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Starving the Statehouse: The Hidden Tax Policies Behind States' Long-Run Fiscal Crises

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INTRODUCTION

In 2014, news of a water crisis in Flint, Michigan, shook the nation.[1] Tests conducted after months of public complaints confirmed investigators' worst fears: the city's taps contained dangerously high levels of lead and had poisoned people for years.[2] A wave of studies soon revealed that tens of thousands had been exposed to the neurotoxin.[3] Children were among those most severely affected.[4]

The crisis shed light on a city and state in disrepair. To prevent Flint from going bankrupt after the Great Recession, Michigan's Governor had appointed an emergency manager who reduced costs by pulling water from a nearby river.[5] The river's corrosive water leached lead off the aging pipes that carried it across the city.[6] Residents quickly notified officials of a decrease in water cleanliness.[7] However, Michigan's Department of Environmental Quality had been hollowed by years of austerity and failed to respond.[8]

Seasoned observers blamed the disaster on inadequate tax revenues. As former state treasurer Robert Kleine put it, "the crisis was decades in

1. *See* Ryan Felton, *Flint's Water Crisis: What Went Wrong*, GUARDIAN (Jan. 16, 2016, 8:30 AM), http://www.theguardian.com/environment/2016/jan/16/flints-water-crisis-what-went-wrong [https://perma.cc/DUM5-397Z].
2. *Id.*
3. *Id.*
4. *Id.*
5. *See* Ryan Felton, *Governor Rick Snyder 'Very Sorry' About Flint Water Lead Levels Debacle*, GUARDIAN (Dec. 30, 2015, 8:54 AM), http://www.theguardian.com/us-news/2015/dec/30/michigan-governer-rick-snyder-very-sorry-about-water-supply-debacle [https://perma.cc/VCC8-JFBC].
6. *See* Ted Roelofs, *Signs of Trouble at MDEQ, Years Before Flint Lead Crisis*, BRIDGE MAG. (Feb. 10, 2016), http://www.theguardian.com/us-news/2015/dec/30/michigan-governer-rick-snyder-very-sorry-about-water-supply-debacle [https://perma.cc/VCC8-JFBC].
7. *Id.*
8. *Id.*

the making."[9] He pointed to tax limits passed in the 1970s and 1990s, which constrained the state's ability to fund infrastructure and health inspections.[10] The situation only worsened in the years preceding the water crisis. In 2011, to offset a $1.6 billion business tax cut, Michigan's Governor curtailed the tax revenue the state shared with municipalities—money that cities like Flint relied on to stay solvent.[11]

Sadly, Flint's story is emblematic of a much larger trend. American states have underinvested in infrastructure, education, and public welfare for decades.[12] While the growing costs of certain state programs have accounted for part of the problem, stagnant and more volatile tax levies have also contributed to the lack of funds for public services. Surprisingly, however, scholars have devoted little attention to the latter problem. This Note begins to fill that void by proposing a new research agenda.

From the 1930s to the 1970s, states invested in public services that fostered opportunity for each of their residents. States partnered with the federal government to build the infrastructure that twentieth-century businesses and their workers needed to thrive. States bolstered expenditures on high schools so that a majority of people could earn the credential for a well-paying job. In anticipation of the technological revolutions that would soon reshape their labor markets, states poured vast sums of money into higher-education systems that equipped millions with advanced skills. Finally, states developed a suite of social policies that kept families healthy and out of poverty.

Since the late 1970s, however, states have taken a dramatic turn. Though their populations have continued to grow at an impressive pace, states have tapered the investments needed to guarantee broad social mobility. Lawmakers have slowed infrastructure maintenance and eschewed new construction, leading America's roadways, buildings, and water systems to fall into disrepair. State spending on primary and secondary schools has failed to keep up with the growing number of children, necessitating oversized classes and prompting teacher shortages that have reduced education quality for the poorest students. States have steadily defunded public colleges by requiring tuition increases that have

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9. Robert J. Kleine, *Former Treasurer of Michigan: The Flint Water Crisis was 'Decades in the Making'*, BUS. INSIDER (Feb. 1, 2016 9:02 AM), http://www.theguardian.com/us-news/2015/dec/30/michigan-governer-rick-snyder-very-sorry-about-water-supply-debacle [https://perma.cc/VCC8-JFBC].

10. *Id.*

11. *See* Rachel Richards & Alicia Guevara Warren, *Enough is Enough: Business Tax Cuts Fail to Grow Michigan's Economy, Hurt Budget*, MI LEAGUE FOR PUB. POL'Y 1, 7 (2015), http://www.milhs.org/wp-content/uploads/2015/11/Enough-is-Enough-BusinessTaxCuts.pdf [https://perma.cc/42GR-LVED].

12. *See infra*, Section I.B.

diminished access to higher education. Finally, states have struggled to adequately fund public health services.

States' move from investment to retrenchment remains an enigma. Existing research has focused on the ways in which competing budget commitments have crowded one another out. For instance, researchers have shown that rising Medicaid costs have put pressure on funds available for other programs. There is also growing evidence that prison outlays and high infrastructure prices have drawn money away from welfare projects. Yet the scale of states' spending shortfalls and their consistency across budget areas suggest that other forces have also been at work. These two elements imply that states have faced severe, structural budget deficits. As such, they point to a conspicuous culprit: insufficient revenue.

A close look at the data confirms that states have confronted two major revenue challenges in the past forty years. First, unlike polities that have maintained healthy economies and robust investments in public services, American states have allowed their long-run tax receipts to stagnate. Second, states' tax hauls have become more volatile in recent decades. Just as they do with the spending side of the equation, scholars must analyze the origins of these revenue problems. In particular, they must probe *how* tax laws have led to suboptimal revenue growth and *why* legislators have allowed tax systems to underperform.

Prior work in economics and political science has provided a foundation for addressing these questions. With respect to the first, past studies have pointed to the roles of four legal institutions:[13] laws actively limiting states' tax hauls; withering sales tax regimes; eroding corporate tax bases; and multiplying tax expenditures. With respect to the second, the literature has stressed the rise of organized interests that have lobbied to diminish taxes across the states. Further probing and combining these strands should yield a wealth of research questions in the coming years.

It bears emphasizing that this Note does not provide a definitive account of states' tax histories over the past four decades. Indeed, no individual study could do so. It instead seeks to bring attention to an area

13. This Note adopts a broad definition of "institutions" borrowed from neo-institutional approaches in economics and political science. Specifically, the term refers to "the shared concepts used by humans in repetitive situations organized by rules, norms, and strategies," where the word "rules"—which encompasses formal laws of the kind legal scholars usually focus on—means "shared prescriptions (must, must not, or may) that are mutually understood and predictably enforced in particular situations by agents responsible for monitoring conduct and imposing sanctions." Elinor Ostrom, *Institutional Analysis and Development: Elements of the Framework in Historical Perspective*, *in* HISTORICAL DEVELOPMENTS AND THEORETICAL APPROACHES IN SOCIOLOGY 263 (Charles Crothers ed., 2010).

of law that has remained underexplored for too long. It also aims to arm researchers with the conceptual tools needed to uncover which tax institutions have decreased state revenue and why tax laws have evolved to promote this outcome—histories that undoubtedly vary richly across states, policy domains, and time periods.

To elaborate the foregoing arguments, the discussion proceeds in four parts. Section I charts the shift in states' commitment to public services. Section II shows that insufficient tax revenues bear some of the blame. It further notes that legal scholars have yet to address this problem despite the link between states' tax codes and the funds they raise. Section III draws on recent work in economics to unearth stagnant and unstable revenues' legal origins. Finally, Section IV invokes theories of policy change to hypothesize these laws' political determinants.

I. AMERICA'S STRUGGLING STATES

This section traces the rise and fall of states' investments in critical public services. American states are hidden engines of economic prosperity. They finance three-quarters of the nation's infrastructure.[14] Along with localities, they take primary responsibility for providing public elementary, secondary, and tertiary education.[15] States also administer a host of health and welfare programs.[16] Nonetheless, they tend to receive less scholarly attention than the federal government.

States became more difficult to ignore after the Great Recession. By devastating states' budgets, the crash spurred public service cuts so deep that they hampered the national recovery.[17] More importantly, the downturn showed that states' woes extend well beyond a single crisis.[18] As analysts have begun sifting through the data, it has become clear that state

14. *See* STATE BUDGET CRISIS TASK FORCE, REPORT OF THE STATE BUDGET CRISIS TASK FORCE 6 (2012), https://www.theindustrycouncil.org/publications/State_Budget_Crisis_Task_Force_Full_Report.pdf [https://perma.cc/NVX2-FDJC].

15. *See* Nicholas Johnson & Michael Leachman, *Four Big Threats to State Finances Could Undermine Future U.S. Prosperity*, CTR. ON BUDGET & POL'Y PRIORITIES 2 (Feb. 14, 2013), https://www.cbpp.org/sites/default/files/atoms/files/2-14-13sfp.pdf [https://perma.cc/L4Q4-PCSS].

16. *Id.*

17. *See* Tracy Gordon, *State and Local Budgets and the Great Recession* BROOKINGS INSTITUTION (Dec. 31 2012), https://www.brookings.edu/articles/state-and-local-budgets-and-the-great-recession/ [https://perma.cc/ZBB8 4H6T]; Paul Krugman, *Fifty Herbert Hoovers*, N.Y. TIMES (Dec. 28, 2008), http://www.nytimes.com/2008/12/29/opinion/29krugman.html [https://perma.cc/7S52-ULCP].

18. *See* STATE BUDGET CRISIS TASK FORCE, *supra* note 14, at 6.

spending on infrastructure, K-12 schools, public colleges, and public health has fallen short of residents' needs for decades.

These trends form part of a major policy reversal. From the 1940s to the 1970s, states worked with the federal government to make investments intended to foster social mobility. Over the last forty years, however, states have taken a radical turn. Though their populations have continued to grow, states have stopped expanding institutions that promote broad opportunity. This choice has almost certainly helped accelerate the rise[19] of inequality levels unseen since the 1920s.[20] Both the magnitude of this shift toward disinvestment and its consequences raise profound questions about which forces caused it.

19. Contemporary economic research shows that budgetary austerity increases inequality. *See, e.g.*, Lawrence Ball et al., *The Distributional Effects of Fiscal Consolidation* (Int'l Mon. Fund, Working Paper 13/151, June 2013), https://www.imf.org/external/pubs/ft/wp/2013/wp13151.pdf [https://perma.cc/C28H-W3JC]. This is likely especially the case in U.S. states because the health, education, and infrastructure programs they have retrenched are particularly good at minimizing the effects of income and wealth disparities. The positive relationship between these services and improved state-level outcomes is well-documented and need not be detailed here. For some of the most recent scholarship on the societal benefits of public infrastructure investment, see Emma Hooper et al., *To What Extent Can Long-Term Investments in Infrastructure Reduce Inequality?* (Banque de France, Working Paper # 624, Mar. 2017), https://publications.banque-france.fr/sites/default/files/medias/documents/wp_624.pdf [https://perma.cc/3Z7Q-G4T6]; for the social benefits of investing in public K-12 education, see Minghao Li et al., *Human Capital and Intergenerational Mobility in U.S. Counties*, 32 ECON. DEV. Q. 18 (2018); for the social benefits of investing in public higher education, see Philip A. Trostel, *High Returns: Public Investment in Higher Education*, 2008 COMMUNITIES & BANKING 31 (2008) and Michael Hout, *Social and Economic Returns to College Education in the United States*, 38 ANN. REV. SOCIOL. 379 (2012); and for the social benefits of investing in public health programs, see Daniel Kim, *The Associations Between U.S. State and Local Spending, Income Inequality, and Individual All-Cause and Cause-Specific Mortality: The National Longitudinal Mortality Study*, 84 PREV. MED. 62 (2016) and Linda Diem Tran et al., *Public Health and the Economy Could be Served by Reallocating Medical Expenditures to Social Programs*, 3 SSM – POP. HEALTH 185, 185-86 (2017).

