and Midwestern states are relatively flat, whereas the West and particularly the South have increased the sales tax burden on the poor. Summarizing across all these data (Figure 3) unearths a remarkable trend: Since 1982, the total state and local tax liability (income and sales) for a family of three at the poverty line has increased in the Southern and, to a lesser extent, Western states while the burden has declined in the Midwestern and, most dramatically, in the Northeastern states.

FIGURE 4 Figure 4. Tax treatment of food for home consumption, 2008.



Taxation and Poverty-Related Outcomes

But does this increasing regional divergence and—in the South and West—increasing tax burden on the poor help us to understand regional variation in the poverty-related outcomes we care about?

The poor in the Southern region are at a greater disadvantage than their counterparts in other parts of the country *because* the state and local tax burdens they face make them even poorer. A particularly pernicious driver of these differences lies in the sales taxes the poor must pay (alongside the non-poor), especially the food taxes that many Southern states and localities assess. That tax policy is making a bad situation considerably worse. Our statistical models show that across time, states that increase taxes on the poor do considerably worse on aggregate measures of health (mortality) and crime (aggregate property and violent crime rates) as well as social indicators (high school completion and out-of-wedlock births).

Why should taxation make such a difference? Well, money matters. When the poor lose more of their income to taxation, it weakens their already vulnerable position, which has repercussions for aggregate measures of crime, health, family formation, and educational attainment. But we were also interested in exploring if there were any knock-on consequences to the type of tax used to extract revenue from the poor. As we noted above, many Southern states are unique in that they tax food for home consumption (Figure 4). We know there is a connection between the price of food and obesity; when faced with a limited bud-

get, low-income families typically opt for cheaper, high-calorie, low-quality foodstuffs over relatively more expensive, healthful, fresh products. By increasing the cost of each item, a sales tax may therefore lead some low-income families to consume less nutritious food in an effort to stretch their budget. Sales taxes on food, therefore, may be one explanation for the fact that obesity rates are higher in the South than in the rest of the country. We conducted another series of statistical analyses to test this proposition and found that indeed, high sales taxes on food is related to higher rates of obesity in the population of Southern states.

What Is to Be Done?

At the federal level, the poor have fared relatively well over the last 25 years. The advent of the Federal EITC has had a salutary impact on the nation's low-income households, dropping their federal tax burden by nearly 200 percent. To the extent that social scientists focus on taxation, this is the story we know, and it is both positive and universal (for working poor families). The real action in terms of divergence is to be found in the states. There we see profound differences that hit Southern and increasingly Western pocketbooks much harder.

The reliance on regressive taxation—undergirded by supermajority rules and limits on taxation and spending—has hammered the poor both by taking money from the pockets that can least afford it and by stripping states of the revenue they need to run first-class institutions that could potentially equalize or at least take a stab at improving the public services that support

better life chances for the poor. This strategy is self-defeating; it is costing these states more every year in lives lost prematurely, young people descending into poverty in greater numbers than they should, and crime, which takes a toll on everyone. It will take a monumental effort to change course and place the South on a trajectory that is dependent on the federal government and better able to support the infrastructure and human capital requirements of its citizens. The cost of doing otherwise is simply too high for the people of the Southern states, and it may become so in the West as well.

What, then, are the alternatives? We offer two ways of thinking about policy directions. One emphasizes redressing some of the most regressive aspects of existing sales tax, without contemplating its elimination. The other takes into account the challenge of reversing course at the state level and hence focuses instead on reducing the influence of states altogether on the fundamental social policies which every American should be entitled to, regardless of their residential location.

Most states make use of sales taxes, but not all of them are as punishing to the poor as the Southern states. Some achieve a more equitable solution by exempting basic necessities like food for home consumption. We should mount a national campaign to follow suit in the Southern states and any other region of the country where basic foodstuffs are taxed and continue with an initiative designed to eliminate sales taxes on medicine and clothing.

Another means to redress regressivity is to follow the lead of states that rebate sales tax on a means-tested basis—tilting heavily toward low-income families—or refund money through earned income credits. At a minimum, one could use the annual consumer expenditure survey to calculate the amount the Jones family would need to pay for a healthy diet and rebate at least that much to households that are currently paying into the system.

The Federal EITC is by far the most effective way to put resources in the hands of working poor families. Some recent deficit-reduction proposals have proposed to eliminate this federal tax provision on the grounds of “shared pain.” We should recognize, first and foremost, what a catastrophe any such move would represent. It would instantly plunge poor families deeper into deprivation by removing one of the most important and effective redistributive mechanisms we have.

Assuming this is not genuinely on the table, we note that it is the refundability of the Federal EITC that makes it so important. It actually puts much-needed dollars in the hands of low-income families. Twenty-four states have recognized the wisdom of the approach and have enacted statutes of their own, but they are not all created equal. Some are more generous than others in that they send families checks because the liability falls below zero. Encouraging (and even rewarding) the other 26 states to enact their own refundable EITCs would also be a boon, particularly in the Southern states. Spreading childcare tax credits and making them refundable as well would have similar positive consequences.

Still, making tax systems more progressive will not solve the central problem facing the South and increasingly the Western states, which, following California’s Proposition 13, are becom-

ing ever more reliant on regressive taxation. In the South, the situation is more egregious because there is too much need and too few resources. A more progressive taxation scheme may be able to generate slightly more revenue—and will ensure that the poor are able to hold on to more of their earnings—but it will not be enough to fund social programs and education on par with the rest of the country without significant federal intervention.

As long as major social policies remain in the hands of the states, we are likely to see interregional inequality persist. This is only partly because the states that are least generous are also the most conservative. The current system requires the poorest states to provide for the poorest citizens by generating revenue for programs like Temporary Assistance for Needy Families (TANF) and Medicaid from the weakest tax base. What are the prospects for shifting some of the power to set eligibility and benefit levels federally?

America’s federal structure has resulted in 50 distinct welfare states—each with the responsibility of providing for its poorest citizens. Wealthier states, blessed with either a deep tax base or fewer needy citizens, or both, can afford to provide much more than those states burdened with the double whammy of poor citizens and, consequently, a shallow tax base. American social policy in the twenty-first century is largely a federal story, with Washington playing an increasingly central—and equalizing—role in the financing of education, welfare, and health care. But, as students of welfare reform can attest, states continue to play a central role.

We think that needs to change. Specifically, we believe that the major safety net programs, particularly TANF and Medicaid, should be regulated and financed at the federal level, just like food stamps, Supplemental Security Income (SSI), Medicare, and Social Security. We can follow the advice of the National Research Council’s recommendations, included in a report on changing the way we calculate the national poverty line, and adjust payments to take into account regional differences in the cost of living. But the basic principle, that all American families are entitled to safety nets of equivalent value, should be made real by taking states out of the equation. The long history of Social Security and the GI Bill, to name two major social policies that have had durable effects on mobility and economic stability for millions of American families, tells us why this is so important. It took decades to redress the racial inequalities that emerged in the administration of these critical programs because they were left in the hands of the states (a requirement Southern senators insisted on if they were not to torpedo the central provisions of the New Deal). Leaving these decisions in the hands of states and localities introduces inequalities that punish the poor if they happen to live in states that are unwilling or less able to address their needs.

Katherine S. Newman is Professor of Sociology and the James Knapp Dean of the Krieger School of the Arts and Sciences, John Hopkins University. Rourke L. O’Brien is a Ph.D. Candidate in Sociology and Social Policy at Princeton University and a Nonresident Fellow of the New American Foundation.