20. *See* Estelle Sommeiller & Mark Price, *The New Gilded Age: Income Inequality in the U.S. by State, Metropolitan Area, and County*, ECON. POL'Y INST. 14 (July 2018), https://www.epi.org/files/pdf/147963.pdf [https://perma.cc/L7M-59P4].

A. The Investment Age

In the mid-twentieth century, state and local governments made substantial commitments to their residents. The U.S. population grew from 127 million to 216 million people between 1935 and 1975—a more than 70 percent increase.[21] To accommodate the ever-rising number of inhabitants and guarantee each the chance to prosper, states expanded their social policies in nearly every area important to human wellbeing.

First, together with federal agencies, states poured millions of dollars into the infrastructure that powered the mid-twentieth-century economy.[22] Throughout the New Deal, states served as crucial partners to the federal government in its effort to pull the nation out of the Great Depression. State and local governments financed upwards of 30 percent of each project undertaken by the federal Works Progress Administration (WPA),[23] the largest public works program in the nation's history.[24] States and localities also directly sponsored most of these projects.[25] As the

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21. *See* POPULATION ESTIMATES PROGRAM, POPULATION DIVISION, U.S. CENSUS BUREAU, HISTORICAL NATIONAL POPULATION ESTIMATES: JULY 1, 1900 TO JULY 1, 1999 (June 28, 2000), https://www2.census.gov/programs-surveys/popest/tables/1900-1980/national/totals/popclockest.txt [https://perma.cc/3UEF-XVSG].

22. *See* JAMES A. MAXWELL, FEDERAL GRANTS AND THE BUSINESS CYCLE 26 tbl. 9 (1952); John Joseph Wallis, *The Birth of the Old Federalism: Financing the New Deal, 1932–1940*, 44 J. ECON. HIST. 139, 147 (1984) (noting that nearly "[a]ll of the [New Deal's] relief programs . . . were jointly financed by federal, state, and local governments . . . [and] required explicit or implicit matching of federal funds for state and local contributions").

23. *See* ROBERT D. LEIGHNINGER JR., LONG-RANGE PUBLIC INVESTMENT: THE FORGOTTEN LEGACY OF THE NEW DEAL 63 (2007).

24. From 1935 to its conclusion in the early 1940s, the WPA put more than 8.5 million people to work on 1.4 million projects across the country. The WPA "built, improved or renovated 39,370 schools; 2,550 hospitals; 1,074 libraries; 2,700 firehouses; . . . [and] 1,050 airports . . . . It also dug more than 1,000 tunnels; surfaced 639,000 miles of roads and installed nearly 1 million miles of sidewalks, curbs and street lighting . . . ." Andrea Stone, *When America Invested in Infrastructure, These Beautiful Landmarks Were the Result*, SMITHSONIAN MAG. (Dec. 10, 2014), http://www.smithsonianmag.com/history/when-america-invested-infrastructure-these-beautiful-landmarks-were-result-180953570/ [https://perma.cc/W6X4-VMAL].

    As one historian has observed, "a vast amount of [states'] physical and cultural infrastructure went up between 1933 and 1940 . . . . [N]ever in [the country's] history has so much been built for so many . . . ." *Id.*

25. *See* KENTUCKY HERITAGE COUNCIL, THE NEW DEAL BUILDS: A HISTORIC CONTEXT OF THE NEW DEAL IN EAST KENTUCKY, 1933 TO 1943 at 16 (2005); Beverly Bunch, *Planning and Financing Infrastructure in the Trump Years: What Can the*

decades progressed and the nation's economic health recovered, state and local governments assumed an even greater share of responsibility for infrastructure financing. By 1960, excluding federal grants, state and local spending accounted for nearly 70 percent of outlays on infrastructure projects in the United States.[26]

States and localities also undertook significant investments in education. This began with an extraordinary increase in public high school enrollments. Barely 9% of all American 18-year-olds graduated from secondary school in 1910. By 1940, the median 18-year-old had a high school diploma and 73% of teens were in a secondary program.[27] As Harvard economists Claudia Goldin and Lawrence Katz have shown, this "rising supply of educated workers outstripped the increased demand [for them] caused by technological advances," leading to "[h]igher real incomes . . . accompanied by lower inequality."[28] Robust state investment in elementary and secondary schooling continued well into the 1970s. According to sociologist Salvatore Babones, "[b]etween 1964 and 1974 state and local governments created more than 2.4 million new jobs in education" to meet the needs of growing student populations.[29]

To respond to the mounting demand for skilled workers, states also invested substantially in public colleges and universities. Between 1960 and 1980, states boosted their public higher education expenditures from \$3.56 to \$10.42 in tax revenues per \$1,000 of personal income—a 193% increase.[30] As a result, the number of four-year state colleges climbed from 367 to 465 and the number of community colleges skyrocketed from 328

Administration Learn from Previous Large Infrastructure Programs?, *in* THE PUBLIC INFRASTRUCTURE OF WORK AND PLAY 59 (Michael A. Pagano ed., 2018).

26. *See* Barry Bosworth & Sveta Milusheva, *Innovations in U.S. Infrastructure Financing: An Evaluation*, BROOKINGS INSTITUTION 19 (2011), https://www.brookings.edu/wpcontent/uploads/2016/06/1020_infrastructure_financing_bosworth_milusheva.pdf [https://perma.cc/SD4D-WQ6Q].

27. *See* CLAUDIA GOLDIN & LAWRENCE F. KATZ, THE RACE BETWEEN EDUCATION AND TECHNOLOGY 195 (2008).

28. *Id.* at 7.

29. *See* SALVATORE BABONES, SIXTEEN FOR '16: A PROGRESSIVE AGENDA FOR A BETTER AMERICA 19 (2015).

30. *See State Investment and Disinvestment in Higher Education 1961 to 2015* at 1, PELL INST. FOR STUDY OPPORTUNITY IN EDUC. (Feb. 2015), http://www.starvingthebeast.net/Feb%202015%20PSO%20Newsletter-State%20Investment%20and%20Disinvestment%20in%20Higher%20Education%201961%20to%202015.pdf [https://perma.cc/JSR8-ZRKK].

to 869,[31] accommodating a rise in public enrollments of nearly seven million students.[32]

States reaped important returns on these investments. Affordable public higher education fostered widespread social benefits, including "higher income, lower unemployment, better health, longer life, faster technology creation and adaption, reduced crime, greater tolerance, [and] increased civic involvement."[33] Evidence suggests that states likely also enjoyed a positive fiscal return on their public college and university expenditures.[34]

Finally, states committed to provide healthcare for millions of their poorest residents. In 1965, federal legislation established the Medicaid program to supply government-financed health coverage for people receiving welfare assistance. Medicaid was designed as a state-federal partnership. From its inception, states have taken responsibility for over two-fifths of the program's funding.[35]

B. The Retrenchment Age

Since the late 1970s, states' priorities have shifted markedly. Residents' needs have remained substantial, particularly as increased global competition has placed downward pressure on wages and a premium on higher education. The population has also grown even more rapidly than in the preceding forty years, from 216 million to 324

31. *See* NAT'L CTR FOR EDUC. STAT., 2012 DIGEST OF EDUCATION STATISTICS, TABLE 306: DEGREE-GRANTING INSTITUTIONS, BY CONTROL AND LEVEL OF INSTITUTION, SELECTED YEARS, 1949–50 THROUGH 2011-12 (2012), https://nces.ed.gov/programs/digest/d12/tables/dt12_306.asp [https://perma.cc/3TSZ-VMYS].

32. *See* NAT'L CTR FOR EDUC. STAT., 2012 DIGEST OF EDUCATION STATISTICS, TABLE 254: FULL-TIME EQUIVALENT FALL ENROLLMENT IN DEGREE-GRANTING INSTITUTIONS, BY CONTROL AND LEVEL OF INSTITUTION AND STATE JURISDICTION, 2000, 2010, AND 2011 (2012), https://nces.ed.gov/programs/digest/d12/tables/dt12_254.asp [https://perma.cc/5FRB-VBEX].

33. Trostel, *supra* note 19, at 31.

34. *See* JOHN STILES ET AL., CALIFORNIA'S ECONOMIC PAYOFF: INVESTING IN COLLEGE ACCESS & COMPLETION 6 (2012). Studies have found that a state recoups anywhere from $2.5 to $7.5 dollars for every $1 it invests in its public, four-year university system. *See Trostel, supra note 19, at* 32 (top-left-hand figure).

35. *See* KAISER COMM'N ON MEDICAID & UNINSURED, MEDICAID: A PRIMER 31 (2013), https://kaiserfamilyfoundation.files.wordpress.com/2010/06/7334-05.pdf [https://perma.cc/E76Q-UFJH].

million.[36] Unlike during the Investment Age described above, however, states' ability to provide high-quality public services has waned dramatically. This trend has particularly affected four areas of public investment: infrastructure, K-12 education, higher education, and public health.

1. Crumbling Infrastructure

State and local expenditures on infrastructure now stand at a thirty-year low.[37] In constant terms, and excluding federal grants, total state and local spending on infrastructure fell from 3.3% of GDP in the 1960s to 2.1% of GDP in the early 2000s.[38] While capital investments on schools, bridges, and other projects rose from 0.5% to 3% of GDP between 1945 and the mid-1970s, it has since dipped to below 2%.[39] As noted above, these figures are significant because state and local governments finance three-quarters of the nation's infrastructure.[40]

Decades of neglect have led much-needed airports, roadways, and buildings to fall into disrepair. The American Society of Civil Engineers (ASCE) recently gave the country's infrastructure a D+ rating, estimating the cost of upgrading it at $2 trillion.[41] These deficiencies highlight the extent of the need for renewed investment. Despite serving more than two million passengers a day, U.S. airports face a funding gap of $42 billion

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36. *See* U.S. CENSUS BUREAU POPULATION DIVISION, ESTIMATES OF THE COMPONENTS OF RESIDENT POPULATION CHANGE: APRIL 1, 2010 TO JULY 1, 2016 (Mar. 2017) https://factfinder.census.gov/bkmk/table/1.0/en/PEP/2016/PEPTCOMP/0100000US|0100000US.04000|0200000US1|0200000US2|0200000US3|0200000US4 [https://perma.cc/5UEZ-52WT].

37. *See* Elizabeth McNichol, *It's Time for States to Invest in Infrastructure,* CTR. ON BUDGET & POL'Y PRIORITIES 10 (last updated Aug. 10, 2013), https://www.cbpp.org/sites/default/files/atoms/files/2-23-16sfp.pdf [https://perma.cc /2VLW-4BC7].

38. *See* Bosworth & Milusheva, *supra* note 26, at 19.

39. *Id.*

40. *See* STATE BUDGET CRISIS TASK FORCE, *supra* note 14, at 6.

41. *See* AM. SOC'Y OF CIV. ENGINEERS, AMERICA'S INFRASTRUCTURE REPORT CARD 5, 7 (2017), http://www.infrastructurereportcard.org [https://perma.cc/B9DS-NE6S]. The ASCE's grading scale runs from a high of "A" (indicating that infrastructure is "exceptional" and "fit for the future") to a low of "F" (meaning that it is "failing/critical"). *Id.* at 12-13. A "D" grade denotes "infrastructure [that] is in poor to fair condition and mostly below standard, with many elements approaching the end of their service life" and whose "[c]ondition and capacity are of serious concern with strong risk of failure." *Id.* at 13.

over the next decade.[42] Almost four in ten bridges across the country are at least fifty years old. Of the nation's approximately 614,000 bridges, over 56,000 are structurally deficient.[43] The number of high-hazard potential dams across the nation has also climbed to nearly 15,500.[44]

Beyond creating safety concerns, this lack of upkeep has produced significant economic inefficiencies. According to a 2012 study by the Texas A&M Transportation Institute, the annual cost of congestion has risen to $121 billion, or $818 per commuter.[45] The country stands to lose $14.2 trillion in GDP and 5.8 million jobs by 2040 if it fails to address the infrastructure investment gap.[46]

2. Under-Resourced Schools

States and localities have also sacrificed school quality for large swaths of their populations. Many states have circumvented the minimum funding guarantees that courts and their constitutions demand.[47] These shortfalls

42. *Id.* at 14.

43. *Id.*

44. *Id.* at 15.

45. *See* NAT'L ASS'N OF MANUFACTURERS, CATCHING UP: GREATER FOCUS NEEDED TO ACHIEVE MORE COMPETITIVE INFRASTRUCTURE 6 (2014), http://www.nam.org/Issues/Infrastructure/Surface-Infrastructure/Infrastructure-Full-Report-2014.pdf [https://perma.cc/E5DW-NGW6].

46. *See* Niall McCarthy, *The Massive Cost of America's Crumbling Infrastructure*, FORBES (Mar. 13, 2017), https://www.forbes.com/sites/niallmccarthy/2017/03/13/the-massive-cost-of-americas-crumbling-infrastructure-infographic/#41a829653978 [https://perma.cc/5RDQ-B4CZ].

47. *See* EDUC. LAW CTR & THE LEADERSHIP CONFERENCE EDUC. FUND, CHEATING OUR FUTURE: HOW DECADES OF DISINVESTMENT BY STATES JEOPARDIZES EQUAL EDUCATIONAL OPPORTUNITY 3 (2015), http://civilrightsdocs.info/pdf/reports/Resource-Equity-Report-WEB.pdf [https://perma.cc/VBL2-XGJN]. Courts have excoriated states for failing to adequately fund their schools. In "New York, Colorado, Wyoming, Kansas, Washington and many other states, courts have determined that there is 'a causal connection between the poor performance of . . . students and the low funding provided their schools.'" Valerie Strauss, *How Grossly Underfunded Are Public Schools?*, WASH. POST (Nov. 25, 2012), https://www.washingtonpost.com/news/answer-sheet/wp/2012/11/25/how-grossly-underfunded-are-public-schools [https://perma.cc/G77V-4L56] (quoting *Montoy v. State*, No. 99-C-1738, 2003 WL 22902963 (Kan. Dist. Ct., 3d Jud. Dist. Dec. 2, 2003)).

have hit underserved communities especially hard.[48] As the Education Law Center recently observed, "[t]he evidence from across the country is clear[:] . . . our nation must dramatically increase the resources available for public education."[49]

Throughout the country, states and school districts have deferred vital funding for school facilities. Research shows that school districts need high-quality facilities to help "improve student achievement, reduce truancy and suspensions, [and] improve staff satisfaction and retention . . . ."[50] Yet the 21st Century School Fund recently estimated that states underspend on school facilities by about $46 billion a year—a 32% shortfall.[51] As a result, the ASCE now gives the nation's school buildings a D+ rating.[52]

Comparative and historical evidence suggests that inadequate funding reaches far beyond facilities. In 1970, the United States spent an average of 4.5% of GDP on elementary and high school education.[53] By 2013, that figure had dropped a full point, to 3.5%.[54] This level lies below the Organisation for Economic Cooperation and Development's (OECD) average expenditure of 3.6% of GDP.[55] It also falls well short of the

48. *See* EDUC. L. CTR & LEADERSHIP CONFERENCE EDUC. FUND, *supra* note 47, at 3. The highest poverty districts in America now receive about $1,200 less per student than their more affluent counterparts. *Id.*

49. *Id.*

50. 21ST CENTURY SCHOOL FUND AND NAT'L COUNCIL ON SCHOOL FACILITIES, STATE OF OUR SCHOOLS: AMERICA'S K-12 FACILITIES 3 (2016), https://kapost-files-prod.s3.amazonaws.com/published/56f02c3d626415b792000008/2016-state-of-our-schools-report.pdf [https://perma.cc/ANB7-MPWH].

51. *Id.* at 4.

52. *See* AM. SOC'Y OF CIV. ENGINEERS, *supra* note 41, at 81. The ASCE's 2017 Infrastructure Report Card also found that no fewer than 24 percent of public school buildings lie in "fair" or "poor" condition. *Id.* Overall, 53 percent of public schools need to make investments for repairs, renovations, and modernizations to be considered in "good" condition. *Id.* at 82.

53. *See* NAT'L CTR. FOR EDUC. STAT., 2015 DIGEST OF EDUCATION STATISTICS, FIGURE 2: ENROLLMENT, TOTAL EXPENDITURES IN CONSTANT DOLLARS, AND EXPENDITURES AS A PERCENTAGE OF THE GROSS DOMESTIC PRODUCT (GDP), BY LEVEL OF EDUCATION, SELECTED YEARS, 1965-66 THROUGH 2014-15 (2015), https://nces.ed.gov/programs/digest/d15/figures/fig_02.asp [https://perma.cc/CT7T-QRZV].

54. *Id.*

55. *See* NAT'L CTR. FOR EDUC. STAT., THE CONDITION OF EDUCATION: EDUCATION EXPENDITURES BY COUNTRY (2017), https://nces.ed.gov/programs/coe/indicator_cmd.asp [https://perma.cc/SBN9-YT34].

thresholds set by nations recognized as global leaders in education.[56] In 2013, Finland spent 3.9% of its GDP on schools.[57] Denmark and Norway respectively spent 4.5% and 4.7% of their GDPs on primary and secondary schooling.[58]

While data on school districts' shortfalls are hard to come by, research on individual states paints a concerning portrait. California, the most populous state in the nation, is a telling example. Scholars estimate that to bring all schools to the 2011–12 State Board of Education-established achievement targets under the federal No Child Left Behind standards, California would need to spend an additional $42 billion a year—the equivalent of about a quarter of the state's entire annual budget. The state would also need to hire over 237,000 additional instructional aides and educators.[59]

3. Defunded Public Colleges

States have also retrenched higher education. Public colleges and universities now educate nearly seventy percent of American students.[60] Yet states have failed to provide these institutions with the resources needed to meet growing and more diverse populations.[61] Between 1988 and 2013, states decreased their average public higher education expenditures per full-time-enrolled student from $8,579 to $6,105.[62] As

56. *See* LynNell Hancock, *Why Are Finland's Schools Successful?*, SMITHSONIAN MAG. (Sept. 2011), https://www.smithsonianmag.com/innovation/why-are-finlands-schools-successful-49859555/ [https://perma.cc/55A6-ASR6].

57. *See* NAT'L CTR. FOR EDUC. STAT., 2016 DIGEST OF EDUCATION STATISTICS, TABLE 605.20: PUBLIC AND PRIVATE EXPENDITURES ON EDUCATION INSTITUTIONS AS A PERCENTAGE OF THE GROSS DOMESTIC PRODUCT (GDP), BY LEVEL OF EDUCATION AND COUNTRY, SELECTED YEARS, 2005 THROUGH 2013 (2016), https://nces.ed.gov/programs/digest/d16/tables/dt16_605.20.asp [https://perma.cc/GPM3-N46W].

58. *Id.*

59. *See* CAL. SCH. BOARDS ASS'N, CALIFORNIA'S CHALLENGE: ADEQUATELY FUNDING EDUCATION IN THE 21ST CENTURY 2 (2015), https://www.csba.org/CAchallenge2015 [https://perma.cc/J8JY-FVYJ].

60. *See* NAT'L CTR. FOR EDUC. STAT., 2013 DIGEST OF EDUCATION STATISTICS: TABLE 307.20 (2013), https://nces.ed.gov/programs/digest/d13/tables/dt13_307.20.asp [https://perma.cc/8K44-8EBL].

61. *See* John Quinterno, *The Great Cost Shift*, DEMOS 2 (Mar. 2012), https://www.demos.org/sites/default/files/publications/TheGreatCostShift_Demos_0.pdf [https://perma.cc/Q7R7-Z7AN].

62. *See* STATE HIGHER EDUC. EXEC. OFFICERS, STATE HIGHER EDUCATION FINANCE: FY 2013 at 18, http://www.sheeo.org/sites/default/files/publications/SHEF

lawmakers reduced funding for tertiary instruction, institutions made up for the shortfall by raising tuition nearly four times faster than inflation.[63]

The soaring price of a college degree has caused access to fall rapidly. Working-class students and families pursuing a degree have found it more difficult to graduate.[64] Growing numbers of low- and middle-income youth have foregone tertiary instruction altogether.[65] States have thereby increasingly deprived themselves of the social and fiscal benefits of an educated populace and workforce outlined earlier.

4. Declining Public Health Spending

Finally, states have restricted their public health expenditures. Though measuring such spending is difficult due to the complexity of the U.S. health system,[66] recent studies have shown that states' public health

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_FY13_04292014.pdf [https://perma.cc/HJ39-SEMR]. The proportion of tax revenues states have invested in higher education has fallen even more precipitously in recent decades. In 1981, states spent an average of $10.47 in tax revenues per $1,000 of personal income on public colleges. Since then, that rate has steadily dropped to $5.57—the lowest level in 50 years. *State Investment and Disinvestment in Higher Education 1961 to 2015*, *supra* note 30.

63. *See* NAT'L CTR. FOR EDUC. STAT., 2012 DIGEST OF EDUCATION STATISTICS, TABLE 381: AVERAGE UNDERGRADUATE TUITION AND FEES AND ROOM AND BOARD RATES CHARGED FOR FULL-TIME STUDENTS IN DEGREE-GRANTING INSTITUTIONS, BY CONTROL AND LEVEL OF INSTITUTION AND STATE JURISDICTION, 2000, 2010, AND 2011 (2012), https://nces.ed.gov/programs/digest/d12/tables/dt12_381.asp [https://perma.cc/WE5E-6SAH]. Stagnant wages have aggravated the burden this shift has placed on the poor; while the cost of attending a public four-year institution inched from six percent to nine percent of the highest quintile's family income in the past two decades, the lowest quintile saw this burden more than double, from 42 percent to 114 percent of their earnings. SUZANNE METTLER, DEGREES OF INEQUALITY: HOW THE POLITICS OF HIGHER EDUCATION SABOTAGED THE AMERICAN DREAM 121 (2014).

64. *See* Jean Johnson & Jon Rochkind, *With Their Whole Lives Ahead of Them: Myths and Realities About Why So Many Students Fail to Finish College* 5-11 (Pub. Agenda, 2010), https://www.publicagenda.org/files/theirwholelivesaheadofthem.pdf [https://perma.cc/78SH-GJ57].

65. *See* Donald E. Heller, *Student Price Response in Higher Education: An Update to Leslie and Brinkman*, 68 J. HIGHER EDUC. 624 (Nov./Dec. 1997); Mark C. Berger & Thomas Kostal, *Financial Resources, Regulation, and Enrollment in US Public Higher Education*, 21 ECON. EDUC. REV. 101 (2002).

66. *See* Jonathon P. Leider, *The Problem with Estimating Public Health Spending*, 22 J. PUB. HEALTH MGMT. & PRAC. E1 (2016).

investments have stagnated in the last ten years.[67] Data from the Association of State and Territorial Health Officials have revealed that "[s]tate public health spending [was] actually lower in 2016-2017 than it was in 2008-2009 . . . ."[68] As with infrastructure and education, this lack of spending is concerning because state and local governments take the lead in public health financing; over the past few decades, they have been responsible for roughly eighty to ninety percent of the nation's public health outlays.[69]

C. Toward a New Research Agenda

In short, state spending on public programs has undergone a profound transformation over the past eighty years. During the first half of this period, states made remarkable new investments in infrastructure, education, and welfare services that bolstered economic opportunity for all residents. Over the last four decades, by contrast, state expenditures in these areas have fallen short of a growing population's needs by hundreds of billions of dollars annually.

This structural shift has significant implications for the health and well-being of the next generation of Americans. By failing to invest programs that support social mobility,[70] states risk deepening the record levels of inequality that already characterize the twenty-first-century United States.[71] It is therefore crucial that scholars make sense of this policy transformation's roots and offer legislators actionable solutions. Doing so will require that researchers look beyond the effects of the most recent recession. In particular, they will need to dissect the legal and political institutions that have shaped states' long-run fiscal conditions. The following sections take the first steps toward elaborating this law and political economy agenda.

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67. *See* Tran et al., *supra* note 19; David Himmelstein & Steffie Woolhandler, *Public Health's Falling Share of U.S. Health Spending*, 106 AM. J. PUB. HEALTH 56, 57 (2016); Albert Lang et al., *A Funding Crisis for Public Health and Safety: State-by-State Public Health Funding and Key Health Facts* 14 (Trust for America's Health, Mar. 2018), https://www.issuelab.org/resources/29958/29958.pdf [https://perma.cc/FM77-PVQS];

68. Lang et al., *supra* note 67, at 14.

69. *See* Himmelstein & Woolhandler, *supra* note 67, at 57.

70. *See supra*, note 19.

71. *See* Sommeiller & Price, *supra* note 20.

II. Bringing Taxes Back In

There is no doubt that part of the explanation for states' disinvestment involves competing expenditure commitments. While states' budget histories remain underexplored, political scientists have shown that the rising costs of some public programs have crowded out funds for essential services.[72]

Chief among these cost drivers is Medicaid. Along with several coverage expansions, aging and increasingly impoverished populations have pushed up Medicaid enrollments.[73] The program has also suffered from the outsized cost inflation characteristic of the American medical sector.[74] As a result, Medicaid now consumes an average of one-fifth of states' general funds, placing intense pressure on other spending areas.[75]

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72. Popular commentators often lay the blame for public service cuts on government pension programs. In most states, however, unfunded retirement liabilities mainly pose a *future* threat. *See* Irvis Lav & Elizabeth McNichol, *Misunderstandings Regarding State Debt, Pensions, and Retiree Health Costs Create Unnecessary Alarm*, CTR. ON BUDGET & POL'Y PRIORITIES (Jan. 20 2011), https://www.cbpp.org/research/misunderstandings-regarding-state-debt-pensions-and-retiree-health-costs-create-unnecessary [https://perma.cc/B5UQ-UGEV]. Contrary to misconceptions about the solvency of public pensions, most state and local governments can spread the costs of unfunded liabilities over up to 30 years. *Id.* at 4. Nonetheless, aging populations and maturing obligations may soon force states to adjust policies to prevent retirement costs from encroaching on other programs. D. Roderick Kiewiet & Mathew D. McCubbins, *State and Local Government Finance: The New Fiscal Ice Age*, 17 ANN. REV. POL. SCI. 105, 113-17 (2014). The Congressional Budget Office indeed recently concluded that "[m]ost of the additional funding needed to cover pension liabilities is likely to take the form of higher government contributions and therefore will require higher taxes or reduced government services for residents." Frank Russek, *The Underfunding of State and Local Pension Plans*, CONG. BUDGET OFF. 1 (May 2011), https://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/doc12084/05-04-pensions.pdf [https://perma.cc/9AJ9-97D9].

73. *See* Kiewiet & McCubbins, *supra* note 72, at 110-112.

74. *See State Healthcare Spending on Medicaid: A 50-State Study of Trends and Drivers of Costs*, PEW CHARITABLE TRUSTS 5 (2014), http://www.pewtrusts.org/~/media/data-visualizations/interactives/2014/medicaid/downloadables/state_health_care_spending_on_medicaid.pdf [https://perma.cc/B39C-6ZBY]. This inflation largely stems from the lack of a central government insurer capable of streamlining administrative costs and negotiating lower drug and health service prices. *See* Gerald F. Anderson et al., *It's The Prices, Stupid: Why The United States Is So Different From Other Countries*, 22 HEALTH AFF. 89, 102 (2003).

75. *See* Kiewiet & McCubbins, *supra* note 72, at 112.

Studies have shown that increased Medicaid spending has taken a particularly harsh toll on public higher education investment in the past 30 years.[76]

Research has similarly found that climbing prison costs form part of the picture. Between 1972 and 2012, the incarceration rate in the United States soared from 161 to 707 people per 100,000 residents.[77] Much of this rise occurred in state prisons, as voters and legislators adopted stricter sentencing laws for petty offenders and drug users.[78] Unsurprisingly, multiplying numbers of inmates inflated prison budgets and drew funds away from public programs.[79]

Finally, American states and localities have incurred higher infrastructure costs than other parts of the world.[80] To take just one example, New York City's rail extensions can now cost as much as $3 billion per kilometer—15 times the cost of equivalent projects in Paris and

76. *See generally* David Tandberg, *Interest Groups and Governmental Institutions: The Politics of State Funding of Public Higher Education*, 24 EDUC. POL'Y 735, 768 (2010) (finding that Medicaid is area of spending "siphoning dollars from higher education"); Thomas J. Kane & Peter R. Orszag, *Higher Education Spending: The Role of Medicaid and the Business Cycle* (Brookings Institution, Policy Brief #124, 2003), https://www.brookings.edu/research/higher-education-spending-the-role-of-medicaid-and-the-business-cycle/ [https://perma.cc/MUG2-M2R6] (finding that "Medicaid spending appears to explain the vast majority of the . . . decline in higher education appropriations").

77. *See* Jeremy Travis, Bruce Western, & Steve Redburn, *Rising Incarceration Rates*, *in* THE GROWTH OF INCARCERATION IN THE UNITED STATES: EXPLORING CAUSES AND CONSEQUENCES 33 (Nat'l Res. Council of the Nat'l Acad. of Sci., 2014), https://www.nap.edu/read/18613/chapter/4 [https://perma.cc/RMD4-QWXH].

78. *Id.* at 42, 74; Wendy Sawyer & Peter Wagner, *State Policy Drives Mass Incarceration*, PRISON POL'Y INITIATIVE (2016), https://www.prisonpolicy.org/graphs/state_driver_numbers_1925-2015.html [https://perma.cc/7TZD-H9SS].

79. *See* Christian Henrichson & Ruth Delaney, *The Price of Prisons: What Incarceration Costs Taxpayers*, VERA INST. OF JUST. 2 (2012), https://www.vera.org/publications/price-of-prisons-what-incarceration-costs-taxpayers [https://perma.cc/EF4M-T5X7]; David J. Weerts & Justin M. Ronca, *Understanding Differences in State Support for Higher Education Across States, Sectors, and Institutions: A Longitudinal Study*, 83 J. HIGHER EDUC. 155, 167 (2012).

80. *See* Tracy Gordon & David Schleicher, *High Costs May Explain Crumbling Support for US Infrastructure*, Urban Inst. (Mar. 31, 2015), http://www.urban.org/urban-wire/high-costs-may-explain-crumbling-support-us-infrastructure [https://perma.cc/2S4A-K5JE].

36 times the cost of similar construction in Madrid.[81] Elevated costs have almost certainly made it more difficult to get new infrastructure projects up and running.

Nevertheless, the scale of states' under-investment in public services implies that other forces are also at work. Even assuming that states reduced their prison populations and found ways to keep health and construction prices in check, these savings would not make up for the decades-long shortfalls that have sapped public programs. The fact that expenditures have failed to meet populations' needs across most major budget categories[82] suggests that this is not a story of profligacy in some policy areas. Instead, this level of uniformity points to a more obvious culprit: insufficient tax receipts. This section first shows that states have grappled with two serious revenue challenges in the past forty years. It then explains that legal scholars have yet to explore these problems despite being ideally situated to do so.

A. Waning and More Volatile State Revenues

State budgeting is never simply a question of efficient outlays; it is also about the *revenues* chosen to pay for them. As Irene Rubin has explained in *The Politics of Public Budgeting*, state "[b]udgets have to balance. A plan for expenditures that pays no attention to ensuring that revenues cover expenditures is not a budget."[83] For the most part, these revenues come from state and local taxes. State budgets reveal "citizens' preferences for different forms of taxation and different levels of taxation, as well as the ability of specific groups to shift tax burdens to others. The budget reflects the degree to which the government redistributes wealth upward or downward through the tax system."[84]

Scholars generally understand that budgeting is a two-fold challenge. However, many studies examining how, for instance, Medicaid and prisons

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81. *Id.*

82. *See* NAT'L ASS'N OF STATE BUDGET OFFICERS, STATE EXPENDITURE REPORT 2014-16 at 6 (2016), https://higherlogicdownload.s3.amazonaws.com/NASBO/9d2d2db1-c943-4f1b-b750-0fca152d64c2/UploadedImages/SER%20Archive/State%20Expenditure%20Report%20(Fiscal%202014-2016)%20-%20S.pdf [https://perma.cc/VJ79-EMH5] (breaking state budgets into the following categories, most of which—*see supra,* Section I.B—suffered significant cutbacks beginning in the late 1970s: elementary and secondary education; higher education; public assistance; Medicaid; corrections; transportation; other).

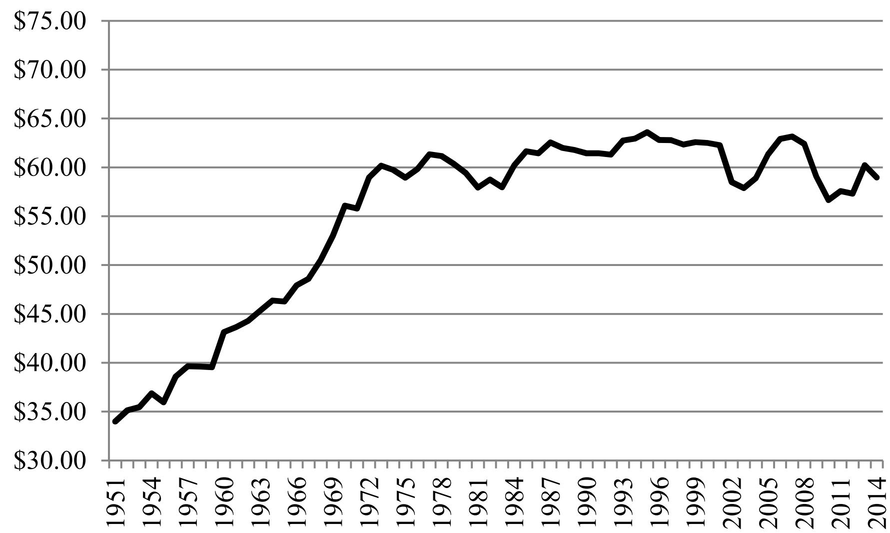
83. IRENE S. RUBIN, THE POLITICS OF PUBLIC BUDGETING: GETTING AND SPENDING, BORROWING AND BALANCING 4 (4th ed. 2000).

84. *Id.* at 2.

displace other public programs have foregone a discussion of taxation.[85] In doing so, they have intimated that states' resource woes stem entirely from competing expenditure choices.

A close look at states' fiscal portraits shows that this could not be further from the truth. States have encountered two major revenue-based hurdles in the Retrenchment Age described in the previous section. First, and most importantly, tax receipts have stagnated since the late 1970s.[86] Average state tax revenues per $1,000 of personal income climbed from $34 to $61 between 1951 and 1976 (Figure 1). Since then, however, this figure has essentially flattened. Average state tax revenues per $1,000 of personal income reached just $63.15 at the height of the 2007 housing bubble. As states grappled with the subsequent recession, they allowed this rate to dwindle to as little as $58.96 (Figure 1).

Figure 1. Tax Revenues Per $1,000 of Personal Income, All States, 1951 to 2013.



SOURCE: U.S. Bureau of the Census; Bureau of Economic Analysis; author's own calculations.

85. *See*, *e.g.*, Kane & Orszag, *supra* note 76; Albert A. Okunade, *What Factors Influence State Appropriations for Public Higher Education in the United States?* 30 J. EDUC. FIN. 123 (2004); Tandberg, *supra* note 76; Weerts & Ronca, *supra* note 79.

86. STATE BUDGET CRISIS TASK FORCE, *supra* note 14, at 46-53.

This shift cannot solely be attributed to exogenous forces such as slowed economic growth or globalization. Other developed democracies have avoided revenue stagnation while maintaining healthy economies. Between 1975 and 2015, tax revenue as a percentage of GDP increased from 38.9% to 43.3% in Sweden.[87] In the same period, this proportion rose from 36.8% to 45.9% in Denmark and from 36.1% to 43.9% in Finland.[88] Greater tax revenues have allowed these countries to continue to invest in some of the highest-quality public services and education systems on earth.[89] These differences indicate that poorly-designed tax policies have played a role in impairing U.S. states' budget health.

A second pernicious trend has plagued U.S. states in recent years: heightened revenue volatility. As the dips on the right-end of Figure 1 indicate, states experienced more severe fiscal stress during the 2001 and 2008 recessions than they did in previous downturns. Studies confirm that state tax revenues became more sensitive to business cycle fluctuations in the past decade.[90] On average, every one percentage point change in a state's real per capita income elicited a 1.8 percentage point change in its real per capita tax revenues.[91] Such volatility has produced deeper public service cuts during recessions, lengthened the amount of time needed to

87. *See* ORG. FOR ECON. COOPERATION AND DEV., REVENUE STATISTICS: TAX REVENUE AS A PERCENTAGE OF GDP (2017), https://stats.oecd.org/Index.aspx?DataSetCode=REV [https://perma.cc/WK6W-XC2Z].

88. *Id.*

89. *See* GØSTA ESPING-ANDERSEN, THE THREE WORLDS OF WELFARE CAPITALISM 27-28 (1990); Emanuele Ferragina & Martin Seeleib-Kaiser, *Welfare Regime Debate: Past, Present, Futures?*, 39 POL'Y & POL. 583, 584-85 (2011); Paul Pierson, *Coping with Permanent Austerity: Welfare State Restructuring in Affluent Democracies*, 43 REVUE FRANÇAISE DE SOCIOLOGIE 369, 388-92 (2002); Abby Jackson, *Finland Has One of the World's Best Education Systems. Here's How It Compares to the US*, WORLD ECON. F. (Nov. 21, 2016), https://www.weforum.org/agenda/2016/11/finland-has-one-of-the-worlds-best-education-systems-four-ways-it-beats-the-us [https://perma.cc/NJ8F-LE7A].

90. *See, e.g.*, Gary C. Cornia & Ray D. Nelson, *State Tax Revenue Growth and Volatility*, 6 FED. RES. BANK ST. LOUIS REG'L ECON. DEV. 23, 27-30 (2010); Timothy Schiller, *Riding the Revenue Roller Coaster: Recent Trends in State Government Finance*, FED. RES. BANK OF PHILA. BUS. REV. 23 (Quarter 1 2010); Yolanda Kodrzycki, *Smoothing State Tax Revenues Over the Business Cycle: Gauging Fiscal Needs and Opportunities* 1 (Fed. Res. Bank of Bos,, Working Paper No. 14-11, 2014), https://www.bostonfed.org/publications/research-department-working-paper/2014/smoothing-state-tax-revenues-over-the-business-cycle-gauging-fiscal-needs-and-opportunities.aspx [https://perma.cc/N8SV-2QQ3].

91. *See* Kodrzycki, *supra* note 90, at 17 (examining trends from 2000 to 2012).

restore program funding, and impaired leaders' ability to plan for the future.[92]

Probing the mystery of states' long-run disinvestment therefore prompts deeper questions about their tax policy choices. The data show that stagnant and volatile tax revenue has constrained states' ability to fund public programs, especially as these programs have become more expensive. To get at the roots of these problems, legal scholars need to answer two specific questions. First, *how have changing tax institutions led to increasingly slow and unstable revenue growth in the past four decades?* And second, *why did this mismatch between states' tax laws and their economies arise in the first place?*

B. A Gap in Legal Scholarship

Legal scholars have yet to closely investigate these problems. While there has been some research on the origins of tax structures, much of it has remained confined to federal law. Legal writing examining state institutions has focused on the prospective economic effects of reform proposals. This opens a space to investigate both how tax laws have produced unreliable revenue growth and which political forces have pushed them in that direction.

Most tax experts who have addressed long-term revenue erosion have focused on the federal landscape. In a landmark study, Michael Graetz and Ian Shapiro explained how a group of conservative reformers waged a thirty-year campaign to repeal the estate tax.[93] In more recent work, Graetz has called for the United States to simplify its tax code and stabilize revenue by adopting a value-added tax (VAT), like the kind found throughout Europe.[94] Eric Zolt has urged federal lawmakers to update tax institutions to account for mounting income and wealth inequality.[95] Finally, Anne Alstott has shown the need to alter fiscal policy in ways that

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92. *See* Tucker Staley, *The Effect of TELs on State Revenue Volatility: Evidence from the American States*, 35 PUB. BUDGETING & FIN. 29, 30, 32 (2015).

93. *See e.g.*, MICHAEL J. GRAETZ & IAN SHAPIRO, DEATH BY A THOUSAND CUTS (2006).

94. *See* Michael J. Graetz, *VAT as the Key to Real Tax Reform*, *in* THE VAT READER: WHAT A FEDERAL CONSUMPTION TAX WOULD MEAN FOR AMERICA 112 (Tax Analysts, 2011).

95. *See* Eric M. Zolt, *Inequality in America: Challenges for Tax and Spending Policies*, 66 TAX L. REV. 641, 641 (2013).

accurately reflect changing poverty demographics[96] and family configurations.[97]

For the most part, scholars have not similarly explored the legal and political changes responsible for states' budget woes. Kirk Stark is one of the few authors who has embarked on such a project. In a seminal paper, he unearthed federal laws that have precluded states from controlling revenue volatility.[98] Stark outlined a series of conformity incentives, subsidies, statutes, and judicial decisions that have prevented legislatures from enacting desirable reforms.[99] However, even this work did not examine state legal distortions untethered to federal policy.

Stark's piece has also proven the exception to the trend in state tax law scholarship. Most work in this arena has begun with a discrete defect in a state's tax system and elaborated forward-looking reforms intended to cure it. Rather than look back at how a range of intertwined legal structures evolved to promote an ongoing fiscal crisis, this research has built on economic theory to help lawmakers strengthen future state budgets.

In a separate article co-authored with Brian Galle, for instance, Stark proposed policies to help states save the money needed to weather recessions.[100] Noting the weaknesses of many states' rainy-day funds, their paper outlined federal legal reforms designed to boost state contributions and limit unnecessary withdrawals during boom periods.[101] Galle and Stark clearly acknowledged the revenue volatility that states grapple with at the start of their article. Nonetheless, they centered their analysis on policy proposals that economics suggests could boost government saving down the road.

David Gamage has also tackled state-level concerns using economic principles. In a 2010 article, Gamage highlighted the threat that slow and unstable revenues pose for states' prosperity.[102] Using risk allocation

96. *See* Anne L. Alstott, *Why the EITC Doesn't Make Work Pay*, 73 L. & CONTEMP. PROBS. 285, 287-88 (2010).

97. *See* Anne L. Alstott, *Updating the Welfare State: Marriage, the Income Tax, and Social Security in the Age of Individualism*, 66 TAX L. REV. 695, 695 (2013).

98. *See* Kirk J. Stark, *The Federal Role in State Tax Reform*, 30 VA. TAX REV. 407, 431 (2010).

99. *Id.* at 423-30.

100. *See* Brian Galle & Kirk J. Stark, *Beyond Bailouts: Federal Tools for Preventing State Budget Crises*, 87 IND. L.J. 599, 602 (2012).

101. *Id.* at 619-42.

102. *See* David Gamage, *Preventing State Budget Crises: Managing the Fiscal Volatility Problem*, 98 CALIF. L. REV. 749, 751 (2010).

theory—which focuses on how economic actors can most effectively spread risk—he encouraged lawmakers to confront instability by adjusting broad-based tax rates.[103] Gamage explained that such rates distribute risk better than cuts to services because they target wealthy residents who can absorb their costs.[104] Like his research on state efforts to tax e-commerce,[105] however, this prospective lens left open the question of which dynamics generated stagnant tax receipts to begin with

Following a similar mold, UC Davis law professor Darien Shanske has proposed that states stabilize revenues by reviving the property tax.[106] In a 2014 study, he underlined that property taxes withered in the last half-century as states restricted their rates and let them fall out of step with the economy.[107] He thereby outlined a detailed reform plan based on withholding for individuals paying property tax on residential land.[108] Like the proposals Stark and Gamage put forward, Shanske's analysis primarily explored the lessons that economic theory holds for aspiring tax reformers.

These studies are rich in policy prescriptions and have made valuable additions to the field. From an empirical perspective, however, this scholarship has left the two foregoing questions largely unanswered: *which legal changes (or lack thereof) engendered stagnant and erratic state revenues in the past 40 years? Furthermore, why did states' tax laws evolve in such a way to begin with?*

Other disciplines have tried to grapple with these problems. As Section IV of this paper describes in more detail, social scientists have started to interrogate the relationship between taxation and social change. Fiscal sociologists, in particular, have trained their sights on the ways in which tax systems have shaped poverty and inequality.[109] Yet even this

103. *Id.*

104. *Id.*

105. *See* David Gamage & Devin J. Heckman, *A Better Way Forward for State Taxation of E-Commerce*, 92 B.U. L. REV. 483, 497-516 (2012).

106. *See* Darien Shanske, *Revitalizing Local Political Economy Through Modernizing the Property Tax*, 68 TAX L. REV. 143 (2014).

107. *Id.* at 144.

108. *Id.* at 154-58.

109. *See, e.g.*, ISAAC WILLIAM MARTIN, THE PERMANENT TAX REVOLT: HOW THE PROPERTY TAX TRANSFORMED AMERICAN POLITICS 1-25 (2008); ISAAC WILLIAM MARTIN, RICH PEOPLE'S MOVEMENTS: GRASSROOTS CAMPAIGNS TO UNTAX THE ONE PERCENT (2013). *See generally* Isaac William Martin & Monica Prasad, *Taxes and Fiscal Sociology*, 40 ANN. REV. SOC. 331 (2014) (reviewing contributions of "fiscal sociology" research to the study of poverty and inequality).

scholarship remains in its infancy.[110] It has also mainly focused on nations or on comparisons between them, rather than on sub-national entities such as U.S. states. Researchers therefore still have much to learn about states' tax histories.

Legal scholars have important contributions to make to these debates. As is true of all facets of capitalist markets,[111] tax structures and the outcomes they engender are the product of laws—including state-level statutes, regulations, ballot measures, and court decisions. These legal institutions order the economies around which state budgets are built. Because tax laws are operationalized and enforced through government power, legal scholars are also uniquely positioned to identify the sites where political actors contest this authority.

The next two sections are designed to help legal thinkers wade into these areas. Specifically, they draw on existing work in political science, sociology, and economics to hypothesize (1) which tax institutions played a role in limiting state revenue over the past forty years and (2) which political forces did the most to bring this change about. The hope is that legal scholars can use these insights as the basis for more wide-ranging historical studies of particular states, time periods, and tax policies—and provide lawmakers with concrete reform ideas along the way.

III. The Legal Institutions at the Heart of States' Revenue Woes

In order to uncover the causes of states' long-run budget crises, legal scholars must first grasp which tax institutions contributed to slow and unstable revenue growth in the past forty years. Recent work in economics suggests possible answers. As numerous studies have noted, both states' tax codes and the social environments in which they lie have significantly transformed in recent decades. At least four legal shifts stand out: (1) rising Tax and Expenditure Limitations (TELs) and Super-Majority Requirements (SMRs); (2) withering sales tax regimes; (3) eroding corporate tax bases; and (4) multiplying tax expenditures. Becoming familiar with these policy changes will allow legal researchers to test their importance across particular states, time periods, and budget areas. Furthermore, once analysts have a clear sense of these shifts, they can they turn their attention to the political forces that set them in motion.

110. *See* Martin & Prasad, *supra* note 109, at 332.

111. *See* David Singh Grewal, *The Laws of Capitalism*, 128 HARV. L. REV. 626, 652 (2014) (reviewing Thomas Piketty's *Capital in the Twenty-First Century*).

A. The Rise of TELs & SMRs

Over the past thirty years, TELs and SMRs have radically altered states' fiscal landscapes. TELs attempt to limit tax revenue or spending growth by linking it to an external indicator, such as state income growth.[112] SMRs require a supermajority (often two-thirds or more) for a legislature to approve tax increases.[113] Beginning in the 1970s, a nationwide "tax revolt" propelled these restrictions into law across most states.[114] Seventeen states adopted local government TELs between just 1970 and 1976.[115] Similarly, sixteen states enacted state government TELs in the four years after 1977.[116] Today, forty-six states feature some form of local government TEL,[117] thirty possess state government TELs, and another fifteen have SMRs in place.[118]

These limits come in a range of forms. As the National Conference on State Legislatures has pointed out, "no two TELs are exactly alike . . . [and] they vary considerably in design, scope and restrictiveness."[119] Though some state government TELs constrain both revenues and expenditures, many focus on just one or the other.[120] About half of these provisions lie embedded in state constitutions; the rest are statutory in nature.[121] Meanwhile, local government TELs exhibit an even more dizzying array of characteristics. Experts have generally regrouped them into seven categories: property tax rate limits that apply to all local governments; property tax rate limits that apply to specific types of local government; property tax levy limits; general revenue increase limits; general

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112. *See* Robert B. Archibald & David H. Feldman, *State Higher Education Spending and the Tax Revolt*, 77 J. HIGHER EDUC. 618, 618 (2006).

113. *Id.*

114. MARTIN, THE PERMANENT TAX REVOLT, *supra* note 109, at 1-25.

115. *See* Daniel R. Mullins & Bruce A. Wallin, *Tax and Expenditure Limitations: Introduction and Overview*, 24 PUB. BUDGETING & FIN. 2, 3-6 (2004).

116. *See* Archibald & Feldman, *supra* note 112, at 621.

117. *See* Mullins & Wallin, *supra* note 115, at 3.

118. *See* Bert Waisanen, *State Tax and Expenditure Limits* (Nat'l Conf. of State Leg., 2010), http://www.ncsl.org/research/fiscal-policy/state-tax-and-expenditure-limits-2010.aspx [https://perma.cc/R5GJ-KANZ].

119. *Id.*

120. *See* Mullins & Wallin, *supra* note 115, at 10.

121. *See* Waisanen, *supra* note 118.

expenditure increase limits; limits on assessment increases; and full disclosure (or "truth in taxation") laws.[122]

Understanding how and why these rules were implemented is important because they have significant real-world effects on state budgets. While these rules' diversity has made them difficult to study, evidence has increasingly suggested that they depress state revenues. Research conducted shortly after the first TELs came into force tended to conclude that they had little impact.[123] But as these laws' numbers and longevity have risen, scholars have demonstrated their influence. Harold Elder has revealed that TELs have a negative effect on tax revenue growth after controlling for a range of economic and demographic factors.[124] Using panel data for the years between 1969 and 1994, Dale Bails and Maggie Tieslau have further shown that expenditures remain lower in states with TELs than in those without them.[125] Robert B. Archibald and David H. Feldman have also found that TELs and SMRs enacted in the past fifty years have had "significant adverse effects on state appropriations" for discretionary programs, namely public higher education.[126]

Interestingly, local government TELs seem to have a particularly harsh impact on *states'* fiscal fortunes. The U.S. Advisory Commission on Intergovernmental Relations has noted that localities rely on large infusions of state aid for education and infrastructure once TELs come into law.[127] States, in turn, end up with less room in their budgets for other services. California provides an instructive case. When residents voted to cap property taxes and assessment-rate increases in 1978 by passing the now-infamous "Proposition 13," local governments lost around $7 billion

122. *See* Mullins & Wallin, *supra* note 115, at 6; *see also* Philip G. Joyce & Daniel R. Mullins, *The Changing Fiscal Structure of the State and Local Public Sector: The Impact of Tax and Expenditure Limitations*, 51 PUB. ADMIN. REV. 240, 240 (1991).

123. *See e.g.*, Burton A. Abrams & William R. Dougan, *The Effects of Constitutional Restraints on Governmental Spending*, 49 PUB. CHOICE 101, 111 (1986); Dale G. Bails, *The Effectiveness of Tax-Expenditure Limitations: A Re-evaluation*, 49 AM. J. ECON. & SOC. 223, 235 (1990); James Cox & David Lowery, *The Impact of the Tax Revolt Era State Fiscal Caps*, 71 SOC. SCI. Q. 492, 506-07 (1990).

124. *See* Harold W. Elder, *Exploring the Tax Revolt: An Analysis of the Effects of State Tax and Expenditure Limitation Laws*, 20 PUB. FIN. Q. 47, 60 (1992).

125. *See* Dale G. Bails & Margie A. Tieslau, *The Impact of Fiscal Constitutions on State and Local Expenditures*, 20 CATO. J. 255, 270 (2000).

126. Archibald & Feldman, *supra* note 112, at 641.

127. *See* U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, TAX AND EXPENDITURE LIMITS ON LOCAL GOVERNMENTS 58-59 (1995), http://digital.library.unt.edu/ark:/67531/metadc1198 [https://perma.cc/S57X-QKZ8].

in revenue.[128] State legislators quickly stepped in with emergency grants to prevent the most severe municipal cuts.[129] When these proved inadequate, however, voters passed a proposition mandating that close to 40% of the state budget go to K–12 schools each year—significantly diminishing discretionary funds available for other areas, such as higher education and public assistance.[130]

TELs may also indirectly decrease revenue by dampening economic progress on a broader scale. Taking care to correct for statistical limitations in previous studies,[131] Steven Deller, Judith Stallman, and Lindsay Amiel have explored TELs' impact using a growth rate model for all fifty states covering the period between 1969 and 2005.[132] Their "results provide strong evidence that the imposition of increasingly more restrictive TELs on either state and/or local governments has a negative impact on economic growth."[133]

Finally, recent research has suggested that TELs aggravate revenue volatility. As Mathew D. McCubbins and Ellen Moule have pointed out, localities suffered worse post-recession revenue declines in recent decades after TELs forced them to substitute unstable income levies for lost property taxes.[134] Tucker Staley has similarly noted a correlation between more stringent TELs and state revenue instability, after controlling for a range of economic and political factors.[135]

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128. *See* ALBERT J. LIPSON & MARVIN LAVIN, POLITICAL AND LEGAL RESPONSES TO PROPOSITION 13 IN CALIFORNIA 1 (RAND Corp., R-2483-DOJ, 1980), www.dtic.mil/cgi-bin/GetTRDoc?AD=ADA511800 [https://perma.cc/W27F-2AJV].

129. *See* Nirupama Jayaraman, *School Finance in California and the Proposition 98 Guarantee*, CAL. BUDGET & POL'Y CTR. 2 (2006), http://calbudgetcenter.org/wp-content/uploads/0604_prop98.pdf [https://perma.cc/3B63-298E].

130. *Id.* at 2-3; *see also* CALIFORNIA LEGISLATIVE ANALYST'S OFFICE, PROPOSITION 98 PRIMER (Feb. 2005), https://lao.ca.gov/2005/prop_98_primer/prop_98_primer_020805.htm.

131. *See* Steven Deller & Judith I. Stallmann, *Tax and Expenditure Limitations and Economic Growth*, 90 MARQ. L. REV. 497 (2007); Judith I. Stallmann & Steven Deller, *Impacts of Local and State Tax and Expenditure Limits on Economic Growth*, 17 APPLIED ECON. LETTERS 645 (2010).

132. *See* Steven Deller, Judith I. Stallmann & Lindsay Amiel, *The Impact of State and Local Tax and Expenditure Limitations on State Economic Growth*, 43 GROWTH & CHANGE 56, 65 (2012).

133. *Id.* at 79-80.

134. *See* Mathew D. McCubbins & Ellen Moule, *Making Mountains of Debt Out of Molehills: The Pro-Cyclical Implications of Tax and Expenditure Limitations*, 63 NAT'L TAX J. 603, 604 (2010).

135. *See* Staley, *supra* note 92, at 42.

B. Disappearing Sales Tax Revenue

In addition to imposing revenue restrictions, states have failed to counteract shrinking sales tax bases. Sales tax receipts make up about one-third of tax revenue in most states.[136] As such, their deterioration has significantly impaired revenue growth in the past half-century. On average, the sales tax base fell from 55% of personal income in 1970 to just 35% in 2010.[137]

This shift appears to bear substantial responsibility for heightened revenue volatility. Sales taxes have proven a far more stable source of revenue than income taxes over time.[138] However, in the past three decades, sales tax receipts have progressively lost ground to income levies. While general sales tax revenue inched from 31.5% to 31.9% of total tax receipts between 1980 and 2010, the proportion of revenue derived from personal income taxes rose from 27.1% to 33.6%.[139] Had states prevented the erosion of their sales tax bases, they would have limited income tax revenues' relative growth and the instability that accompanied it.

Public finance scholar David Sjoquist has tied eroding sales tax revenue to three legal challenges.[140] First, states' sales taxes have continued to exclude nearly all service purchases. This omission has proven increasingly important as the economy has transitioned away from heavy industry. According to the Bureau of Economic Analysis, services rose from 52.6% to 63.3% of total consumption expenditures between 1980 and 2011.[141] State sales taxes have therefore been "applied to a smaller share of consumer purchases."[142]

Second, states have multiplied the number of sales tax exemptions allowed in their codes. As Sjoquist has noted, "[w]hen sales taxes were first adopted, exemptions were generally restricted to goods and materials that were used as inputs in manufacturing process[es] . . . ."[143] However, in the past three decades, states have eagerly added one exemption after another

136. *See* STATE BUDGET CRISIS TASK FORCE, *supra* note 14, at 46.

137. *See id.*

138. *See* Cornia & Nelson, *supra* note 90, at 33.

139. *See* David L. Sjoquist, *State Tax Structures: Past Trends, Future Possibilities*, *in* SUSTAINING THE STATES: THE FISCAL VIABILITY OF AMERICAN STATE GOVERNMENTS 56 (Marilyn Marks Rubin & Katherine G. Willoughby eds., 2015).

140. *Id.* at 67-71.

141. *Id.* at 67.

142. *Id.* at 68.

143. *Id.*

to placate businesses, particularly those in the agricultural and energy sectors.[144]

Third, until recently, states mostly found themselves unable to take advantage of rising online sales. The Supreme Court's 1992 ruling in *Quill Corporation v. North Dakota* held that states could only force vendors who have a physical presence within their borders to collect sales and use taxes.[145] As tax scholar Kirk Stark has emphasized, for decades, the "practical effect of this rule [was] to carve out an area of tax-free consumption via mail-order and internet purchases."[146] Recent estimates have shown that this loophole cost states over $20 billion in uncollected sales tax revenue each year.[147]

Some states tried to scale this hurdle by enacting statutes that broadly interpreted the physical presence requirement. These laws took "a number of forms, such as imputing physical presence when a remote vendor ha[d] sales affiliates within a state or attributing physical presence whenever a remote vendor license[d] trademarks to an in-state firm."[148] In the face of aggressive litigation, however, such legislation proved difficult to enforce.[149] Moreover, as recently as 2012, fewer than a third of U.S. states actually had such laws on the books.[150]

Fortunately for states, in June 2018, the U.S. Supreme Court reversed *Quill* in *South Dakota v. Wayfair, Inc.*[151] Writing for the Court, Justice Kennedy stressed that "[m]odern e-commerce does not align analytically with a test that relies on the sort of physical presence defined in *Quill*."[152] He also admonished the *Quill* rule as an "extraordinary imposition by the Judiciary on States' authority to collect taxes and perform critical public functions."[153]

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144. *Id.*

145. 504 U.S. 298 (1992).

146. Stark, *supra* note 98, at 430.

147. *See* Leachman & Johnson, *supra* note 15, at 5.

148. Gamage & Heckman, *supra* note 105, at 484-85.

149. *See* ERIKA K. LUNDER & CAROL A. PETTIT, CONG. RES. SERV., R42629, "AMAZON LAWS" AND TAXATION OF INTERNET SALES: CONSTITUTIONAL ANALYSIS 6-9 (2015), https://www.fas.org/sgp/crs/misc/R42629.pdf [https://perma.cc/C3XL-QS9Z].

150. *See* Donald Bruce et al., *E-Tailer Sales Tax Nexus and State Tax Policies*, 68 NAT'L TAX J. 735, 749 (2015).

151. 138 S. Ct. 2080 (2018).

152. *Id.* at 2095.

153. *Id.*

It is still too early to tell exactly how states will react to *Wayfair*. Many lawmakers eagerly awaited the ruling to tax online retailers whose transactions in their states exceed a certain threshold.[154] However, Justice Kennedy was careful to reiterate that the Dormant Commerce Clause prevents states from discriminating against interstate commerce.[155] Exactly what such non-discrimination requires will likely form the basis of future court challenges. In the meantime, both states' policy experimentation and companies' desire to shape how these taxes are structured should provide fruitful areas for real-time research.

C. Eroding Corporate Tax Revenue

States' corporate tax revenues have also contracted in the past three decades. Average corporate income tax revenue declined from 9.7% to 5.2% of states' total tax hauls between 1980 and 2010.[156] Strikingly, corporate income tax revenue nearly halved as a proportion of the American economy in this period, from $6 to just $3 per $1,000 of personal income.[157] Legal structures have again stood at the heart of this trend. As Michael Leachman and Nicholas Johnson have stressed, "[s]tate tax laws do not reflect the reality of current corporate structures."[158]

Three sets of legal institutions stand out. First, corporations have taken advantage of existing classifications to minimize their tax burdens. Many smaller entities have chosen to operate as S-Corporations and Limited Liability Companies rather than as C-Corporations.[159] This has

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154. *See* Paul Graney, Opinion, *States Will Move Quickly to Capture More Sales Tax in Wake of Wayfair Ruling*, MARKETWATCH (June 22, 2018, 1:12 PM), https://www.marketwatch.com/story/states-will-move-quickly-to-capture-more-sales-tax-in-wake-of-wayfair-ruling-2018-06-22 [https://perma.cc/6WKU-GNZ6]; David Casper, Laura Robichaud & Sonya Storm, *States Respond to SCOTUS Wayfair Decision*, EIDE BAILLY, LLP (Sept. 24, 2018), https://www.eidebailly.com/insights/articles/2018/7/states-respond-to-scotus-wayfair [https://perma.cc/V2ZM-VUQL].

155. *See Wayfair*, 138 S. Ct. at 2091. Justice Kennedy also looked particularly favorably upon South Dakota's safe harbor for businesses that transact with the state in a limited manner; ban on retroactive applications of the sales tax; and participation in a multi-state agreement that standardizes tax rules so as to reduce companies' compliance costs. *Id.* at 2099-100. Whether these or other elements will come to be seen as minimum requirements for a constitutional sales tax on e-commerce remains to be decided.

156. *See* Sjoquist, *supra* note 139, at 56.

157. *Id.* at 71.

158. Johnson & Leachman, *supra* note 15, at 6.

159. Sjoquist, *supra* note 139, at 71-72.

allowed them to pass profits through to their owners and ensure that they are only subject to personal income taxation. Similarly, firms have sought to both convert business income to non-business income for tax purposes and establish subsidiaries that shield their parent companies from state levies.[160] State governments have largely stood by as corporations have made these changes.[161]

Second, states have multiplied the tax breaks they provide corporations in a push to create "business-friendly" climates.[162] The Upjohn Institute has estimated that states roughly tripled their business incentives from 1990 to 2015.[163] Though these tax breaks' exact quantity is hard to pin down, they have had clear effects: on average, states' real corporate tax rate has decreased by approximately one-third since the 1980s.[164]

Finally, federal statutes have circumscribed states' taxing authority. Since 1959, Public Law 86-272 has limited the scope of state corporate income taxes.[165] The law "restricts a state from imposing a net income tax . . . if the only business activity of the company within the state consists of the solicitation of orders for sales of tangible personal property . . . filled by shipment or delivery from a point outside of the state."[166] As tax scholar Kirk Stark has underlined, uncertainty regarding what qualifies as a "net income tax" has prevented states from adopting value-added taxes that would bolster their revenue streams.[167] Public Law 86-272 has thus effectively diminished state revenue levels and stability.

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160. *Id.*

161. *Id.*

162. *Id.*

163. *See* Timothy J. Bartik, *A New Panel Database on Business Incentives for Economic Development Offered by State and Local Governments in the United States*, W.E. UPJOHN INST. FOR EMP. RES. 3, 65 (Feb. 2017), http://www.upjohn.org/models/bied/maps/ReportFinal.pdf [https://perma.cc/ZYH7-F535].

164. *See* William F. Fox & LeAnn Luna, *State Corporate Tax Revenue Trends: Causes and Possible Solutions*, 55 NAT'L TAX J. 491, 495 (2002).

165. *See* Stark, *supra* note 98, at 427-29.

166. MULTISTATE TAX COMM'N, STATEMENT OF INFORMATION CONCERNING PRACTICES OF MULTISTATE TAX COMMISSION AND SIGNATORY STATES UNDER PUBLIC LAW 86-272, at 1 (2001), http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/StatementofInfoPublicLaw86-272.pdf [https://perma.cc/Y759-BQM6].

167. *See* Stark, *supra* note 98, at 429.

D. Multiplying Tax Expenditures

Last but not least, states have increasingly used tax expenditures to achieve their policy goals. Tax expenditures regroup the exclusions, deductions, deferrals, exemptions, credits, and preferential rates in states' tax codes. Because these fiscal levers remove potential revenue from state coffers, their multiplication over the past thirty years has reduced states' tax receipts. These laws' especially low visibility has concealed this revenue drain.

While tax preferences have long existed, the modern concept of tax expenditures only gained steam after Stanley Surrey and Lawrence Woodworth published a review of the federal tax code in 1969.[168] As Christopher Howard's seminal studies have shown, federal tax expenditures became a primary fiscal tool from that point onward, generating a "hidden welfare state" that escaped public scrutiny and the political pressures that usually influence social policy.[169] Congress's embrace of these laws in the 1970s and 1980s put a robust tax expenditure ecosystem in place. In fiscal year 2015, 169 different expenditures in the federal tax code caused the federal government to forego $1.2 trillion in tax revenue—the equivalent of about one-third of the federal budget.[170]

States have eagerly followed the U.S. government's lead. States now spend tens of billions of dollars on tax expenditures each year.[171] In many states, these provisions account for nearly *half* of all public outlays.[172] Unfortunately, like at the national level, the breadth and depth of states' tax expenditures remain poorly understood. As public policy analysts Jason Levitis, Nicholas Johnson, and Jeremy Koulish have stressed, "[t]ax expenditures usually receive far less scrutiny [than does direct spending]. For the most part, policymakers do not regularly examine tax

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168. *See* Julian E. Zelizer, *The Hidden Welfare State: Tax Expenditures and Social Policy in the United States*, 74 BUS. HIST. REV. 166, 166 (2000) (book review).

169. *See e.g.*, CHRISTOPHER HOWARD, THE HIDDEN WELFARE STATE: TAX EXPENDITURES AND SOCIAL POLICY IN THE UNITED STATES (1997).

170. *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-16-622, TAX EXPENDITURES 1 (2016), https://www.gao.gov/assets/680/678262.pdf [https://perma.cc/QU88-2LLC].

171. *See* Jason Levitis, Nicholas Johnson & Jeremy Koulish, *Promoting State Budget Accountability Through Tax Expenditure Reporting*, CTR. ON BUDGET & POL'Y PRIORITIES 1 (Apr. 2009), https://www.cbpp.org/sites/default/files/atoms/files/4-9-09sfp.pdf [https://perma.cc/PNS2-PVHN].

172. *Id.*

expenditures, nor do states document their effectiveness the same way they do for on-budget expenditures."[173]

Evidence from individual states confirms that tax expenditures have altered revenue flows in dramatic, yet under-appreciated ways. Virginia provides a useful example. Between 1990 and 2009, the state created or amended more than sixty different tax expenditure programs.[174] By the end of this period, these laws were costing the state $2.5 billion a year.[175] About half of this amount stemmed from the repeal of an unpopular vehicle levy rather than from targeted social policy.[176] This "car tax" repeal represented little more than a giveaway by a governor who wished to curry favor with his constituents.[177] In a state that has chronically faced deficits of up to $1.5 billion in recent years,[178] decisions like this one have proven more destabilizing than supporters likely anticipated.

Indeed, the lawmakers who implement these kinds of rules have only a vague sense of how expensive they really are. As the Commonwealth Institute has pointed out, "[l]ittle evaluation of tax expenditures occurs in Virginia. The state does not regularly report on tax expenditures in any comprehensive way or subject proposed new expenditures to standard criteria that might determine whether adopting one is good policy."[179] Tax expenditures' obscure nature makes it especially important that scholars study these laws in the coming years.

E. A New Baseline from Which to Study States' Tax Histories

In sum, economists have begun to develop a clear view of states' evolving tax regimes. Over the past four decades, surging TELs and SMRs,

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173. *Id.*

174. *See* Michael Cassidy & Sara Okos, *A Drop in the Bucket? Assessing the High Cost of Virginia Tax Expenditures*, COMMONWEALTH INST. 2 (Nov. 2009), http://www.thecommonwealthinstitute.org/wp-content/uploads/2011/08/091109_drop_in_the_bucket_REPORT.pdf [https://perma.cc/N3HZ-MBY8].

175. *Id.*

176. *Id.* at 10-11.

177. DAVID BRUNORI, STATE TAX POLICY: A PRIMER 43-44 (4th ed. 2016).

178. *See, e.g.*, Ryan Butler, *Virginia Legislators Face $1 Billion Budget Shortfall*, LOUDON TRIB. (Jan. 11, 2017), https://www.loudountribune.com/virginia-legislators-face-1-billion-budget-shortfall/ [https://perma.cc/D4Q2-3XR7]; Nick Iannelli, *Va. Gov. McAuliffe to Announce Actions on Budget Shortfall*, WTOP (Oct. 13, 2016), https://wtop.com/virginia/2016/10/va-gov-mcauliffe-announce-actions-budget-shortfall/ [https://perma.cc/SKU8-MLYH].

179. Cassidy & Okos, *supra* note 174, at 2.

shrinking sales and corporate tax bases, and multiplying tax expenditures have both constrained state tax revenues and heightened their volatility. Though there is little doubt that this list is non-exhaustive—and that legal scholars will need to identify further causes of revenue stagnation—it provides a starting point from which to dissect the history of states' budgets.

The analytical categories outlined above remain fluid and intertwined. Tax expenditures, for instance, have played a large role in diminishing corporate tax receipts. By curbing lawmakers' ability to align tax codes with socioeconomic advances, TELs have likely also contributed to disappearing levies on consumer transactions.

Nonetheless, these groupings provide a useful heuristic through which to begin examining states' shifting political economies. By probing these areas in comparative and historical perspective, legal scholars can rigorously test how institutions have changed over time, how they have combined to alter particular states' fiscal fortunes, and whether some laws have held more sway than others across the nation. Furthermore, these categories offer a baseline from which to answer the second question vital to tracing the origins of slow revenue growth and public service retrenchment: why legislators designed state tax structures in a way that generated negative outcomes to begin with.

IV. The Political Determinants of Legal Change

Chronicling which institutions have transformed only partially solves the mysteries of the Retrenchment Age described earlier. In order to make sense of unreliable revenue growth and propose meaningful reforms, law and political economy scholars should also ask *why* tax systems developed in ways that fostered suboptimal results.

An emerging group of theorists has offered a framework geared toward these problems. As political parties have become more polarized and unresponsive to majorities' needs, researchers have moved away from models premised on median voters' preferences.[180] They have instead sought to make sense of change by placing contested *policies* at the center of their analysis—policies like the tax institutions outlined in the prior section.[181]

By honing in on specific tax arrangements that have produced inadequate state revenue, scholars can identify both the political actors

180. *See* Martin Gilens & Benjamin I. Page, *Testing Theories of American Politics: Elites, Interest Groups, and Average Citizens*, 12 PERSP. ON POL. 564 (2014).

181. *See* Jacob S. Hacker & Paul Pierson, *After the "Master Theory": Downs, Schattschneider, and the Rebirth of Policy-Focused Analysis*, 12 PERSP. ON POL. 643 (2014).

who shaped their configuration and the reasons for which they did so. Existing evidence suggests that anti-tax interest groups both pushed for tax cuts and prevented elected officials from revising tax laws to reflect new social arrangements. Scholars will need to further test this hypothesis across particular states and time periods in the coming years.

A. *Policy as a Contested Arena*

According to political scientists Jacob Hacker and Paul Pierson, policy defines politics because it forms the prize over which different interests compete.[182] Policy can confer substantial advantages on particular groups and individuals. It can also threaten others' very existence. As such, "the institutional terrain established by significant public policies has a powerful impact on structures of political organization."[183] Focusing on the laws that undergird a policy—and the outcomes these laws mold—can expose "who organizes, how they organize," and why they organize.[184]

Fiscal policy is a highly desirable prize. As noted above, tax preferences provide billions of dollars each year to the people they benefit. Groups that secure lower tax rates in areas that concern them stand to retain more of their earnings. Politically-savvy actors therefore have a great interest in shaping tax laws like those described in the last section in ways that maximize their gains.

B. *The Power of Interest Groups*

According to this "policy-focused" strand of political science, interest groups are the actors best positioned to guide political change.[185] Navigating legislative and bureaucratic rulemaking demands broad sophistication. As Hacker and Pierson have shown, sustaining activity over the long periods needed to attain policy victories "requires the capacity to overcome collective action problems, mobilize resources, coordinate actions with others, develop extensive expertise, . . . and operate flexibly across multiple domains of political authority."[186] These are not often characteristics associated with individuals. Rather, "[t]hey are the comparative strength of organized interests."[187]

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182. *Id.* at 648.

183. *Id.* at 647.

184. *Id.*

185. *Id.* at 644-52.

186. *Id.* at 649.

187. *Id.*

Existing research suggests that interest groups have played a key role in reconfiguring state revenue institutions. As Isaac Martin has revealed, the movement that swept TELs into law across the country in the 1970s benefited from decades of well-funded opposition to taxes.[188] Martin has traced the efficiency with which states adopted revenue restrictions to a network of groups created to rally for a repeal of the Sixteenth Amendment, which gave Congress broad powers to levy an income tax.[189] The first of these groups formed in response to the Revenue Act of 1935, which increased income taxes on the wealthy to help pay for the New Deal.[190] By the 1960s, organizations such as the National Committee for Economic Freedom (NCEF) and the National Taxpayers Union (NTU) operated full-fledged campaigns to limit governments' tax authority.[191] While the 1970s tax revolt was rooted in local fears that rising property taxes would force people out of their homes,[192] this pre-existing web of anti-tax activists, donors, and lawmakers helped inspire the movement's rise and spread its message across the nation.[193]

Today, a wide array of state-based organizations promotes an agenda centered on tax cuts. Alexander Hertel-Fernandez and Theda Skocpol have shown that right-wing policy entrepreneurs rely on three resource-rich groups to pass new laws.[194] First, a cluster of think tanks associated with the State Policy Network (SPN) generates studies and opinion pieces that advocates can point to when pushing a bill.[195] Second, campaign operatives paid by Americans for Prosperity (AFP) sponsor forums, rallies, and television ads to mobilize public support for their cause.[196] Third, the American Legislative Exchange Council (ALEC) prepares model legislation and deploys lobbyists to sway lawmakers to vote its way.[197]

These groups appear to have achieved considerable success in shaping tax policy in recent years. As ALEC's 2015 *Rich States, Poor States* survey

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188. *See* MARTIN, RICH PEOPLE'S MOVEMENTS, *supra* note 109.

189. *Id.*

190. *Id.* at 68-79.

191. *Id.* at 146-48, 157-60.

192. *Id.* at 165.

193. *Id.* at 164-80.

194. *See* Alexander Hertel-Fernandez & Theda Skocpol, *How the Right Trounced Liberals in the States*, 39 DEMOCRACY (2016), http://democracyjournal.org/magazine/39/how-the-right-trounced-liberals-in-the-states [https://perma.cc/NPW5-Q6K6].

195. *Id.*

196. *Id.*

197. *Id.*

reported, "14 . . . states reduc[ed] their tax burdens in the 2014 legislative session. This trend continued in 2015, with governors proposing many . . . tax and fiscal policy reforms . . . and many states successfully acting on those proposals."[198] Scholars need to more closely explore how these groups may have altered individual states' fiscal fortunes. Future studies should also pinpoint the kinds of tax laws upon which these groups have centered their efforts.

C. The Politics of Drift

Focusing solely on active policymaking would be a mistake. Determined actors can have just as powerful an impact by *inhibiting* reform. Hacker has labeled this strategy "policy drift," or "the fine political art of producing change by doing nothing."[199] As he has underlined, "[i]n an environment of new or worsening social risks, opponents of expanded state responsibility do not have to enact major [laws] to move policy toward their favored ends. Merely by blocking compensatory interventions designed to ameliorate intensified risks, they can gradually transform the orientation of programs."[200]

Grover Norquist's Americans for Tax Reform (ATR), the most powerful anti-tax group in the country, has relied heavily on drift. With funding from the country's largest corporations, ATR has spent twenty-five years convincing state and federal legislators to sign a pledge never to raise taxes while in office.[201] The campaign has proven a triumph: by 2011, thirteen governors, forty of the forty-seven Republicans in the U.S. Senate, 236 of the 242 Republicans in the U.S. House of Representatives, and close to 1,300 state lawmakers had signed the pledge.[202] As political scientists Michael Tomz and Robert Van Houweling have shown using survey experiments, Norquist's pledge has proven remarkably "effective at

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198. Arthur B. Laffer, Stephen Moore & Jonathan Williams, *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index*, AM. LEG. EXCH. COUNCIL 8 (2015), https://www.alec.org/app/uploads/2015/10/RSPS_8th_Edition-Final.pdf [https://perma.cc/XAR5-KDSQ].

199. Hacker & Pierson, *supra* note 181, at 651.

200. Jacob S. Hacker, *Privatizing Risk Without Privatizing the Welfare State: The Hidden Politics of Social Policy Retrenchment in the United States*, 98 AM. POL. SCI. REV. 243, 246 (2004).

201. *See* Tim Dickinson, *Grover Norquist: The Billionaires' Best Friend*, ROLLING STONE (Nov. 9, 2011), http://www.rollingstone.com/politics/news/grover-norquist-the-billionaires-best-friend-20111109 [https://perma.cc/6VB7-VJDY].

202. *Id.*

locking politicians into anti-tax positions."[203] ATR has therefore used drift to pick up where groups like the NCEF and the NTU left off.

Evidence suggests that drift has profoundly shaped states' revenue structures. For example, state legislators have become more reluctant to raise taxes to cope with economic downturns. As recently as the 1990s, lawmakers remained unafraid to increase taxes to combat recessionary revenue declines.[204] However, in the last decade, they have sharply turned away from tax increases. This shift has both depressed revenue and lengthened the time needed for budgets to stabilize and recover.[205]

This trend first took hold during the 2001 recession. According to Elaine Maag and David Merriman, "[r]ather than reacting quickly to increase revenue when it declined by increasing broad-based taxes, states enacted relatively few tax increases—and concentrated those increases on narrowly targeted tobacco taxes."[206] The pair has shown that states would have raised approximately $33 billion more in 2003 if they had adopted the same tax-rate increases between 2002 and 2003 as they did between 1991 and 1992.[207]

Reactions to the Great Recession were no different. Only a small handful of states significantly raised taxes to cope with budget shortfalls.[208] California, New York, and Illinois alone accounted for 81% of all new revenue raised between 2010 and 2014.[209] This unwillingness to raise taxes had a clear effect on states' fiscal health. Over this five-year

203. Michael Tomz & Robert P. Van Houweling, Political Pledges as Credible Commitments 30 (Working Paper, Mar. 27, 2012), https://web.stanford.edu/~tomz/working/TomzVanHouweling-Pledges-2012-03-27.pdf [https://perma.cc/23JT-UKTY].

204. *See* Richard F. Dye & Therese J. McGuire, *State Fiscal Systems and Business Cycles: Implications for State Welfare Spending When the Next Recession Occurs* 5, 9 (Urban Inst., Discussion Paper No. 99-04, 1999), http://www.urban.org/sites/default/files/alfresco/publication-pdfs/409068-State-Fiscal-Systems-and-Business-Cycles.PDF [https://perma.cc/57XP-47U8].

205. *See* Donald J. Boyd & Lucy Dadayan, *The Economy Recovers While State Finances Lag*, NELSON A. ROCKEFELLER INST. GOV'T 20 (June 2015), http://www.rockinst.org/pdf/government_finance/2015-06-23-Blinken_Report_Two.pdf [https://perma.cc/YE8Z-RG7M].

206. Elaine Maag & David F. Merriman, *Understanding States' Fiscal Health During and After the 2001 Recession*, 2007 STATE TAX NOTES 359, 359.

207. Elaine Maag & David Merriman, Tax Policy Responses to Revenue Shortfalls 8 (Working Paper, Apr. 22, 2003), http://webarchive.urban.org/UploadedPDF/410798_tax_policy_responses.pdf [https://perma.cc/GB4U-ULXZ].

208. Boyd & Dadayan, *supra* note 205, at 6.

209. *Id.*

period, states collected only an $33 billion in additional tax receipts. This figure is 38% lower than the total additional amount—$54 billion—that they levied after the 1990 recession.[210]

It is likely that many of the challenges that states face can be traced to lawmakers' failure to align tax codes with new economic conditions. Prominent examples include states' decisions not to apply the sales tax to services or to counter firms' efforts to reclassify their activities to avoid taxes. The causes of such choices deserve closer scholarly scrutiny in the coming years. By focusing on fiscally-minded interest groups—and the tactics they use to promote or deter the adoption of particular tax laws—researchers have the opportunity to bring this history to the foreground.

CONCLUSION

This Note has aimed to bring attention to an area in need of significant future research: the legal and political origins of states' long-run fiscal challenges. For decades, public services have deteriorated in the face of tightening state budgets. Stagnant and more volatile tax revenues have significantly contributed to these funding constraints. However, despite tax laws' effect on revenue patterns, legal scholars have not thoroughly explored the roots of states' fiscal struggles. Looking forward, scholars ought to examine *which* tax institutions fostered inadequate levies over time and *why* revenue systems evolved to promote this outcome.

Current findings in economics and political science suggest paths forward on both fronts. With respect to which tax institutions are to blame for slow and unsteady revenue growth, researchers have pointed to new tax limitations, withering sales tax regimes, eroding corporate tax bases, and multiplying tax expenditures. With respect to why tax institutions have been allowed to underperform, political scientists have stressed the rise of organized interests that have lobbied to lower state taxes. Fleshing out these hypotheses across particular states, time periods, and budget areas will require analyses that place states' political economies in comparative and historical perspective. Such work can now hopefully begin on stronger footing.

210. *Id.*